



DIVISION OF  
MARKET REGULATION

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

March 31, 2000

The Honorable John D. Dingell  
Ranking Member  
Committee on Commerce  
U.S. House of Representatives  
Room 2125 Rayburn House Office Building  
Washington, D.C. 20515-6115

Re: Stratton Oakmont Liquidation Proceeding

Dear Congressman Dingell:

Chairman Levitt has asked me to respond to your letter of February 23, 2000, to him concerning the court-supervised liquidation of Stratton Oakmont, a former securities brokerage firm.

On January 27, 1997, the Securities Investor Protection Corporation ("SIPC") commenced the Stratton Oakmont liquidation by filing an application in the United States District Court for the Southern District of New York. SIPC made its application three days after Stratton Oakmont petitioned for bankruptcy protection. The district court granted SIPC's application on January 29, 1997, which stayed the bankruptcy proceeding. The court then appointed a trustee, and transferred the matter to federal bankruptcy court. Since that time, a U.S. bankruptcy judge has presided over the liquidation.

In your letter, you ask the Commission to look into why the trustee in the Stratton Oakmont proceeding is taking the position that, when conversions transpire, the victims are entitled to the positions they originally held, and not the value of those positions on the date of the conversion. You note that an attorney representing certain claimants in the liquidation believes the trustee's position is contrary to unambiguous common law precedent. We believe the trustee's position – that claims for securities are to be satisfied with like kind securities – is likely correct under the Securities Investor Protection Act of 1970 ("SIPA").<sup>1</sup>

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<sup>1</sup> 15 U.S.C. § 78aaa - §78111.

The claimants referenced in your letter filed claims with the trustee contending that Stratton Oakmont sold securities in their accounts without authorization, and then used the proceeds to purchase new securities they did not want. The trustee investigated these claims, and determined they had merit. Accordingly, as will be discussed below, under SIPA these claimants are entitled to the securities that Stratton Oakmont improperly traded away, but not their value at the time of the conversion.<sup>2</sup>

We share your concern that victims of fraud be able to obtain appropriate remedies. As you know, however, SIPA was intended to protect investors from the loss of their securities and cash. SIPA's limited role was not designed to protect investors from losses from fraud generally. SIPA imposes a duty on trustees to replace a customer's missing or stolen securities with securities of the same class, series and issuer, "to the maximum extent possible."<sup>3</sup> If the broker-dealer's estate does not have sufficient securities to satisfy all or part of a given customer's claim for a particular security, SIPA requires the trustee to buy the security for the customer, provided there exists a "fair and orderly market."<sup>4</sup> Congress adopted this buy-in requirement as a 1978 amendment to SIPA. The Senate Report discussing the amendment explained that it was intended to restore customer accounts to their status quo.<sup>5</sup> As the Senate wrote in its report on the 1978 amendment,

Under present law, because securities belonging to customers may have been lost, improperly hypothecated, misappropriated, never purchased or even stolen, it is not always possible to provide customers that which they expect to receive, that is, securities which they maintained in their brokerage account....

A principal underlying purpose of the bill is to permit a customer to receive securities to the maximum extent possible instead of cash, in satisfaction of a claim for securities. By seeking to make

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<sup>2</sup> Our analysis is restricted solely to situations where securities were sold without authorization, and the proceeds used to purchase other securities, also without the customer's consent. In cases where securities were sold at the customer's request, but then the proceeds were used to purchase other securities without the customer's authorization, the customer would have a claim for cash.

<sup>3</sup> 15 U.S.C. § 78fff-1(b).

<sup>4</sup> 15 U.S.C. § 78fff-2(d).

<sup>5</sup> S. Rep. No. 763, 95<sup>th</sup> Cong., 2<sup>ND</sup> Sess. 1978.

customer accounts whole and returning them to customers in the form they existed on the filing date, the amendments not only satisfy the customers' legitimate expectations, but would also restore the customer to his position prior to the broker-dealer's financial difficulties.<sup>6</sup>

The Senate Report indicated that Congress was also seeking to protect claimants from unintended tax consequences that might arise as a result of receiving cash as a replacement for missing securities.<sup>7</sup> If the trustee cannot purchase the missing securities in a fair and orderly market, SIPA requires the trustee to pay claimants the value of their securities positions as of the date the liquidation proceeding commenced.<sup>8</sup>

In December of 1996, the National Association of Securities Dealers expelled Stratton Oakmont on the grounds that the firm excessively marked-up securities it underwrote and sold to its own customers. One federal court presiding over a case involving some of the firm's former employees characterized Stratton Oakmont as having run "a classic boiler room operation" in which it manipulated the prices of the securities it sold to its customers.<sup>9</sup> When the firm ceased doing business, any prices it was manipulating would have collapsed. This is the likely reason why the securities originally held by the claimants identified in the attachment to your letter are now worth very little, and, in some cases, less than the unwanted securities purchased by Stratton Oakmont in the unauthorized transactions.

It is understandable that these claimants would want to receive the value of their positions as of the conversion date, when Stratton Oakmont may still have been artificially supporting the prices of the securities. However, this remedy would appear to be contrary to the specific requirements of SIPA. Moreover, it would provide different treatment for customers with unauthorized trading claims than for customers whose accounts still held the manipulated securities when the liquidation commenced. The former would receive the value of their securities as of the conversion date (when the prices were being artificially supported), whereas the latter would receive the securities, or their value as of the filing date (after the

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<sup>6</sup> Id.

<sup>7</sup> Id.

<sup>8</sup> 15 U.S.C. § 78lll(11).

<sup>9</sup> Sanders et al. v. Gardner, 7 F.Supp.2d 151, 163, 170 (E.D.N.Y. 1998).

prices had collapsed).<sup>10</sup> To the extent that the losses suffered by each group primarily resulted from Stratton Oakmont's fraud in inducing the purchase of manipulated securities, there would be no fair basis for treating one class more favorably than the other. Certainly, there is no support in SIPA for making such a distinction.

The trustee's approach in applying the specific provisions of SIPA will result in all customers being treated equally to the fullest extent possible. While we recognize that this will provide little solace to claimants who Stratton Oakmont deceived into purchasing manipulated securities, it appears that Congress did not intend SIPA to cover losses arising from this type of fraud.

Finally, it should be noted that claimants in this proceeding, as in all SIPA liquidations, are entitled to have the trustee's determinations of their claims reviewed by the bankruptcy judge presiding over the case. Moreover, any ruling by the bankruptcy court is subject to review by a district court judge, and the district court's judgment is subject to review by the appropriate circuit court of appeals. This process of judicial review is intended to ensure that SIPA trustees handle claims in a manner that is consistent with the statute.

If you have any questions, please do not hesitate to call me at (202) 942-0131.

Sincerely,



Michael A. Macchiaroli  
Associate Director

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<sup>10</sup> Conversely, if the price had increased after the conversion, the customers holding the stock would get the more valuable securities, while the victims of the unauthorized trading would get the lower conversion date value.

TOM BILEY, VIRGINIA, CHAIRMAN

W. J. "BILLY" TAUZIN, LOUISIANA  
MICHAEL G. OXLEY, OHIO  
MICHAEL BILIRAKIS, FLORIDA  
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JAMES E. DERDERIAN, CHIEF OF STAFF

U.S. House of Representatives  
Committee on Commerce  
Room 2125, Rayburn House Office Building  
Washington, DC 20515-6115

February 23, 2000

The Honorable Arthur Levitt, Jr.  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

The Honorable David M. Walker  
Comptroller General  
U.S. General Accounting Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Chairman Levitt and Mr. Walker:

I am writing with respect to the enclosed complaint from Mr. Mark Maddox concerning how the Securities Investor Protection Corporation (SIPC) and its Trustee are carrying out their responsibilities in the Stratton Oakmont SIPC Liquidation Proceeding.

Mr. Maddox complains that, contrary to unambiguous common law precedent, SIPC and its Trustee have taken the position that, when conversions transpire, the victims are entitled to the positions they originally held, and not the value of those positions on the date of the conversion. This appears to have left fraud victims with no viable remedy and, in a few cases, requires victims to pay SIPC more than the remedy being offered. Clearly this is not consistent with the protection of investors or with the intent of Congress in adopting the Securities Investor Protection Act of 1970 (SIPA) "to provide greater protection for customers of registered brokers and dealers and members of national securities exchanges."

Given the SEC's oversight responsibilities over SIPC under SIPA, I ask that the Commission look into this matter and provide me with your views by the close of business on Friday, March 17, 2000.

The Honorable Arthur Levitt, Jr.  
The Honorable David M. Walker  
Page 2

Separately, I ask that GAO include this issue in the comprehensive SIPC study that I requested by letter dated November 16, 1999. I understand that GAO recently staffed the SIPC project and has begun exploratory work on the status of GAO's 1992 recommendations and how to design the larger job. Please include this complaint in your deliberations and consider using Stratton Oakmont or some similar complex liquidation as a case study of how SIPC works or doesn't work, as the case may be.

Thank you both for your cooperation and attention to my request.

Sincerely,



JOHN D. DINGELL  
RANKING MEMBER

Enclosure

cc: Mark E. Maddox, Esq.

# Maddox Koeller Hargett & Caruso

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January 19, 2000

Katherine McGuire  
US Securities and Exchange Commission  
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Michael Macchiaroli  
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Washington, D.C. 20549

Judith Starr  
Assistant Chief Litigation Counsel  
450 Fifth Avenue NW  
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**RE: Stratton Oakmont SIPC Liquidation**

Dear Ms. McGuire, Mr. Macchiaroli and Ms. Starr:

As you are aware, through our previous conversations and correspondence, we are concerned about how SIPC and its Trustee are administering their duties and responsibilities in the Stratton Oakmont SIPC Liquidation Proceeding. Because of our concerns, we ask the Securities and Exchange Commission, pursuant to their oversight responsibilities of SIPC, to evaluate the remedies SIPC is making available to the victims of Stratton Oakmont when they conclude conversions have transpired. Those concerns were expressed to you in letters dated June 2, 1999 and June 10, 1999, copies of which are attached.

Katherine McGuire  
Michael Macchiaroli  
Judith Starr

**RE: Stratton Oakmont SIPC Liquidation**

January 19, 2000

Page 2

SIPC and its Trustee have taken the position that when conversions transpire, the victims are entitled to the positions they originally held, and not the value of those positions on the date of the conversion. This position is taken without any common law or statutory authority. If this position is upheld, it effectively means that even if a former Stratton Customer can prove conversions transpired, they have no viable remedy. This has led to ludicrous results. In some instances, SIPC, through its Trustee, have offered to return expired, and hence worthless, warrants where they have concluded that a conversion transpired. In a few cases, the customers have been offered a "remedy" that requires them to pay SIPC more than the remedy being offered.

This adds nothing but insult to this group of injured people and offers no protection to the victims of conversions. Case law relative to conversion is uniform, clear and black letter law: the proper measure of damages is the "highest value which [the converted] stock has reached between the date of conversion and reasonable time after notice..." Gallagher v. Jones 129U.S.193, 200, 9S.Ct. 335,32L.Ed.658(1889); "The federal courts have historically approved a rule of damages for conversion of stock measured by the price at the time of conversion" or its highest intermediate value within a reasonable time. Myzel v. Fields, et al, 386 F.2d 718 (8<sup>th</sup> Cir. 1968); "We agree that the general rule is that the proper measure of damages in a conversion case is the value of the property as of the time of the conversion." L.E. Frey v. Frankel and Duo-Bed Corporation, 443 F.2d 1240 (10<sup>th</sup> Cir. 1971); "We agree that the general rule is that the proper measure of damages in a conversion case is the value of the property as of the time of the conversion." Transcontinental Oil Corporation v. Trenton Products Company, 560 F.2d 94 (2<sup>nd</sup> Cir. 1977); The "measure of damages for wrongful conversion of stock is either its value at time of conversion or its highest intermediate value between notice of conversion and reasonable time thereafter during which stock could have been replaced had that been desired, whichever is higher." Schultz v. Commodity Futures Trading Commission 716 F.2d 136 (2<sup>nd</sup> Cir. 1983); 90 F.3d 1080 (5<sup>th</sup> Cir. 1996); "[M]easure of damage in stock conversion suit is market value at time of conversion"; Quest Medical, Inc v. Aprill 90 F.3d 1080 (5<sup>th</sup> Cir. 1996).

In addition to unambiguous common law, precedent under SIPC is also clear, "[w]here funds have been misappropriated, including [the] unauthorized...purchase of securities, there is a claim to cash, covered by SIPC. 15U.S.C. Sec.78fff 6f of SIPC



Katherine McGuire  
Michael Macchiaroli  
Judith Starr

**RE: Stratton Oakmont SIPC Liquidation**

January 19, 2000

Page 3

citing SEC v. S.J. Salmon & Co. 1974 Fed. Sec L Reg. 94 582 (S.D.N.Y.) A claim for conversion is a claim for cash". SEC v. Howard Lawrence & Co., 1 Bankr. Ct. Dec. 577 (Bankr. S.D.N.Y.1975).

From our previous conversations, we were under the impression that the Securities and Exchange Commission was looking closely at the issue of what remedies should be made available for a victim of conversion. We understand that you have had meetings with SIPC and its Trustee regarding this issue. SIPC's Trustee forwarded a letter to us, dated September 17, 1999, that verifies their position to return the securities which were liquidated to facilitate and/or finance an unauthorized trade as opposed to returning the value of those securities.

This position is completely unfair, all be it consistent with SIPC's adversarial approach to the victims of Stratton Oakmont's conversions. We were hopeful that the SEC will intervene, via their supervisory capacity, and persuade and/or mandate the SIPC and its Trustee to do what is right and just.

At this juncture, we ask the SEC to inform us in writing as to their position relative to this issue. We remain hopeful that the SEC will mandate that SIPC and its Trustee do what is fair, equitable and called for under SIPA's protections. Given the length of time that has transpired in these proceedings and your previous review of this matter, we would ask you to act promptly in evaluating these situations and giving us your decision.

Additionally, we would ask you to notify us of your response in writing.

If you have any questions or concerns, please do not hesitate to contact me.

Sincerely yours,



Mark E. Maddox

MEM/jmk

cc: Congressman John Dingell ✓  
Michael A. Burnett (GAO)

# Maddox Koeller Hargett & Caruso

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June 2, 1999

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Michael Macchiaroli  
U.S. Securities & Exchange Commission  
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Nancy M. Smith  
Securities and Exchange Commission  
Office of Consumer Affairs  
450 5th Street, N.W.  
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Ladies & Gentleman:

This is to follow-up on my previous conversations with each of you about my concerns as to how SIPC and its Trustee are administering their duties and responsibilities in the Stratton Oakmont SIPC liquidation proceeding.

Katherine McGuire, Judith Starr  
Mike Makearoli and Nancy Smith  
June 2, 1999  
Page 2

One of my biggest concerns relates to the way that SIPC and its Trustee are valuing claims when they acknowledge that a claim is eligible for coverage under the theory of "conversion" as an unauthorized trade. I believe that SIPC's and its Trustee's valuation approach are not supported by SIPA or the Regulations thereunder, and are irrational. For example, I have enclosed for your review documents relating to the claims of approximately 13 Stratton investors who SIPC and its Trustee acknowledge have claims under the theory of "conversion" due to unauthorized trades. In many of these instances, the net result of the offer made to the investor is a negative financial transaction, that would require the investor to lose further money if they accept the proposed offer. Does the SEC really believe this is the way that SIPA was intended by Congress to operate?

I would ask that you promptly review this issue and consider using the SEC's oversight authority of SIPC to cause it to act reasonably and in conformance with SIPA in these matters and in related issues of valuation of customer claims in the Stratton Oakmont liquidation proceeding. If you are unwilling to utilize your oversight authority in this instance, I would ask that you consider using your authority under SIPA to appear and support the investors' request for monetary damages based upon the value of their securities at the time of the unauthorized transaction.

As always, if any of you should have any questions or comments regarding any of these matters, please do not hesitate to contact me.

Very truly yours,



Mark E. Maddox

MEM/jmk

What Client Must Do in response to				SIPC's Determination		Notes
Client	Claim #	Claim Value	SIPC's Offer	SIPC's Determination	Notes	
Peter Alden	2126	\$8,760	SIPC to return 1,000 shares of Visual Equities	Client must transfer \$240.00 to SIPC	Visual Equities no longer in existence. Securities are worthless.	
Gerald & Vimy Blackstock	2723	\$86,098	SIPC to return 7,000 class A warrants of Octagon	Client must transfer \$730.00 and 16,000 shares of Care Group to SIPC	Octagon warrants expired 2/15/99. SIPC failed to determine other UT claims.	
Blackstock Trust	2721	\$177,037	SIPC to return \$105 to client	Client must transfer \$2,730 and 16,000 shares of Care Group to SIPC	SIPC receives windfall. Is this the intent of SIPA? SIPC failed to determine other UT claims.	
Philip Cardiero	2346	\$279,867	SIPC to return \$7,520 in cash and 90,000 class warrants of Select Media Comm.	Client must transfer 120,000 class A warrants of Master Glazier Karate Int'l	Select Media warrants are worthless and expire 8/18/99. SIPC failed to determine other UT claims.	
Everidge, Inc.	2148	\$125,040 & 100 shares of Nestle's	SIPC to return 100 shares of Nestle's ADR and 1,500 shares of SMT Health Services	Client must transfer \$595.66 to SIPC	SIPC failed to determine other UT claims.	
Alfred & Kathleen Francis	2193	\$4,402.50	SIPC to return \$186 to client	Client must transfer \$7,591.88 to SIPC	SIPC receives windfall of \$7,375.88. Is this the intent of SIPA?	
Richard Heidal	2150	\$38,903	SIPC to return 6,500 shares of Select Media Comm. common stock and \$417.88.	Client must transfer \$10,106.63 to SIPC	Select Media stock is worthless.	
Hughes Investments	3176	\$126,165	SIPC to return \$270.00 and 5,000 shares of PDK Labs Inc. 7% Convertible Preferred shares	Client not required to transfer anything	SIPC failed to determine other UT claims. PDK Labs 7% has some value, but not enough to match the amount claimed.	
Robert Keller	2444	\$28,000	SIPC to return 1,241 shares of Master Glazier International stock	Client must transfer 1,898 shares of Dualstar Technologies Corp. to SIPC	1,241 of Master Glazier is worth about \$62.00 before transaction costs.	
Ronald Kuhn Trust	2329	\$69,927.73	SIPC to return 5,500 shares of IDM Environmental common stock and \$327.50 to client	Client must transfer 12 shares of Master Glazier and \$373.52 to SIPC	In April, 1999, IDM Envir. had a 1-10 reverse split. Thus, 5,500 shares splits to 550 shares. Current value of IDM Envir. is about \$952.50. SIPC failed to determine other UT claims.	
Frank Ritchie	2443	\$6,000	SIPC to return 22 shares of Eastbrokers International	Client must transfer \$1.87 to SIPC	SIPC may have failed to determine other claims. Values of claim and remedy don't match.	
Robert & Florence Schreier	2333	\$24,747.50 & 100 shares Dr. Pepper & 7 UP	SIPC to return \$987.58 to client	Client not required to transfer anything	SIPC failed to determine other UT claim.	
Jean Wiseman	2328	\$24,802.35	SIPC to return 2,000 shares of Ventura Entertainment Group to client	Client must transfer 100 shares of Ventura Motion Picture Group and \$70 to SIPC	Ventura Entertainment no longer in existence.	

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June 10, 1999

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Assistant Chief Litigation Counsel  
U.S. Securities & Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

**Via UPS Overnight Delivery**

**RE: Stratton Oakmont SIPC Liquidation**

Dear Ms. Starr:

Thank you for your phone call of June 9, 1999 and your willingness to conduct your own analysis of the subject offers made by SIPC and its Trustee.

As you know, we contend that SIPC and its Trustee's misuse of the "net equity" definition under SIPA is resulting in ridiculous offers to investors in instances where the Trustee acknowledges that unauthorized trading occurred. We contend that the "net equity" definition under SIPA was not designed to measure damages for claims of conversion. Therefore, there is a gap in SIPA as to how to properly measure damages for claims of conversion.

We believe that given this gap under SIPA, courts should look to the Federal Common Law in order to determine the proper way to value claims of conversion. I have enclosed for your review three cases which we believe accurately reflect the Federal Common Law for claims of conversion:

1. Galigher v. Jones, 1888 - which is the grandfather US Supreme Court case on the issue;

Judith Starr

**RE: Stratton Oakmont SIPC Liquidation**

June 10, 1999

Page 2

2. Schultz v. CFTC, 1983 - which is a significant Second Circuit decision on this issue; and
3. Commonwealth Associates v. Palomar Medical Technologies, 1997 - which reflects the so-called New York Rule as to how to measure damages in cases of conversion. Keep in mind that the contracts between Stratton Oakmont and its investors contained New York Choice of Law clauses.

I hope that the above cases help you in making your own determinations and recommendations as to how the SEC should proceed.

Please let me know if I can provide you with any additional information relating to these matters.

Very truly yours,



Mark E. Maddox

MEM/jmk