UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Securities and Exchange Commission, 100 F Street, NE Washington, DC 20549 Applicant, v. **Securities Investor Protection Corporation,** 805 Fifteenth Street, NW Suite 800 Washington, DC 20005 Respondent.	)	Misc. No. _____

SECURITIES AND EXCHANGE COMMISSION'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF APPLICATION

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Applicant Securities and Exchange Commission ("SEC" or "Commission") respectfully submits this memorandum of points and authorities in support of its application under Section 11(b) of the Securities Investor Protection Act of 1970, as amended, 15 U.S.C. § 78aaa, *et seq.* ("SIPA") for an order requiring the Securities Investor Protection Corporation ("SIPC") to file an application for a protective decree with the federal district court for the Northern District of Texas pursuant to Section 5(a)(3) of SIPA with respect to Stanford Group Company ("SGC") and to otherwise discharge its obligations under SIPA.

I. INTRODUCTION AND SUMMARY

Through this application, the Commission seeks to enforce its statutory supervisory authority over SIPC by obtaining an order requiring SIPC to file an application to start a

liquidation proceeding in the federal district court of the Northern District of Texas ("Texas Court") for defunct broker-dealer and SIPC member SGC. A primary purpose of this liquidation proceeding would be promptly to resolve in accordance with SIPA's requirements the claims of SGC customers for protection. Thousands of SGC customers had investments in securities issued by SGC's off-shore affiliate, Stanford International Bank, Ltd. ("SIBL"), that purportedly were worth billions of dollars when the group of companies owned or controlled by Robert Allen Stanford ("Stanford companies") collapsed in early 2009. At that time, the Commission sued Stanford and his companies, including SGC, for running a fraudulent, multi-billion-dollar investment scheme centered on the sale of the SIBL securities.

Congress created SIPC and placed it under the Commission's "plenary" supervision "to protect individual investors from financial hardship" and "to insulate the economy from the disruption which can follow the failure of major financial institutions," among other reasons. S. Rep. No. 91-1218, at 1, 4 (1970) ("Senate Report"). To these ends, SIPC maintains a fund for customer protection ("SIPC Fund") by collecting an annual assessment from its member broker-dealers. In addition, SIPA authorizes SIPC to file an application for a protective decree with an appropriate court if it "determines that . . . the member has failed or is in danger of failing to meet its obligations to customers" and certain other requirements are met. Sections 5(a)(3), (b)(1), 15 U.S.C. §§ 78eee(a)(3), (b)(1). After SIPC's application has been granted and a trustee has been appointed, the liquidation proceeding begins, during which the member's apparent customers are provided notice and an opportunity to submit claims to a SIPC-designated trustee, and, if necessary, to appeal the trustee's decisions to the federal courts. If funds available at the broker-dealer are insufficient to satisfy customers' net equity claims, the SIPC Fund is used to

supplement the distribution, up to a ceiling of $500,000 per customer for certain types of claims. *See* Sections 8(b), 9(a), 15 U.S.C. §§ 78fff-2(b), fff-3(a).

To date, SIPC has failed to initiate a liquidation proceeding for the protection of SGC customers. SIPC's inaction has continued despite the Commission's determination in June 2011, "based on the totality of the facts and circumstances of this case, that SIPC member [SGC] has failed to meet its obligations to customers" and that there are SGC customers in need of the protections provided by SIPA. Analysis of Securities Investor Protection Act Coverage for Stanford Group Company ("Commission Analysis" or "Analysis"), attached to letter from Elizabeth M. Murphy to Orlan M. Johnson, dated June 15, 2011, Declaration of Matthew T. Martens ("Martens Decl.") ¶ 3(a) & Exh. 2. Although the Commission promptly informed SIPC of this determination and requested that SIPC take necessary steps to commence a liquidation proceeding, *see id.*, SIPC has refused to do so. The Commission informed SIPC that if it continued to refuse the Commission's request, the Commission would make this application for an order.

This Court should order SIPC to discharge its obligations under SIPA by filing an application for a protective decree under Section 5(a)(3) in the Texas Court. Section 11(b) of SIPA authorizes the Commission to seek this relief in the event that SIPC refuses to act. 15 U.S.C. § 78ggg(b).[1] Because SIPA empowers the Commission to supervise SIPC, the Commission may, in its discretion, determine that there is a customer who needs protection under SIPA, thereby rectifying SIPC inaction or superseding a contrary judgment by SIPC on this issue.

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[1] This is the first time since SIPA's enactment that the Commission has invoked in court its enforcement authority under Section 11(b).

The ***only*** issues presented by the Commission's present application are (1) whether the Commission has determined that SGC, a SIPC member, has failed or is in danger of failing to meet its obligations to customers; (2) whether one or more of the other statutory conditions required for the issuance of a protective decree are met; and (3) whether SIPA Section 11(b) authorizes the Court to order SIPC to file an application for a protective decree in the Texas Court. Because all of these questions are easily answered in the affirmative, the Court should issue the requested order.

The Commission's preliminary determination that SGC has failed or is in danger of failing to meet its obligations to customers is not subject to judicial review by this Court. The language, structure, and legislative history of SIPA and general administrative law principles demonstrate that the Commission has absolute discretion to make this preliminary determination. Moreover, if this Court were to undertake review of this determination, it would risk creating an onerous and lengthy fact-finding exercise concerning the legitimacy of SGC customers' claims under SIPA. Such an exercise here is unauthorized and unnecessary because the subsequent liquidation process itself provides the intended means for resolving customer need issues, and the Commission's preliminary determination is not binding on the courts supervising the customer claims resolution process in that liquidation. Such review by this Court also would threaten to undermine SIPA's overriding goal of prompt relief for investors. Given that the Commission has determined in its discretion that SGC customers need protection under SIPA[2] and, therefore, that a liquidation proceeding is warranted, this Court should issue the requested order directing SIPC to initiate such a proceeding in the Texas Court.

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[2] Arguably the Commission's assessment of whether one or more of the other statutory conditions are met is also beyond the scope of judicial review performed by this Court, as discussed below. *See infra* Section III.A.2.c. In any event, one or more of the other statutory conditions are obviously met here. SGC is insolvent and the subject of a receivership. *See* Sections 5(b)(1)(A), (B), 15 U.S.C. §§ 78eee(b)(1)(A), (B).

II. BACKGROUND

A. SIPA

Congress enacted SIPA in 1970 in response to numerous failures of broker-dealer firms and other problems in the industry in the late 1960s. *See* Senate Report at 2-4; H.R. Rep. No. 1613, at 1-2 (1970) ("House Report"). In the years preceding SIPA, "[c]ustomers of failed firms found their cash and securities on deposit either dissipated or tied up in lengthy bankruptcy proceedings," leading to "disastrous effects on customer assets and investor confidence." *SIPC v. Barbour*, 421 U.S. 412, 415 (1975).

SIPA sought to correct these problems through the creation of "a new form of liquidation proceeding, applicable only to member firms, designed to accomplish the completion of open transactions and the speedy return of most customer property." *Barbour*, 321 U.S. at 416; *see also SEC v. S.J. Salmon & Co., Inc.*, 375 F. Supp. 867, 871 (S.D.N.Y. 1974). The statute also created SIPC, a nonprofit, private membership corporation to which most registered brokers and dealers are required to belong and to pay assessments. *See* Sections 3 and 4, 15 U.S.C. §§ 78ccc, ddd; *Barbour*, 321 U.S. at 416.[3] Because SIPC has no authority to examine its members, it relies on the self-regulatory organizations and the Commission for information regarding financially troubled brokers. *See* Section 5(a)(1), 15 U.S.C. § 78eee(a)(1). The statute gives the Commission plenary supervisory authority over SIPC, including authority to apply for an order requiring SIPC to discharge its statutory obligations regarding customer protection, *see* Section 11(b), 15 U.S.C. § 78ggg(b).[4]

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[3] SIPC is led by a seven-person board of directors that includes one director appointed by the Secretary of the Treasury, one director appointed by the Federal Reserve Board, and five directors appointed by the President, by and with the advice and consent of the Senate. *See* Section (3)(c), 15 U.S.C. § 78ccc(3).

[4] The Commission is the only party able to seek such relief. SIPA does not provide investors with a private right of action against SIPC. *See Barbour*, 321 U.S. at 424-25.

The federal district court that issues a protective decree upon SIPC's application has exclusive jurisdiction over the member firm and its property wherever located. *See* Section 5(b)(2)(A)(i), 15 U.S.C. § 78eee(b)(2)(A)(i). Upon issuance of the decree, the court must appoint a trustee designated by SIPC and order the removal of the entire liquidation proceeding to bankruptcy court. *See* Section 5(b)(3), (4), 15 U.S.C. § 78eee(b)(3), (4). There the trustee has the same powers and title with respect to the broker-dealer and its property as a trustee in bankruptcy. *See* Section 7(a), 15 U.S.C. § 78fff-1(a). The purposes of the liquidation proceeding include, "as promptly as possible," delivery or distribution of customer property or other satisfaction of customer claims subject to statutory limits. Section 6(a), 15 U.S.C. § 78fff(a).

B. The Stanford Ponzi Scheme

SGC was a broker-dealer registered with the Commission under Section 15 of the Securities Exchange Act of 1934, 15 U.S.C. § 78o, a SIPC member, and indirectly owned by Allen Stanford. *See SEC v. Stanford Int'l Bank, Ltd.*, Case No. 3:09-cv-0298-N, Second Am. Compl. ¶ 14 (dated June 19, 2009) ("Complaint"), Martens Decl. ¶ 3(b) & Exh. 2, Attachment 1. Stanford was also chairman of the board and sole shareholder of SIBL, a purported private international bank chartered and domiciled in St. Johns, Antigua. Complaint ¶¶ 13, 16. SGC operated through 29 offices located throughout the United States, and its principal business was the sale of securities issued by SIBL marketed as certificates of deposit ("CDs"). *Id.* ¶ 14.

In February 2009, the Commission filed a civil enforcement action in the Texas Court against Allen Stanford, SGC, SIBL, and others. According to the Second Amended Complaint, for at least a decade, defendants had executed a massive Ponzi scheme centered on SIBL CDs. *Id.* ¶¶ 1, 2, 14. By year-end 2008, more than $7.2 billion of CDs had been sold by falsely touting: (1) the bank's safety and security; (ii) consistent, double-digit returns on the bank's

investment portfolio; and (iii) high rates of return on the CDs that greatly exceeded those offered by commercial banks in the United States. *Id.* ¶ 2. Contrary to those representations, Stanford misappropriated billions of dollars of investor money and "invested" an undetermined amount of investor funds in speculative, unprofitable private businesses controlled by Stanford. *Id.* ¶ 3.

Promptly after the Commission filed suit, the Texas Court appointed a receiver ("Receiver") for defendants' assets. The Receiver has since filed periodic reports with findings from his investigation of the Stanford entities, and declarations of the forensic accountant who assisted the investigation. The Receiver confirmed that, as of February 2009, SGC had approximately 32,000 active accounts for which it acted as an introducing broker. *See* Report of the Receiver Dated April 23, 2009 ("Receiver Report") at 12, 45, Martens Decl. ¶ 3(c) & Exh. 2, Attachment 2.[5] The Receiver also determined that approximately $7.2 billion of SIBL CDs were outstanding and held by thousands of public investors worldwide, including investors in the United States. *See id.* at 12.[6] The Receiver's materials also conclude that: SGC, SIBL, and Stanford Group Holdings, Inc. were three entities within "a complex, sprawling web of more than 100 companies, all of which were controlled and directly or indirectly owned by Allen Stanford," Receiver Report at 5; "The companies were operated in a highly interconnected fashion" to advance the selling of SIBL CDs, *id.*; and "Stanford's financial advisors used the apparent legitimacy offered by U.S. regulation of Stanford's U.S. brokerage subsidiary [SGC] in order to generate sales of SIBL CDs," *id.* at 7. Third-party broker-dealers cleared and carried the

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[5] As an "introducing broker," SGC's registered representatives could and did promote investment products, including SIBL CDs, to customers. An introducing broker may refer execution and clearing of trades to a third-party brokerage firm.

[6] Although, according to the Receiver Report, SIBL CDs were held by approximately 21,500 holders worldwide, Receiver Report at 12, likely a smaller number of holders purchased their CDs through a SGC representative.

SGC accounts. *See id.* at 45; Declaration of Karyl Van Tassel dated July 28, 2009 ¶ 6 ("Van Tassel Decl."), Martens Decl. ¶ 3(e) & Exh. 3, Attachment 4.

The Receiver's materials describe how the proceeds from SIBL CD sales flowed within the Stanford complex. These funds variously were diverted for Stanford's personal use, disbursed to Stanford-controlled entities, used to purchase private equity and other investments, and used to pay CD redemptions and interest. *See* Receiver Report at 7. At SGC, the funds were used to support SGC's operations and to compensate its personnel, who were "highly incentivized" to sell CDs. *Id.* at 7-9; Van Tassel Decl. ¶¶ 50-54. Although interest and redemptions from pre-existing CDs should have been paid from earnings, liquid assets, or reserves, these obligations were instead paid by new CD sales proceeds – classic indicia of a Ponzi scheme. *See* Van Tassel Decl. ¶ 14; Receiver Report at 13. By late 2008 and early 2009, this arrangement became untenable as CD redemptions increased, and the scheme collapsed. Van Tassel Decl. ¶ 12.

The Commission also has received correspondence from the Stanford Victims Coalition ("SVC") alleging how SIBL CDs were sold to SGC customers in particular. *See* Letter from Matthew B. Comstock to The Honorable Mary L. Schapiro dated November 12, 2009 ("SVC Letter"), Martens Decl. ¶ 4 & Exh. 3.[7] SVC contends that SGC registered representatives introduced investors to the CDs, and investors opened brokerage accounts at SGC in order to purchase them. *See* SVC Letter at 3. In doing so, many customers entered into an Account Application and Agreement ("Account Agreement"). *See id.* A sample Account Agreement provided by SVC includes the Stanford logo and contains language on the first page indicating

[7] SVC describes itself as "a non-profit organization representing 28,000 innocent investors from around the world who collectively have lost up to $7.2 billion in [SIBL] certificates sold to them through the Stanford Financial Group of Companies ('SFG'), a global network of financial services companies based in Houston, Texas, and owned and controlled by R. Allen Stanford." SVC Letter at 1 n.1.

that customers were entering into an Agreement with SGC, an NASD/Financial Industry Regulatory Authority ("FINRA") and SIPC member. *See id.*; Martens Decl. ¶ 4(a) & Exh. 3, SVC Exhibit 3. SVC also alleges that at least some customers received SGC account-related documents that showed their CD balance, were emblazoned with the Stanford logo across the top of the page, and indicated that SGC was an NASD or FINRA member and a member of SIPC. *See* SVC Letter at 3-4 (referencing sample document).

C. The Commission's Customer Need Determination

Although the Receiver asked SIPC to review the Stanford Ponzi scheme with the goal of compensating SGC customers, SIPC declined coverage on the asserted ground (among others) that SGC did not perform a custody function for its customers. *See* Letter from Stephen P. Harbeck to Ralph S. Janvey dated August 14, 2009, Martens Decl. ¶ 4(c) & Exh. 3, SVC Exhibit 6. On June 15, 2011, the Commission determined that SGC customers were entitled to protection under SIPA and formally requested SIPC's Board of Directors to take the necessary steps to institute a SIPA liquidation proceeding of SGC. *See* Murphy Letter, Martens Decl. Exh. 2.

The Commission supplied SIPC with an analysis of SIPA coverage on which the Commission's decision was based. *See* Commission Analysis, Martens Decl. Exh. 2. In the Analysis, the Commission observed that SGC was insolvent and the subject of a receivership and concluded that SGC has failed to meet its obligations to customers. *See id.* at 6. The Commission determined that a SIPA liquidation proceeding for SGC was warranted under the totality of the facts and circumstances of the case. *Id.* at 6-7, 14.

The Commission Analysis referenced court decisions recognizing that, under certain circumstances, an investor may be *deemed* to have deposited cash with a broker-dealer for the

purpose of purchasing securities – and thus be a "customer" under Section 16(2) of SIPA – even if the investor initially deposited those funds with an entity other than a broker-dealer. *See id.* at 6, 7-12 (discussing case law and application to SGC's circumstances). The Analysis also referenced court decisions holding that when securities purportedly acquired for customers by a broker-dealer are actually fraudulent vehicles for carrying out a Ponzi scheme, customers' "net equity" claims under SIPA can be measured by the net amount of cash customers invested and not by the purported but unreal value of the fraudulent securities. *See id.* at 7, 12-14 (same). The Commission supported its Analysis with findings by the Receiver and his expert investigators and information received from the SVC. *See id.* at 1-5, 8-10, 13-14.

After receiving the Commission's request and Analysis, SIPC announced that it would consider the matter and would announce a decision on or about September 15, 2011. This announcement was delayed. To date, SIPC has refused to take the necessary steps to institute a liquidation proceeding of SGC as requested by the Commission. Martens Decl. ¶¶ 8-9.

III. ARGUMENT

This Court should issue an order directing SIPC to file an application for a protective decree in the Texas Court under Section 5(a)(3) of SIPA, 15 U.S.C. § 78eee(a)(3), and otherwise to take necessary steps to commence a SIPA liquidation proceeding for SGC. Section 11(b) of SIPA provides:

> In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under this chapter and for such other relief as the court may deem appropriate to carry out the purposes of this chapter.

15 U.S.C. § 78ggg(b). SIPC has refused "to commit its funds or otherwise to act for the protection of customers" under this provision by refusing the Commission's request to institute a liquidation proceeding for SGC.

By refusing to take action in response to the Commission's request, SIPC also has failed "to discharge its obligations" under SIPA. The Commission has determined that SGC "has failed or is in danger of failing to meet its obligations to customers" under SIPA Section 5(a)(3), 15 U.S.C. § 78eee(a)(3)(A) (hereafter, "the Commission's customer need determination"). Thus the Commission has exercised its plenary supervisory authority over SIPC to conclude that a liquidation proceeding is warranted. Under SIPA Section 5, in order for SIPC to apply for a protective decree and for the district court to issue such a decree, one or more statutory conditions – listed in Section 5(b)(1) – must be met. *See* Sections 5(a)(3), (b)(1), 15 U.S.C. §§ 78eee(a)(3), (b)(1). These criteria are satisfied here because SGC is insolvent and the subject of a receivership.[8] Accordingly, under Section 11(b) this Court should order SIPC to discharge its obligations under the statute by filing an application for a protective decree under Section 5(a)(3) in the Texas Court.

The Court should order the Commission's requested relief without reviewing the merits of the Commission's customer need determination. As discussed below, this determination is judicially unreviewable here (although nonbinding in the subsequent claims resolution process). Because the Commission undeniably has made this determination and one or more of the other specified statutory conditions are met, the statutory requirements exist for this Court to issue an order compelling SIPC to apply to the Texas Court for a protective decree.

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[8] *See* SIPA Sections 5(b)(1)(A), (B), 15 U.S.C. §§ 78eee(b)(1)(A) (insolvency), (B) (subject of a receivership); Commission Analysis at 6, Martens Decl. ¶ 3(a) & Exh. 2.

A. SIPA Precludes Judicial Review of the Commission's Customer Need Determination

As noted above, the Commission has concluded that SGC customers are in need of protection because the firm "has failed or is in danger of failing to meet its obligations to customers." That preliminary determination by the Commission is not subject to judicial review. "Whether and to what extent a particular statute precludes judicial review is determined not only from its express language, but also from the structure of the statutory scheme, its objectives, its legislative history, and the nature of the administrative action involved." *Block v. Community Nutrition Inst.*, 467 U.S. 340, 345 (1984) (applying 5 U.S.C. § 701(a)(1)); *see also United States v. Fausto*, 484 U.S. 439, 452 (1988). Here, all of these factors demonstrate that, under SIPA, this Court may not review the Commission's determination that there is an SGC customer in need of protection. The Commission's customer need determination is judicially unreviewable because:

- The text of Section 11(b) implies there is no judicial review;
- SIPA authorizes the Commission to make a customer need determination in the place of SIPC, which itself (absent Commission objection) has judicially unreviewable discretion on this issue;
- SIPA already provides a comprehensive framework for addressing customer need issues – *i.e.*, the liquidation proceeding – and efforts by this Court similarly to address these issues would be inefficient and would threaten to deprive SGC customers of an opportunity to assert claims;
- Such review would further delay – perhaps substantially – resolution of claims of SGC customers, contravening SIPA's express goal of prompt remedial action for harmed investors; and
- Such review would be inconsistent with the summary nature of this proceeding.

1. SIPA Section 11(b) Implies No Judicial Review of the Commission's Customer Need Determination

SIPA Section 11(b) expressly distinguishes between the category of relief that requires a judicial determination and the category that does not. Section 11(b) authorizes the Commission to seek a judicial order "requiring SIPC to discharge its obligations under [SIPA] ***and*** for such other relief as the court may deem appropriate to carry out the purposes of this chapter." 15 U.S.C. § 78ggg(b) (emphasis added). SIPC's "discharge [of] its obligations" includes bringing a liquidation proceeding as instructed by the Commission after the Commission determines that a customer needs protection and other statutory conditions are met. *See infra*, Section III.A.2.c.

Notably, under SIPA Section 11(b), the Commission is ***not*** required to make any particular showing to the Court for the issuance of the order compelling SIPC to "discharge its obligations," including the initiation of a liquidation proceeding. By contrast, the Commission's ability to obtain "other relief" under Section 11(b) is limited to that which "the district court may deem appropriate to carry out the purposes of [SIPA]." Section 11(b)'s express reference to a judicial determination as to "other relief" against SIPC but not as to the "discharge [of] its obligations" implies that the grounds for the latter – *e.g.*, that a customer needs the protection of a liquidation proceeding – are not subject to judicial review. *See Fausto*, 484 U.S. at 447 ("congressional silence" indicated certain personnel actions were unreviewable where statute expressly provided review procedures for other actions); *Block v. Community Nutrition Inst.*, 467 U.S. at 345-48 (omission of review procedures for consumers affected by agency orders, coupled with provision of such procedures for industry group, evidenced Congressional intent to preclude judicial review for the former).

2. The Commission's Plenary Authority Over SIPC Gives the Commission Unreviewable Discretion To Determine the Need for Customer Protection at This Juncture

The judicially unreviewable nature of the Commission's customer need determination is also shown by the combined effect of two fundamental aspects of SIPA: (1) SIPA gives the Commission plenary authority to supervise SIPC; and (2) SIPC itself has judicially unreviewable discretion (absent Commission objection) to determine at the liquidation-commencement stage that a customer needs protection. SIPA authorizes the Commission to stand in the shoes of SIPC for purposes of exercising the same judicially unreviewable discretion to determine that a customer needs protection.

a. The Commission Has Plenary Control Over SIPC

In *SIPC v. Barbour*, 421 U.S. 412 (1975), the Supreme Court held that SIPA invests the Commission with "plenary authority" to supervise SIPC. *Id.* at 417; *see also In re New Times Securities Servs., Inc.*, 371 F.3d 68, 77 (2d Cir. 2004). The Supreme Court based this holding on the extensive and specific powers conferred on the Commission by the statute. In particular, the Commission has full authority to approve, disapprove, adopt, amend, and repeal SIPC's rules and bylaws. *See* SIPA Sections 3(3), 11(a), 15 U.S.C. §§ 78ccc(3), 78ggg(a); *Barbour*, 421 U.S. at 417.[9] The Commission also may "inspect and examine the SIPC's records and require that any information it deems appropriate be furnished to it, and it receives the corporation's annual report for inspection and transmission, with its comments, to the President and Congress," *Barbour*, 421 U.S. at 417; 15 U.S.C. § 78ggg(c); and the Commission "may participate in any

[9] Under Section 3(e)(2)(A), 15 U.S.C. 78ccc(3)(e)(2)(A), SIPC must file a proposed rule with the Commission, which then publishes the proposed rule for notice and comment. Unless the Commission makes an affirmative finding that the proposed rule "is in the public interest and is consistent with the purposes" of SIPA, the Commission "shall disapprove" the proposed rule. Any rule approved by the Commission "shall be given force and effect as if promulgated by the Commission." Section 3(e)(2)(D), 15 U.S.C. 78ccc(3)(e)(2)(D). In addition, Section 3(e)(3), 15 U.S.C. 78ccc(3)(e)(3), authorizes the Commission to "require SIPC to adopt, amend or repeal any SIPC bylaw or rule" as the Commission determines to be "necessary or appropriate in the public interest or to carry out the purposes" of SIPA.

liquidation proceeding initiated by the SIPC," *Barbour*, 421 U.S. at 417; *see* SIPA Section 5(c), 15 U.S.C. § 78eee(c). However, even "more important" than these powers, according to the Supreme Court, was the Commission's authority under Section 11(b) to apply to the District Court for an order compelling SIPC to commence a liquidation proceeding. *Barbour*, 421 U.S. at 417-18; 15 U.S.C. 78ggg(b).

SIPA's legislative history confirms and the Supreme Court declared that the statute was intended to give the Commission "'plenary authority' to supervise the SIPC," *Barbour*, 421 U.S. at 417 (quoting Senate Report at 1). Indeed, the drafters anticipated the Commission's oversight of SIPC would be "substantial" and "vigorous," House Report at 11-12 (explaining that SIPA provides for "substantial oversight on the part of the Commission over the conduct of the affairs of SIPC," and that the House Committee on Interstate and Foreign Commerce "not only directs, but expects the Commission to use its oversight in a vigorous, but fair, manner"); *see also New Times Secs. Servs., Inc.*, 371 F.3d 68, 77-80 (2d Cir. 2004).

b. SIPC Has Discretion Initially To Determine That a Customer Needs Protection

Putting aside the Commission's authority to supervise SIPC, an initial determination by SIPC that a member "has failed or is in danger of failing to meet its obligations" under SIPA Section 5(a)(3) is conclusive for purposes of deciding to apply for a protective decree. SIPA Section 5 provides in relevant part:

> (a) Determination of need of protection
>
> . . . .
>
> (3) Action by SIPC
>
> . . . .

SIPC ***may***, upon notice to a member of SIPC, file an application for a protective decree with any court of competent jurisdiction specified in section 21(e) or 27 of the Securities Exchange Act of 1934 . . . ***if SIPC determines*** that –

(A) The member . . . ***has failed or is in danger of failing to meet its obligations to customers***; and

(B) One or more of the conditions specified in subsection (b)(1) of this section exist with respect to such member.

. . . .

(b) Court action

(1) Issuance of protective decree

Upon receipt of an application by SIPC under subsection (a)(3) of this section, the court ***shall*** forthwith issue a protective decree if the debtor consents thereto, if the debtor fails to contest such application, or if the court finds that such debtor [satisfies one or more conditions].

15 U.S.C. § 78eee (emphasis added).[10]

As the language of Section 5(a)(3) and its legislative history make clear, SIPC may file an application under that provision "in its discretion." Senate Report at 11.[11] SIPC, in exercising its discretion under Section 5(a)(3), considers both (1) whether a member has failed or is in danger of failing to meet its obligations to customers, and (2) whether, if the broker-dealer has not consented to a decree, one of the specified conditions is present. The district court, however, must issue a protective decree under Section 5(b)(1) based (absent the broker-dealer's consent or failure to object) only on the presence of one of those specified conditions. Section

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[10] The conditions listed in Section 5(b)(1) include: member insolvency; the member is the subject of a proceeding in which a receiver, trustee, or liquidator for such member has been appointed; or the member's non-compliance, or inability to make necessary computations to establish compliance, with laws or rules with respect to financial responsibility or hypothecation of customers' securities. 15 U.S.C. §78eee(b)(1).

[11] The Senate Report states: "The bill provides that SIPC may in its discretion apply to the appropriate federal district court for the appointment of a trustee whenever it appears to it that a SIPC member is in danger of failing to meet its obligations to customers and any of certain other enumerated conditions exist (such as failure to meet applicable financial responsibility rules." Senate Report at 11.

5(b)(1) directs that the district court issue a decree, but does not provide for the district court to review SIPC's preliminary determination that a customer is in need of protection. Stated another way, the presence of customers in need of protection is a consideration for SIPC in determining whether to exercise its discretion to initiate a court proceeding seeking a protective order, but it is not a consideration for the district court in determining whether to grant such a protective order.[12]

Accordingly, it is not within the province of any court to review SIPC's initial determination that a member "has failed or is in danger of failing to meet its obligations to customers," leading to the filing of such application. The Supreme Court has recognized that "the hand of government [need not] be stayed until the courts have an opportunity to determine whether the government is justified in instituting suit in the courts." *Ewing v. Mytinger & Casselberry*, 339 U.S. 594, 599 (1950). Under this principle, SIPC need not obtain judicial approval of its bases for seeking a protective decree.

This was made plain by the court of appeals' decision in *SEC v. Alan F. Hughes, Inc.*, 461 F.2d 974 (2d Cir. 1972), shortly after SIPA's enactment. In *Hughes*, the court held that due process did not require that a broker-dealer be afforded an opportunity for a hearing at the time SIPC makes an initial customer need determination. *See id.* at 979. Citing *Ewing*, the court reasoned, "[t]hat initial determination, in and of itself, has no binding legal consequences . . . Rather, SIPC's determination is merely a preliminary step in the process by which it decides to apply to a district court" for a protective decree under SIPA. *Id.* These precedents establish that SIPC's initial determination about the need for customer protection under SIPA Section 5(a)(3), causing it to commence a liquidation proceeding, is judicially unreviewable.

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[12] However, SIPC's preliminary determination is subject to Commission oversight, as discussed below. *See infra* Section III.A.2.c. For example, if SIPC were to start a proceeding that the Commission believed should not be started, the Commission could file an opposition to the application for a protective decree.

c. The Commission, Superior to SIPC in the Regulatory Scheme, May Exercise Unreviewable Discretion To Determine That a Customer Needs Protection

Because SIPC has discretion to determine that a customer needs protection under SIPA Section 5(a)(3), so too may the Commission make this determination in the exercise of its plenary supervisory authority over SIPC. The Commission's plenary authority allows it to supersede SIPC's judgment that there is no need for customer protection with the Commission's judgment that there ***is*** a need. Moreover, this authority empowers the Commission to require SIPC to file an application for a protective decree under Section 5(a)(3), assuming one of the statutory conditions listed in Section 5(b)(1) is met. Where, as here, the Commission determines that a liquidation proceeding is warranted but SIPC refuses the Commission's direction to start one, the Commission may apply for a judicial order "requiring SIPC to discharge its obligations," including by starting a liquidation proceeding. Section 11(b), 15 U.S.C. § 78ggg(b).

As explained above, SIPC's initial determination that a member "has failed or is in danger of failing to meet its obligations to customers," is not subject to judicial oversight. Similarly here, the Commission's customer need determination, in the exercise of its plenary supervisory authority under SIPA and its discretion under Section 11(b), is conclusive in this Court.[13] To hold otherwise would run contrary to the rule that "interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the

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[13] The court in *Hughes* stated that SIPC has discretion to make an initial determination not only that a member has failed or is in danger of failing to meet its obligations to customers, but also that one of the specified conditions under Section 5(b)(1) is met. *See* 461 F.2d at 979 ("[D]ue process does not require that an opportunity for a hearing be afforded at the time SIPC makes its initial determination that one of its members has failed or is in danger of failing to meet its obligations to customers ***and that there exists one or more conditions specified in [Section 5(b)(1)]***." (emphasis added)). Therefore, under *Hughes*, arguably the Commission's ***entire*** decision that a liquidation should be commenced – both the member failure determination and the finding of one or more of the specified conditions – is unreviewable by this Court, even if the latter decision is subject to review by the Texas Court. In any event, as noted above, *supra* Sections I and III, there can be no dispute that one or more of the specified conditions are met in this case.

legislative purpose are available." *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982); *see also Public Citizen v. U.S. Dep't of Justice*, 491 U.S. 440, 455 (1989) (considering "indicators of congressional intent in addition to the statutory language" in construing statute). It would be nonsensical for SIPA to confer judicially unreviewable discretion on SIPC but not on the federal agency charged with exercising plenary supervisory authority over SIPC. Doing so would incongruously give SIPC more authority than the Commission to decide when to exercise its customer protection function. *Cf. New Times*, 371 F.3d at 80 ("Whatever SIPC's expertise in overseeing SIPA liquidations, Congress did not intend for the Commission's interpretation of SIPA to be overruled by deference to the entity that was made subject to the Commission's oversight."). SIPA permits the Commission to fill the shoes of SIPC both with respect to the determination about the need for customer protection ***and*** the lack of judicial review of that determination.

Judicial review of the Commission's customer need determination also would be inappropriate, because "[h]ere an administrative agency is merely determining whether a judicial proceeding should be instituted. Moreover, its finding of probable cause, while a necessary prerequisite to multiple seizures, has no effect in and of itself" as to SGC. *Ewing*, 339 U.S. at 598. The Commission has determined that a judicial proceeding should be instituted in Texas for the protection of customers. This Court's review of that determination by the Commission is unnecessary because, before that liquidation proceeding results in relief to customers or against the broker-dealer, federal courts in Texas (with all appellate review) will address: (1) whether to grant SIPC's application; (2) the process by which claims in liquidation proceeding are made;[14]

[14] "Generally, after an initial period to allow for customer account transfers, the trustee implements, and as matter of practice normally seeks court approval of, a claim process." 1 Collier on Bankruptcy, ¶ 12.11 at 12-44 (rev. 16th ed. 2011).

and (3) objections by claimants to determinations by the SIPC-designated trustee that SIPA coverage is unavailable.

Finally, the Commission's express authority to sue SIPC under SIPA Section 11 supports the conclusion that the Commission's customer need determination is judicially unreviewable. The Supreme Court recognized that the Commission's power to apply for judicial relief under Section 11 was "even more important" than its other supervisory powers over SIPC, including its authority to approve, disapprove, adopt, and change SIPC's rules. *Barbour*, 421 U.S. at 417-18; 15 U.S.C. §§ 78ccc(3), ggg. Put another way, Section 11 is the primary statutory device by which Congress made SIPC "responsible to an agency experienced in regulation of the securities markets." *Barbour*, 421 U.S. at 423.

If the Commission were unable to direct SIPC to accept the Commission's customer need determination and institute a liquidation proceeding for a particular broker-dealer, thereby overcoming SIPC's inaction, the broker-dealer's customers would have no recourse to SIPC's funds; as the Supreme Court found, SIPA does not provide investors with a private right of action against SIPC. *See id.* at 424-25. Thus *Barbour* recognized that the decision to institute a liquidation proceeding is the quintessential exercise of the Commission's plenary supervisory power over SIPC. The statute provides no basis for weakening this power by imposing judicial review on the Commission's determination that a member has failed or is in danger of failing to meet its obligations to customers.

d. The Language of SIPA Section 5(b) Further Indicates That the Commission Has Complete Discretion

The language and structure of SIPA Section 5(b) further supports the conclusion that Congress did not intend this Court to review the Commission's customer need determination. That provision indicates that the district court in which SIPC files an application for a protective

decree cannot review this same determination when made by SIPC. Section 5(b)(1) provides that, upon receipt of a SIPC application under Section 5(a)(3), the court "***shall forthwith*** issue a protective decree if the debtor consents thereto, if the debtor fails to contest such application, or if the court finds that such debtor" meets one of the other listed conditions. 15 U.S.C. § 78eee(b)(1) (emphasis added). Under this statutory command, if SIPC applies for a liquidation order and the member does not object, the court must issue the order. If SIPC applies for a liquidation order and the member objects, the court must issue the order if it finds one or more of the Section 5(b)(1) conditions. In neither event does the court review SIPC's determination that there is a customer in need of protection. *See Barbour*, 421 U.S. at 416-17 ("If the court finds any of the [listed] conditions on which an SIPC application may be based, it must grant the application and issue the decree . . . .").

SIPC's longstanding practice of filing perfunctory applications for protective decrees confirms this point. For most customer protection proceedings, SIPC submits a boilerplate application that simply states that, upon sufficient information, including information supplied by the Commission or a self-regulatory organization, SIPC has determined that the member has failed to meet its obligations to its customers within the meaning of SIPA Section 5(a)(3), 15 U.S.C. § 78eee(a)(3).[15] The supporting memorandum of law that SIPC typically files provides a similar summary statement.[16] In two recent cases, SIPC departed only slightly from its usual format by acknowledging that the need for customer protection may have been prophylactic,

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[15] *See, e.g., SEC v. Madoff et al.*, Case No.1:08cv10791, Application of SIPC (filed Dec. 15, 2008), at ¶ 5 [Docket Document #5], Martens Decl. ¶ 5 & Exh. 4, Attachment B. This Exhibit provides initial SIPC filings and court orders for 15 SIPC customer protection proceedings since 1998. *See* Martens Decl. ¶ 4.

[16] *SEC v. Madoff et al.*, Case No. 1:08cv10791, Memorandum of Law in Support of the Application of SIPC (filed Dec. 15, 2008), at 5 [Docket Document #6], Martens Decl. Exh. 4, Attachment B (stating, in relevant part: "Upon information supplied by the Commission and FINRA, SIPC has made the determination required by SIPA § 78eee(a)(3) that the Defendant has failed to meet its obligations to customers and that one or more of the conditions specified in SIPA § 78eee(b)(1) exists.").

stating, "Upon information supplied by the Commission, SIPC has made the determination required by SIPA § 78eee(a)(3) that the Defendant has failed to meet its obligations to customers, ***or is in danger of failing to do so*** . . . .").[17]

In neither these cases nor in 12 other customer protection proceedings that SIPC has started since 1998 has SIPC provided a detailed factual basis for its initial determination that a member failed or was in danger of failing to meeting its obligations to customers.[18] Moreover, in most or all of these proceedings it appears that the district courts routinely granted SIPC's applications.[19] Thus, SIPC's own practice reflects the view that its initial customer need determination is not subject to judicial review, at least before customer claims are addressed in connection with a liquidation proceeding.

Because SIPC Section 5(b) precludes the district's court's review of the customer need determination reflected in SIPC's filing for a protective decree ***even after the filing is made***,[20]

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[17] *SEC v. North American Clearing, Inc.*, Case No. 6:08-cv829-GAP-GLK, Memorandum of Law in Support of the Application of SIPC (filed Jul. 28, 2008) at 5 [Docket Document #72], Martens Decl. ¶ 5 & Exh. 4, Attachment E (emphasis added). In its application for a protective decree in *MF Global Inc.*, Case No. 1:11-cv-07750-PAE (filed Oct. 31, 2011), SIPC stated, "Upon sufficient information, including information supplied by the Commission, SIPC has determined that the Defendant has failed or ***is [sic] danger of failing to meet its obligations to its customers*** within the meaning of SIPA §78eee(a)(3)(A), and that there exists one or more of the conditions specified in SIPA § 78eee(b)(1)." *Id.* ¶ 5, Martens Decl. ¶ 5 & Exh. 4, Attachment A (emphasis added).

[18] The 15 total proceedings are provided in Exhibit 4 to Mr. Martens' declaration and were identified from the approximately 66 proceedings listed in the appendices to SIPC's annual reports from 1998-2010, available on SIPC's website at http://www.sipc.org/who/annual.cfm (accessed November 16, 2011), or from publicly available news reports. This tally does not include "direct payment" proceedings. SIPC's papers from proceedings other than these 15 proceedings appear not to be available through commercial electronic databases. *See* Martens Decl. ¶ 5.

[19] Martens Decl. Exh. 4, Attachments A-O.

[20] Although the Commission's preliminary determination is not binding in later proceedings to resolve customer claims, there can be no evaluation (even after the commencement of a liquidation) as to whether the Commission's determination was warranted in the first instance. To the extent this conclusion is inconsistent with the decision by the United States Court of Appeals for the Second Circuit in *Hughes*, 461 F.2d at 979-81, the reasoning in that case should not be followed. But, in fact, *Hughes* does not compel a different result here. The *Hughes* decision was rendered in the context of a SIPC application for a protective decree, not an effort by the SEC to compel SIPC to file such an application. The *Hughes* court recognized that the "literal" reading of SIPA rendered the customer protection issue unreviewable by the courts. *See id.* at 980. The court nevertheless rejected this reading based on concerns that such a reading would raise due process concerns with regard to the broker's ability to challenge the institution of a liquidation proceeding. *See id.* Whatever the legitimacy of those concerns with regard

the Commission's customer need determination is similarly unreviewable. As discussed above, SIPA and logic mandate that the Commission have at least as much discretion as SIPC to determine that a liquidation proceeding is warranted, because the Commission exercises plenary supervision of SIPC. *See supra* Section III.A.2.c. To properly recognize and effectuate this discretion, this Court should not review the Commission's customer need determination for SGC underlying its application for an order under SIPA Section 11(b).

3. SIPA Already Provides For Judicial Resolution of Customer Need Issues Through the Liquidation Process

This Court's review of the Commission's customer need determination is also unwarranted because it would be duplicative of, and possibly inferior to, judicial resolution of customer need issues that would occur in connection with a liquidation proceeding. Importantly, a SIPA liquidation proceeding provides for the development of a factual record on which a bankruptcy or other federal court can base decisions relating to customer need. Indeed, a key point of a liquidation proceeding is to resolve SIPA coverage for customers.

SIPA lays out this liquidation process in detail. Upon issuance of a protective decree, the district court appoints a trustee designated by SIPC and removes the proceeding to bankruptcy court. Sections 5(b)(3),(4), 15 U.S.C. §§ 78eee(b)(3),(4). The trustee is then charged with providing notice of the proceeding to the public and mailing a copy of the notice "to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months." Section 8(a)(1), 15 U.S.C. § 78fff-2(a)(1). Customers seeking a return of property must file with the trustee "a written statement of claim" pursuant to statutory deadlines and limitations. Sections 8(a)(2),(3), 15 U.S.C. §§ 78fff-2(a)(2),(3). After receiving these claims, the trustee "shall promptly discharge" the member's

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to a broker, those concerns are not present here. The Receiver for SGC, as successor to the broker-dealer, has not taken a position as to whether it would object to the start of a liquidation proceeding.

obligations to the customers pursuant to SIPA's requirements "insofar as such obligations are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee." Section 8(b), 15 U.S.C. § 78fff-2(b). The bankruptcy court approves the claims process, including a process for claimants to obtain review of any decision of the trustee with which they disagree.

Claimants can and do file objections to adverse decisions by the trustee with the bankruptcy court, whose decisions may then be appealed. *See, e.g., New Times*, 371 F.3d at 74-75 (describing claimants' objections to trustee's determination); *In re Old Naples Secs., Inc.*, 223 F.3d 1296, 1301 (11th Cir. 2000) (describing appeal process). In these and other cases, courts have made factual findings based on the discovery process that occurs during this review. *See e.g., Old Naples*, 223 F.3d at 1299, 1301 (claimants were entitled to SIPA coverage based on findings they had purchased securities issued by an affiliate of an "introducing broker" and "had no reason to know they were not dealing with the Debtor."); VII Loss, Seligman & Paredes, SECURITIES REGULATION § 8.B.5 at n.417 (Wolters Kluwer on-line version 2011) (collecting cases).

Because SIPA already expressly establishes a judicial process – *i.e.*, the liquidation proceeding – through which questions about customer need can be litigated, it would be duplicative and possibly contrary to the interests of investor protection to attempt to resolve similar issues in this proceeding. Fact-finding by this Court, if any, would be inefficient in light of the later-required process. Furthermore, this Court's involvement would occur ***before*** customers are sent formal notice in accordance with SIPA's procedures, leading to the possibility that some customer scenarios will be overlooked. This Court would face the daunting task of ascertaining potential SIPA coverage for customers quite possibly without the benefit of

receiving complete information about the myriad circumstances facing those customers. Additionally, review by this Court of customer need issues likely would occur – absent a significant expansion of the scope and timeframe for this proceeding – without the full benefit of advocacy from the claimants based on a developed factual record.

If notwithstanding these practical obstacles this Court were to undertake review and to uphold the Commission's customer need determination, then (assuming the Commission's requested relief were granted) SGC customers could make claims in a liquidation proceeding ordered by the Texas Court – just as they assumedly could do if this Court does not undertake review. If, however, the Court, were to disagree with the Commission's determination based on a review of the Commission's evidentiary record, and, therefore, deny the Commission Application, then ***no*** SGC customer would be able to make a claim for SIPA coverage because there would be no liquidation proceeding. Thus, this Court's review of the Commission's customer need determination could have the effect of eliminating the opportunity for SGC customers to make their own claims for SIPA coverage, which otherwise would result from the Commission's determination. Yet judicial review could not provide any benefit to the customers beyond what the Commission's determination already provides.

"[T]he familiar canon of statutory construction that remedial legislation should be construed broadly to effectuate its purposes," *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967), applies to this case. "Congress' primary purpose in enacting the SIPA and creating the SIPC was, of course, the protection of investors." *Barbour*, 421 U.S. at 421; *see also New Times*, 371 F.3d at 84 (adopting SEC's interpretation of SIPA partly because it better served the statute's remedial goals). Under these precepts, this Court should broadly construe the Commission's authority to seek an order under Section 11(b) that compels SIPC to start a liquidation

proceeding, where the Commission has determined that a customer needs protection. This reading most advances SIPA's goals of "promoting investor confidence and providing protection to investors." *New Times*, 371 F.3d at 84. By contrast, a decision by this Court on customer need issues that overrules the Commission's determination and ***forecloses*** a liquidation proceeding would leave SGC customers without a chance to seek SIPA coverage. The proper forum for resolving customer need issues is the liquidation proceeding, just as SIPA expressly provides.[21]

4. Judicial Review of the Commission's Customer Need Determination Is Inconsistent With the Statutory Goal of Speedy Relief for Victims

This Court's review of the Commission's customer need determination – and the precedent such review would set for future cases – also would threaten to undermine SIPA's overriding goal of speedy relief for investors, particularly if time-consuming discovery is allowed here. SIPA states that the first purpose of a liquidation proceeding is, "***as promptly as possible after the appointment of a trustee in such liquidation proceeding***," the appropriate delivery or distribution of customer securities or property or other satisfaction of net equity claims of customers. Section 6(a)(1), 15 U.S.C. § 78fff(a)(1) (emphasis added). Consistent with this purpose, the statute requires the trustee to perform an investigation and provide a report to SIPC ***"as soon as practicable,"*** Section 7(d), 15 U.S.C. § 79fff-1(d) (emphasis added), and to issue notice of the liquidation proceeding and to discharge all of the debtor's obligations to customers ***"promptly,"*** Sections 8(a)(1), (b), 15 U.S.C. §§ 79fff-2(a)(1), (b) (emphasis added).

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[21] As stated above, in the event SIPC files an application for a protective decree in the district court for the Northern District of Texas, SIPA requires that court to issue a decree "forthwith" where one or more of the Section 5(b)(1) conditions is met and therefore the court would not review the customer need determination for SGC. *See supra* Section III.A.2.d. If the Commission's argument is incorrect on this point, review of customer harm issues by the Texas district court, before issuance of a protective decree, would further render this Court's review of these issues duplicative and unnecessary.

The statute similarly admonishes urgency as to the process by which a liquidation proceeding is commenced. The Commission or a self-regulatory organization must notify SIPC ***"immediately"*** of information about a broker-dealer's financial difficulty. Section 5(a)(1), 15 U.S.C. § 78eee(a)(1). After a district court issues a protective decree, it must appoint a trustee and remove the proceeding to bankruptcy court ***"forthwith."*** Sections 5(b)(3),(4), 15 U.S.C. § 78eee(b)(3),(4) (emphasis added).

SIPA's legislative history also repeatedly emphasizes the goal of prompt redress for customer need. For example, the statute's allowance of SIPC fund advances to the trustee is a "significant provision [that] will make it possible for public customers to receive ***promptly*** that to which they are entitled ***without the delay entailed in waiting for the liquidation proceeding to be completed***." House Report at 8 (emphasis added). *See also* Senate Report at 14 (trustee's obligation is "to discharge as ***promptly*** as possible obligations of the debtor which are ascertainable from the books and records whether or not the customer files a formal proof of claim" (emphasis added)); House Report at 21 ("it shall be the duty of the trustee to discharge ***promptly*** all obligations of the member involved to each of its customers relating to securities or cash" (emphasis added)); House Report at 9 (noting customer's interest in the distribution of securities held for their account ***"as rapidly as possible"*** (emphasis added)); Senate Report at 11 (same).

SIPA's mandate of speed was underscored by SIPC's recent rapid response to the MF Global crisis. On the ***same day*** that MF Global filed a petition for bankruptcy under Chapter 11, SIPC filed a Complaint and Application for a protective decree.[22] That application stated that,

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[22] *See* Docket Sheets for *MF Global Holdings Ltd.*, Case No. 1:11bk15059 (Bankr. S.D.N.Y. filed Oct. 31, 2011), and *MF Global Finance USA Inc.*, Case No. 1:11bk15058 (Bankr. S.D.N.Y. filed Oct. 31, 2011) , Martens Decl. ¶ 6 & Exh. 5; *SIPC v. MF Global, Inc.*, Case No. 1:11cv7750 (S.D.N.Y. filed Oct. 31, 2011), Martens Decl. ¶ 5 & Exh. 4, Attachment A.

"[u]pon sufficient information, including information supplied by the Commission, SIPC has determined that the Defendant has failed ***or is [sic] danger of failing to meet its obligations to its customers*** within the meaning of SIPA §78eee(b)(1)."[23]

Nonreviewability of agency action "can fairly be inferred" from a statute designed to provide stakeholders with an administrative process for achieving prompt results. *Morris v. Gressette*, 432 U.S. 491, 501 (1977). In *Morris*, the Supreme Court considered whether the Attorney General's decision not to timely object to a change in the voting laws of a State subject to the Voting Rights Act of 1965 was judicially reviewable. That Act prohibited the State from changing its voting procedures without first obtaining a declaratory judgment from the District Court for the District of Columbia that the proposed change was not unconstitutional, or, alternatively, submitting the change to the Attorney General and receiving no objection within 60 days. *See id.* at 494-95. Recognizing that Congress intended the latter process as "an expeditious alternative to declaratory judgment actions" that otherwise could cause a "dragging out" of States' inability to implement nondiscriminatory legislation, the Court held that the Attorney General's decision not to object was unreviewable. *Id.* at 503-04.

Similarly here, given SIPA's overriding emphasis on prompt action for investors, the Court should avoid a construction of Section 11(b) that "drag[s] out" the statute's remedial process through review of the Commission's customer need determination. Such a construction would unduly delay redress for SGC's customers. To the extent doubts are raised about whether SIPA's protections extend to SGC customers, those doubts can be addressed in the liquidation proceeding or follow-on appeals. *See Morris*, 432 U.S. at 504-05 (recognizing availability of judicial relief in separate proceeding in holding Attorney General's action unreviewable).

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[23] *MF Global Inc.*, Case No. 1:11-cv-07750-PAE, Complaint and Application of SIPC at 5 (filed Oct. 31, 2011) [Docket Document #1], Martens Decl. ¶ 5 & Exh. 4, Attachment A (emphasis added).

Section 11(b) provides a mechanism of last resort to the Commission, to be exercised where, as here, the Commission and SIPC already have spent months (or longer) exchanging information about a defunct member and the Commission has no other means effectively to fulfill its statutory duty to supervise SIPC. *See* House Report at 12 (noting need for "cooperation and coordination between the efforts of the self-regulatory organizations, SIPC and the Commission . . . [for] this legislation [to] see its fullest effectiveness). Insertion of a lengthy judicial process at this juncture, ***before*** initiation of a liquidation proceeding in which customer protection questions will necessarily be decided, would defeat the statute's goals and extend what has already been an over-long wait by SGC account-holders for resolution of their claims.

5. The Commission's Authority To Use a Summary Proceeding Against SIPC Further Supports Deference to the Commission's Customer Need Determination

Finally, SIPA's requirement that the Commission enforce the statute through a summary proceeding similarly counsels against a lengthy review process in this Court. SIPA authorizes the Commission to "apply to the district court" for an order requiring SIPC to discharge its obligations. Section 11(b), 15 U.S.C. § 78ggg(b). This language mandates a summary proceeding rather than a full-blown civil action.

As one court recognized in construing analogous language regarding the Commission's enforcement powers, "'applications' are distinct from 'actions;'" whereas "actions" refer to regular civil or criminal proceedings that commence with formal complaints, "[a]n 'application' is merely a 'motion'" that "does not necessarily include or trigger 'all the formal proceedings in a court of justice' as does the filing of an 'action.'" *SEC v. McCarthy*, 322 F.3d 650, 656-57 (9th Cir. 2003) (quoting BLACK'S LAW DICTIONARY at 28, 96, 1031 (7th ed. 1999)). "Had Congress intended to require the Commission to bring a full-blown civil action under the Federal Rules in

order to enforce its orders [under the securities laws], Congress would have made this explicit by requiring the Commission to file an 'action' in district court, rather than an 'application.'" *Id.* at 657. Similarly, in *SEC v. Sprecher*, 594 F.2d 317 (2d Cir. 1979), the court held that the Commission may enforce subpoenas through summary proceedings under the Securities Act of 1933, because the relevant statutory provision permits judicial orders "upon application by the Commission." *Id.* at 320.

Here, because SIPA authorizes the Commission to enforce the statute through a summary proceeding, the regular rules of civil procedure do not apply. The Supreme Court emphasized the practical nature of summary proceedings in *New Hampshire Fire Ins. Co. v. Scanlon*, 362 U.S. 404 (1960), noting "[t]he very purpose of summary rather than plenary trials is to escape some or most of these trial procedures. Summary trials . . . may be conducted without formal pleadings, on short notice, without summons and complaints, generally on affidavits, and sometimes even *ex parte*." *Id.* at 406. Thus the provision for a summary proceeding in SIPA Section 11(b) further weighs against this Court's use of a lengthy process to review the Commission's customer need determination. A summary proceeding is intended expeditiously to achieve a particular result – in this case, the commencement of a liquidation proceeding in another court – without invoking the full panoply of procedures that otherwise would be available. Indeed, such procedures are unnecessary because, as discussed above, a liquidation proceeding will facilitate the development of an adequate factual record on which competing arguments about customer need can be resolved.

B. The Commission's Customer Need Determination Is Committed to Agency Discretion By Law

Under the Administrative Procedure Act ("APA"), an aggrieved party may not challenge agency action "committed to agency discretion by law." 5 U.S.C. 701(a); *see Heckler v. Chaney*,

470 U.S. 821, 828 (1985). Although this is not a proceeding under the APA, this principle from Section 701(a) is instructive. *Cf. National Clearinghouse for Legal Servs. v. Legal Servs. Corp.*, 674 F. Supp. 37, 40 (D.D.C. 1987) (applying "standards of review analogous to those embodied in the APA"). Applied here, it weighs decisively against this Court's review of the Commission's customer need determination.

1. This Court's Review of the Customer Need Determination Would Improperly Interfere With the Commission's Discretion To Deploy Resources in Litigation

Judicial review of the Commission's customer need determination would be improper because that determination falls into the "categories of administrative decisions that courts traditionally have regarded as 'committed to agency discretion.'" *Lincoln v. Vigil*, 508 U.S. 182, 191 (1993). Specifically, judicial review would interfere with the Commission's discretion to deploy resources in litigation. In *Chaney*, the Supreme Court held that an agency's decision not to take an enforcement action was presumptively unreviewable because it "involves a complicated balancing of a number of factors which are peculiarly within its expertise." 470 U.S. at 831. "Thus, the agency must not only assess whether a violation has occurred, but whether agency resources are best spent on this violation or another, whether the agency is likely to succeed if it acts, whether the particular enforcement action requested best fits the agency's overall policies, and, indeed, whether the agency has enough resources to undertake the action at all." *Id.* As this circuit's Court of Appeals has made clear, an agency's determination "'whether a violation has occurred'" reflects an "antecedent judgment" that falls squarely within the agency's presumptively unreviewable discretion. *Block v. SEC*, 50 F.3d 1078, 1081 (D.C. Cir. 1995) (quoting *Chaney*, 470 U.S. at 831) (SEC's decision not to hold a hearing was presumptively unreviewable); *see also Board of Trade of the City of Chicago v. SEC*, 883 F.2d

525, 531 (7th Cir. 1989) (Commission's decision not to prosecute was presumptively unreviewable because "[a]gencies must compare the value of pursuing one case against the value of pursuing another.").

Similarly here, the Commission's determination that SGC customers need protection reflects an "antecedent judgment" about whether SIPA Section 5(a)(3) applies that is presumptively unreviewable under *Chaney*. *See Hughes*, 461 F.2d at 979 (SIPC's customer need determination under SIPA "is merely a preliminary step in the process"). Moreover, the determination reflects various other judgments by the Commission in its exercise of plenary supervisory authority of SIPC, including, without limitation, whether SIPC's resources are best spent conducting a proceeding for SGC and whether such a proceeding "best fits the agency's overall policies." Nothing in SIPA rebuts the traditional presumption against judicial reviewability on these issues; to the contrary, as discussed above, the language, structure, and legislative history of the statute ***support*** this presumption here. *See supra* Section III.A; *Chaney*, 470 U.S. at 833 ("Congress may limit an agency's exercise of enforcement power if it wishes, either by setting substantive priorities, or by otherwise circumscribing an agency's power to discriminate among issues or cases it will pursue.").

The fact that the Commission's determination is intended to precipitate a liquidation proceeding, and is not a decision not to enforce, is of no consequence as to its reviewability under *Chaney*. The core agency "judgments" at issue – whether or not the criteria of Section 5(a)(3) are triggered and how effectively to deploy SIPC's resources to achieve its statutory objectives – are precisely the types of issues that the Commission, and not the Court, is presumptively best positioned to resolve. *See Ewing*, 339 U.S. at 598 (no hearing required to review agency's administrative finding of probable cause, which was "merely the statutory

prerequisite to the bringing of the lawsuit"); *Board of Trade*, 883 at 530 (SEC staff's no-action letter that allowed company to conduct business without registering as exchange was unreviewable, rejecting argument "that the letter is a substantive rather than a prosecutorial decision").

2. This Court Would Have "No Meaningful Standard" By Which To Review the Commission's Customer Need Determination

Additionally, SIPA provides no meaningful standard by which this Court reasonably could evaluate the Commission's customer need determination. This is particularly true given the extraordinary breadth of circumstances that potentially merit a protective decree under Section 5(a)(3). Judicial review is unavailable under the APA where "statutes are drawn in such broad terms that in a given case there is no law to apply," *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 410 (1971) (internal quotation omitted)), and "a court would have no meaningful standard against which to judge the agency's exercise of discretion, *Chaney*, 470 U.S. at 830.

Although SIPA defines the term "customer," *see* Section 16(2), 15 U.S.C. § 78lll(2), the statute provides no meaningful standard by which this Court can assess the Commission's determination that a broker-dealer "is in ***danger*** of failing to meet its obligations to customers." This determination necessarily requires a highly fact-specific evaluation by the Commission of the nature and extent of this "danger." The Commission must assess – based on factual circumstances and its industry expertise, among other factors – the extent of a member's financial and operational difficulties and the likelihood they will jeopardize a customer's access to his or her cash or securities. It would be challenging, if not impossible, for a court to review such an assessment, especially in the absence of any statutory guidance. *See, e.g.*, *Oryszak v. Sullivan*, 576 F.3d 522, 525-26 (D.C. Cir. 2009) (revocation of security clearance was

unreviewable because the court, as a non-expert body, was unable to evaluate "the breadth of the margin of error acceptable" in a particular case).[24]

Moreover, this Court's review would be even more unmanageable if it also had to evaluate the Commission's assessment, under SIPA Section 5(a)(3), of the likelihood that a "customer" as defined by SIPA even exists. This provision plausibly could be interpreted such that the phrase "in danger of" modifies the phrase "failing to meet its obligations" ***and*** the term "customer." Under this interpretation, the Commission could decide whether a liquidation proceeding is warranted because ***either*** (1) there is a "customer" (as defined by SIPA) placed at risk by the member's broker-dealer's financial difficulties; or (2) there is a "danger" – *i.e.*, a certain degree of likelihood – that there is such a "customer" at risk of harm; or both. In the latter circumstance, a member could be said to be in danger of meeting its obligations to a customer, even if that person ultimately could be found not to meet that definition. Under this interpretation, in order to fulfill its statutory obligation to protect customers, it sometimes would be necessary for SIPC to commence a liquidation proceeding to determine the facts relevant to whether persons are "customers" as defined by SIPA. If SIPC failed to act in this "danger" situation, SIPC could be said to have refused to act for the protection of customers, and the Commission would be authorized under Section 11(b) to apply for an order compelling a proceeding.

Indeed, SIPC's prior practice indicates agreement with this interpretation of Section 5(a)(3). SIPC has initiated proceedings precisely for the prophylactic purpose of addressing the

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[24] Although here the Commission determined that SGC did fail to meet its obligations to customers, if this Court were to review the Commission's customer need determination the Court could uphold it on the alternative ground that the Commission had sufficient evidence of a "danger" that SGC was failing to meet its obligations to customers. In any event, because the Commission could base a customer need determination in a future case on the "danger" element, SIPA should not be interpreted here to impose a requirement of judicial review that is beset by unmanageable judicial standards.

"danger" that there is a customer in need of protection. For example, after the broker-dealer C.J. Wright & Company ceased operation and the Commission conducted a preliminary investigation in 1991, the adjudicating court recounted that SIPC filed an application alleging insolvency "and that there ***may be 'customers'*** within the meaning of Section 5(a)(3) of SIPA in need of protection provided by a liquidation under SIPA." *SIPC v. C.J. Wright & Co., Inc. (In re C.J. Wright & Co.)*, 162 B.R. 597, 600 (Bankr. M.D. Fla. 1993).[25] It did not matter for purposes of SIPC's decision to initiate a proceeding that that the customer status of affected persons was uncertain.

Whether or not this interpretation is correct, the Commission, in making a determination under Section 5(a)(3), at a minimum must assess the likelihood that a member may fail to meet its obligations to a customer (as defined by SIPA) in the future, assuming such failure has not already occurred. The need for SIPC and the Commission to exercise discretion on this point alone is another reason why this Court's review of the Commission's customer need determination would be inappropriate. Because SIPA does not furnish any useful criteria by which to review the Commission's exercise of discretion as to the "danger" that a customer needs protection, the statute "can be taken to have committed the decisionmaking to the agency's judgment absolutely." *Chaney*, 470 U.S. at 830.

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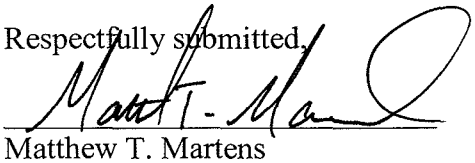
[25] The signed order of a protective decree in *C.J. Wright* "ORDERED, ADJUDGED and DECREED, that there are persons who may be customers of C.J. Wright & Company Incorporated ("Defendant") in need of the protection afforded by the Securities Investor Protection Act ("SIPA"), 15 U.S.C.A. §78aaa *et seq.* (1981). Martens Decl. ¶ 7 & Exh. 6.

IV. CONCLUSION

For the foregoing reasons, the Commission is entitled to an order compelling SIPC to file an application for a protective decree in the Texas Court under Section 5(a)(3) of SIPA, 15 U.S.C. § 78eee(a)(3), and otherwise to take necessary steps to commence a SIPA liquidation proceeding for SGC. In addition, the Commission is entitled to an order directing SIPC to show cause why it should not be ordered to file an application for a protective decree with the Texas Court under Section 5(a)(3), 15 U.S.C. § 78eee(a)(3), and otherwise to take necessary steps to commence a SIPA liquidation proceeding for SGC. The Court should issue the requested order and grant other relief as the Court deems appropriate.

Dated: Washington, D.C.
December 12, 2011

Respectfully submitted,



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