

Freezing of assets in connection with the so-called Madoff Affair

Topic: **Stock exchange and custody accounts** Case number: **2018/16**

The customer, represented by his lawyer, wished to terminate his business relationship with the bank. The latter withheld a six-figure sum however because it asserted a right of pledge over it by way of security for any potential claims in connection with the so-called Madoff Affair. Referring to a Federal Supreme Court decision, the customer's lawyer unsuccessfully demanded payment by the bank of the remaining balance withheld. He then referred the matter to the Ombudsman and asked him to initiate mediation proceedings. The Ombudsman was unable to fulfil this request.

The sum withheld by the bank corresponded to the amount that had been credited to the customer's account due to the redemption of fund units that had been assigned to the Madoff Affair. The trustees and liquidators of these funds had sued various financial institutions in the USA and the British Virgin Islands (BVI) and demanded the reimbursement of the proceeds from the sale of such funds whose shares had been held in their name, but on the customers' behalf and at their risk, and disposed of on the customers' behalf, before the major fraud came to light. The bank, which was affected by such claims, felt that, by virtue of a valid pledge declaration, it was entitled to withhold the funds. By doing so, it hoped to protect itself in the event of having to actually pay back these funds to the trustees and liquidators on the basis of a court ruling.

The customer denied having concluded a pledge agreement with the bank. In the case documentation, there were various pledge declarations with differing dates. The oldest had been signed by the customer while the newer ones had been sent to the customer's hold mail service and remained unchallenged by him. Over the years, the pledge declarations had been worded in more and more detail, particularly with regard to defining the claims secured by the bank. It was only after the customer also disputed the pledge declarations signed by him on the grounds of error with the bank directly that he also claimed to the Ombudsman that he had never arranged for the bank to hold his correspondence. In his view, this meant that the bank could not therefore claim that the pledge declaration served on him via the hold mail service had been tacitly accepted since it remained unchallenged.

The customer also referred to the Federal Supreme Court decision (hereafter "BGE") 142 III 746, in which it was ruled in a specific case that a bank could not invoke a specific pledge declaration for the withholding of assets in connection with the Madoff Affair since, when entering into the pledge agreement, the customer in question could not have anticipated that the right of pledge was to become security for a potential claim of this nature by the bank in the future.

In the present case, the first problem was the need to clarify which pledge declaration was valid. This was disputed between the parties. As a neutral intermediary, the Ombudsman must respect the credibility of the parties and cannot clarify such issues by means of an evidence collection and review process. In view of the specific circumstances and the acknowledgements of receipt for the held mail signed by the customer and submitted by the bank, he advised the customer to review his stance on this aspect of the case however. He also gave the customer the following information with regard to

the case:

To the Ombudsman's knowledge, Swiss courts, and most notably also the Federal Supreme Court, have dealt with cases in which bank customers demand the surrender of assets that banks are retaining on the grounds of claims made against it by trustees or liquidators of Madoff funds and which are subject to corresponding claims in the USA and the BVI, multiple times already. In addition to BGE 142 III 746 already mentioned by the customer's lawyer, Federal Supreme Court decisions 4A_429/2014 and 4A_540/2015 are also known. In decision 4A_429/2014, the right of the institution in question to retain a customer's assets in connection with the repayment of fund units on the grounds of contractual reasons, was confirmed. Decision 4A_540/2015 concerned the question of whether or not a pledge clause could be relied upon as the basis for retaining corresponding assets as security for possible claims by trustees or liquidators. This was also confirmed. As far as the Ombudsman can tell, the pledge clause assessed in this decision was virtually identical to the older, less detailed pledge declarations signed by the customer.

A few months later, the Federal Supreme Court reached the opposite decision called for by the customer's lawyer. Since this decision does not mention the aforementioned decision 4A_540/2015 at all, it is unclear whether the Federal Supreme Court wished to fundamentally change its precedent with this new decision, which would be surprising given the recent opposite decision, or whether different facts resulted in a different decision. This is also hotly debated among lawyers. What is striking however is the fact that BGE 142 III 746 was based on a discretionary asset management mandate under which the customer had no influence over the bank's decision to acquire shares in so-called Madoff funds and to sell them again later, whereas the customer affected by the decision 4A_540/2015 made the investment decisions in question himself. Unfortunately, the unclear situation that has arisen from these two Federal Supreme Court decisions has resulted in the fact that it is generally not possible to resolve disputes of this nature in mediation proceedings.

With the added factor that the relevant contractual basis was unclear, the Ombudsman therefore felt that initiating mediation proceedings with regard to the bank's right, disputed by the customer, to withhold assets in connection with the repayment of Madoff funds, would unfortunately be pointless from the outset. He had to leave it to the customer's lawyer to determine whether or not he could recommend that his client take legal action to pursue this matter.