[ORAL ARGUMENT NOT YET SCHEDULED]

No. 12-5286

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,
Petitioner-Appellant,

v.

SECURITIES INVESTOR PROTECTION CORPORATION,
Respondent-Appellee.

On Appeal from the United States District Court for the District of Columbia

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INITIAL REPLY BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, APPELLANT

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GLOSSARY

SIPA:	Securities Investor Protection Act of 1970
SIPC:	Securities Investor Protection Corporation
SGC:	Stanford Group Company
SIBL:	Stanford International Bank, Ltd.
SIBL CDs:	Stanford International Bank, Ltd., Certificates of Deposit
FSI	Financial Services Institute
SIFMA	Securities Industry and Financial Markets Association
Op. #	*SEC v. SIPC*, No. 11-mc-678 (RLW), Memorandum Opinion and Order (filed July 3, 2012)
SEC #	Brief of the Securities and Exchange Commission, Appellant
Br. #	Brief of the Securities Investor Protection Corporation, Appellee

INTRODUCTION

In its opening brief, the Securities and Exchange Commission established that the district court erred both in incorrectly applying a preponderance standard of proof in this preliminary, summary proceeding and in applying an unduly narrow construction of the statutory term "customer" to preclude the possibility of coverage under the Securities Investor Protection Act of 1970 ("SIPA" or the "Act") for investors in the Stanford Ponzi scheme. The arguments made by the Securities Investor Protection Corporation ("SIPC") in response are based on an incorrect view of the nature of this proceeding and a misreading of the relevant statutory scheme, applicable case law, and underlying facts.

Contrary to SIPC's contention, this proceeding will not lead to a final determination of the key question at issue—whether any of the Stanford victims qualify as "customers" under SIPA. Nor did Congress confer greater discretion on SIPC than on the Commission to make the determination whether to seek to initiate a SIPA liquidation proceeding. Given the preliminary nature of the proceeding here, and the statutory relationship between the parties, a probable cause standard of proof is appropriate. Moreover, SIPC's formalistic construction of the term "customer" to preclude the potential for SIPA coverage here erroneously gives effect to both the fraudulent corporate boundaries designed by Allen Stanford to

facilitate his scheme and the illegitimate securities sent to investors in furtherance of that scheme.

Nor will the Commission's interpretation of the statutory definition of a "customer" undermine the statutory scheme as SIPC and its *amici* contend. The Commission is not advocating that every customer of every Stanford entity would have customer status under SIPA. *See* Brief of the SEC at 49 ("SEC __"). Rather, its position is that in the rare circumstances presented here—where the Stanford entities (including Stanford International Bank, Ltd. ("SIBL") and Stanford Group Company ("SGC")) were operated as a single fraudulent enterprise ignoring corporate boundaries, SGC accountholders who purchased SIBL CDs were solicited by SGC and dealt substantially with SGC employees, and the purported securities issued by SIBL were in reality interests in a Ponzi scheme—SGC accountholders who purchased SIBL CDs through SGC should be deemed to have deposited funds with SGC. This interpretation is the correct one; and it is at least a reasonable one that is entitled to deference.

ARGUMENT

I. The probable cause standard of proof applies in resolving the Commission's application.

A. It would be inconsistent with SIPA to apply a preponderance standard of proof in this preliminary, summary proceeding.

The question presented in this preliminary, summary proceeding under Section 11(b) of SIPA, 15 U.S.C. 78ggg(b),[1] is whether SIPC should be ordered to file an application to begin a liquidation proceeding for SGC in the U.S. District Court for the Northern District of Texas ("Receivership Court"). Claimants in a liquidation proceeding would bear the burden of proving by a preponderance of the evidence both that they qualify as SIPA-defined "customers" and the amounts of their claims. Because Congress created this detailed procedure to adjudicate whether claimants are "customers," the best reading of SIPA's text and structure is that Congress did not intend the Commission to make the *same* showing of customer status simply to require SIPC to apply to initiate a liquidation proceeding under Section 11(b).

SIPC argues that Section 11(b) proceedings and liquidation proceedings are "in no way duplicative" (Br. 29) and thus it is appropriate to apply a preponderance standard in both proceedings. It further argues that Section 11(b) litigation involves the Commission and SIPC as parties and determines whether SIPC is

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[1] Pertinent statutes are set forth in the Addendum bound with the Commission's Opening Brief.

obligated to initiate a liquidation, whereas liquidation proceedings involve SIPC as "overseer" of the liquidation and are "meant to determine the amount" of each claimant's recovery. Br. 29. That is doubly flawed.

This Section 11(b) proceeding involves a *preliminary* determination of the *same* issue that is at the core of a SIPA liquidation: whether there are customers entitled to the statute's protections. The district court reviews the Commission's Section 11(b) application to determine whether it has established that there may be customers in need of SIPA's protections—the basis for requiring SIPC to initiate the proceeding Congress created to *finally* determine whether there are SIPA customers and, if so, the scope of their relief (if any). Thus the question of customer status is at the heart of both proceedings. But, while it makes sense to apply a preponderance standard to the full and final litigation of that question by claimants in the liquidation proceeding, it does not make sense to require the *identical* showing by the Commission in the preliminary proceeding to decide whether there should even be a liquidation proceeding. SEC 30-31.

SIPC also misses the mark in arguing that due process does not *require* use of the probable cause standard in this proceeding. Br. 28. The Commission has not argued that it does. Rather, the salient point in response to the district court's concern is that such a standard is *consistent with* due process. SIPC does not dispute that point. Moreover, the authorities cited by the Commission (SEC 31-32

& n.8) amply demonstrate that the probable cause standard is a familiar and appropriate one in preliminary proceedings such as this, in both the criminal and the civil contexts. *See SEC v. International Loan Network, Inc.*, 770 F. Supp. 678, 688 (D.D.C. 1991), *aff'd*, 968 F.2d 1304 (D.C. Cir. 1992).

B. SIPA's goal of speedy relief for investors supports the use of the probable cause standard.

SIPA's legislative history and purposes also support the use of a probable cause standard here. SEC 32-33. SIPC does not dispute the Commission's detailed showing that Congress intended rapid action to protect investors and to provide speedy relief for their claims. Nonetheless, SIPC argues that this intent does not support the use of the probable cause standard because this case does not involve an emergency and because "no statute pursues its goals at all costs." Br. 37.

Regardless of whether *this* case involves exigent circumstances, however, SIPA must be interpreted in a manner to function effectively in such circumstances. *See* Order at 9 n.5 (Feb. 9, 2012) [Dkt. 21] ("February 9 Order"). Nor would the use of a probable cause standard pursue speed at "all costs." That standard requires a reasonable showing that there are persons who may be "customers," and that is an appropriate basis to afford those persons the opportunity themselves to litigate their claims to "customer" status. And while SIPC questions whether the probable cause standard would make a Section 11(b)

proceeding quicker (Br. 38), a proceeding in which that standard applies rather than a preponderance standard reasonably can be expected to be resolved more quickly.

SIPC also contends that in proceedings where courts allow speedy relief, such as preliminary injunctions, the standard of proof is "far more reaching than probable cause." Br. 38. But this is not always the case. And courts in this Circuit have applied a standard comparable to probable cause to Commission motions for a preliminary injunction against violations of the securities laws. *See International Loan Network, Inc.*, 770 F. Supp. at 688 (quoting *SEC v. General Refractories Co.*, 400 F. Supp. 1248, 1254 (D.D.C. 1975)).

C. A lesser standard applies when SIPC itself seeks to initiate a liquidation.

Consistent with the above reasoning, SIPC itself is held to less than a preponderance standard when initiating a liquidation proceeding. *See* SEC 34-36. In response, SIPC points to the statement in *SEC v. Alan F. Hughes, Inc.*, 461 F.2d 974 (2d Cir. 1972), that "more than a reasonable showing" was made there, and that in fact there was a clear and present danger.[2] Br. 35. But the most natural

[2] SIPC contends that the Commission relies on a "selective quotation" of *Hughes*. Br. 35 (quoting SEC 34). The Commission's brief, however, quoted the entire phrase "'more than a reasonable showing.'" SEC 34 (quoting *Hughes*, 461 F.2d at 982).

reading of that statement is that a "reasonable showing" is the standard and that standard happened to be exceeded on the facts of that case. 461 F.2d at 982.

SIPC also argues that the *Hughes* court's holding that there must be *de novo* review of SIPC's "customer" determinations (where the brokerage firm objects to liquidation) supports a higher standard of proof. *See* Br. 35-36. But there is no inconsistency between the *de novo* standard of *review* and application of the probable cause standard of *proof*. *See United States v. Broadie*, 452 F.3d 875, 879 (D.C. Cir. 2006).

Finally, SIPC attempts to distinguish the *Hughes* court's emphasis on the fact that Section 5(a)(3) of SIPA, 15 U.S.C. 78eee(a)(3), authorizes SIPC to initiate a liquidation not only where a broker-dealer has failed to meet its obligations to its customers but also where there is merely a "danger" of that circumstance. Br. 36 n.7. SIPC argues that the "danger" referred to in Section 5(a)(3) must be one to established "customers." But the use of the word "danger" in that provision indicates Congress contemplated that liquidation proceedings could be initiated based on risks and, consequently, probabilities. *Cf. Hughes*, 461 F.2d at 979-82. Moreover, SIPC's argument that this case involves Section 11(b), "which does not use the word 'danger' at all" (Br. 36.n.7), ignores the direct relationship between the standard to initiate liquidation proceedings in Section 5(a)(3) and Section

11(b)'s authorization of the Commission to seek to require SIPC to initiate such a proceeding.

SIPC maintains that the Commission's reliance on *In re C.J. Wright & Co., Inc.,* No. 5:91-cv-92 (M.D. Fla. April 24, 1991), Martens Second Decl. Ex.1, at 20 ("*C.J. Wright* Decree"), is misplaced because SIPC's request to begin a liquidation proceeding in that case was unopposed. Br. 36. But the *C.J. Wright* court found that "there are persons who *may be* customers of C.J. Wright … in need of the protection afforded by [SIPA]," and began a liquidation on that basis. *C.J. Wright Decree*. It therefore must have viewed SIPA as authorizing a liquidation proceeding based on less than proof by a preponderance that there are "customers." And the fact that the ruling was unopposed by the brokerage firm could not have diminished the requisite customer-need determination by SIPC.

SIPC also dismisses *C.J. Wright* as an isolated case (Br. 36), but the readily available SIPC filings in the customer protection proceedings initiated between 1998 and 2010 amply establish a SIPC practice of applying to initiate proceedings based on less than a preponderance of the evidence. SEC 34-35 & n.9. Moreover, while SIPC contends that the statement that it makes "conclusory" and "boilerplate" filings to begin liquidation proceedings is unsupported (Br. 36), the filings themselves are contained in the record. Even a cursory review of those

documents confirms that they are nothing other than conclusory and boilerplate. *See* Martens First Decl. Ex. 4.

Finally, SIPC maintains that its own past filings do not "prove anything" because the affected brokerage firms had the right to *de novo* review of its determinations. Br. 36. But, again, the firms' right to *de novo* review does not mean that the standard of proof was any higher than probable cause.

D. The statutory relationship between the Commission and SIPC supports the use of the probable cause standard here.

Given the statutory relationship between the Commission and SIPC, the same lesser standard of proof that applies to SIPC should apply to the Commission in this preliminary, summary proceeding. *See* SEC 36-38. SIPC argues that Congress cannot have intended to give the Commission authority to require SIPC to act based on a probable cause showing because SIPC's board is comprised of presidential appointees and representatives of the Department of the Treasury and the Federal Reserve. Br. 34. Regardless of that makeup, however, SIPC is "not … an agency or establishment of the United States Government." SIPA Section 3(a)(1)(A), 15 U.S.C. 78ccc(a)(1)(A). As the Supreme Court has recognized, Congress "provided for substantial supervision of [SIPC's] operations by an agency charged with protection of the public interest—here the SEC" precisely because SIPC is a private, "corporate entity" created to help solve a "public problem." *SIPC v. Barbour*, 421 U.S. 412, 420 (1975). Moreover, Congress

specifically placed supervision of, and enforcement regarding, SIPC's initial determination whether to begin a liquidation in the hands of the Commission as "an agency experienced in regulation of the securities markets." *Id.* at 422-23. Contrary to SIPC's argument, there is nothing extraordinary in our system of government about placing presidential appointees under the supervisory authority of other presidential appointees, and holding the Commission to a higher standard would be inconsistent with the supervisory role that Congress assigned to it.[3]

Furthermore, SIPC's assertion that the probable cause standard would give the Commission "carte blanche to ignore" SIPC's determinations is simply incorrect. Br. 33. There is no reason to suppose that *de novo* judicial review under this standard of proof gives the Commission carte blanche or is otherwise not "meaningful" (Br. 23).

Finally, to the extent SIPC argues that the statutory relationship between it and the Commission supports requiring the Commission to prove "an abuse of discretion" by SIPC (Br. 33, 34), this argument is waived. The district court ruled

[3] SIPC attempts to minimize the Commission's role under SIPA as one of merely giving SIPC notice by selectively quoting a brief in another matter. Br. 34 (quoting United States' Reply in Supp. of Mot. to Dismiss 8, *Zelaya v. United States*, No. 0:11-cv-62644-RNS [Dkt. 64] (S.D. Fla. Jan. 31, 2013) ("U.S. Reply")). The full passage, however, states that "[SIPA] merely *creates a process in which* the SEC provides notice to SIPC …." U.S. Reply at 8 (emphasis added). And the reference to the Commission's function of providing notice to SIPC was not intended to be an exhaustive description of the entire "process" created by SIPA, nor the Commission's full role under that Act.

that the standard of review applicable here is *de novo* and SIPC did not cross-appeal to urge a more stringent standard. February 9 Order at 11-13. In any event, SIPC did not purport to exercise any discretion in this case. Rather, SIPC has consistently taken the position that it lacks statutory authority to initiate a liquidation. *E.g.*, Br. 1.

E. The district court's analogy to Exchange Act Section 21(e) is without basis.

The Commission showed in its opening brief that there is no sound basis for the district court's analogy to Section 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(e), which authorizes courts to grant injunctive relief in Commission enforcement actions based on a preponderance of the evidence. While SIPC does not defend the district court's view that the perceived analogy "compel[s]" the conclusion that a preponderance standard applies here, *SEC v. SIPC*, No. 11-mc-678 (RLW), Mem. Op. & Order at 6 (July 3, 2012) ("Op."), it instead suggests the analogy is "instructive," Br. 31. It is not.

Section 21(e) proceedings for a permanent injunction involve final adjudications of the underlying claims, whereas Section 11(b) proceedings do not finally determine customer claims. *See* SEC 41. SIPC dismisses this distinction because Section 11(b) proceedings and subsequent liquidation proceedings are not "entirely duplicative" (Br. 31) and contends that this proceeding will "finally determine" whether SIPC has to *initiate* a liquidation proceeding (Br. 32). But,

again, the question of customer status is at the heart of both proceedings: the Section 11(b) proceeding determines whether there may be customers in need of protection—which justifies requiring SIPC to initiate a liquidation proceeding; the liquidation proceeding determines whether there are customers with claims entitled to coverage under SIPA. That this proceeding will finally determine whether SIPC must make an application thus makes it no less preliminary in the context of the overall statutory scheme or the key issues to be adjudicated.

SIPC is similarly incorrect in dismissing the fact that Section 11(b) authorizes the Commission to act in its regulatory function as SIPC's statutory supervisor whereas Section 21(e) authorizes the Commission to commence law enforcement proceedings. It is true that "[b]oth provisions authorize the SEC to seek injunctions compelling certain parties to undertake particular actions." Br. 32. But the identity of those parties is meaningful. *See* SEC 40. There is no reason to assume that Congress intended the same burden of proof to apply to the Commission vis-à-vis SIPC, which it supervises, as applies when the Commission seeks to enjoin third parties from violating the securities laws.[4]

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[4] SIPC asserts that the Commission waived its probable cause and deference (*see infra* at 23-28) arguments because it raised them for the first time in a reply brief. Br. 18, 19, 23, 26. But SIPC ignores the sequence of briefing below. Before SIPC filed its response to the Commission's application, the district court issued a decision in which it resolved certain threshold issues. *See* February 9 Order at 8, 11-12. The district court then directed the parties to include "in the remaining briefing" (SIPC's response and the Commission's reply) their arguments

II. The record provides sufficient cause to believe that there are customers who may need the protections of SIPA.

Regardless of the standard of proof applied, the Commission has shown that, under the unusual circumstances presented here, SGC accountholders who purchased SIBL CDs through SGC should be deemed to have deposited funds with SGC, both because it is appropriate to disregard the fictional corporate structure of the Stanford enterprises, the design of which was essential to the Ponzi scheme, and based on the approach followed in the most analogous case law—*In re Old Naples Securities, Inc.*, 223 F.3d 1296 (11th Cir. 2000), and *In re Primeline Securities Corp.*, 295 F.3d 1100 (10th Cir. 2002). SIPC's arguments against either approach depend on giving legal effect to the fictional separateness of the Stanford entities and the purported securities issued in furtherance of the Ponzi scheme, and should be rejected.

A. There is sufficient cause to believe the purported legal separateness of SGC and SIBL should be disregarded.

As the Commission showed in its opening brief, there is little reason to strictly adhere to the corporate form of the Stanford entities, which operated as a

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with respect to "the procedures [and] burdens … that are necessary and appropriate" in this case. *See id.* at 10-11, 13. The Commission's reply was thus its first opportunity to brief the applicable burden of proof. And, in any event, SIPC was granted leave to file a sur-reply to respond to the Commission's probable cause and deference arguments. Minute Order (March 2, 2012); *see* SIPC's Motion for Leave to File Sur-Reply at 1-2 [Dkt. 27].

massive, unified Ponzi scheme. SEC 45-47. There is no merit to SIPC's counterarguments.

First, SIPC asserts that the equitable doctrine of substantive consolidation (through which the corporate forms could be disregarded) should not be used to impose liabilities on a third party like SIPC that is unconnected to the Stanford fraud. Br. 56. But if the Receivership Court were to find that application of the bankruptcy-law doctrine of substantive consolidation is justified in this matter, the effect of the doctrine would be to treat SIBL's liabilities to SGC accountholders as SGC's liabilities, where they would fairly belong. That SIPC may then have obligations under SIPA is not a reason to deny the protections of the Act in an otherwise appropriate circumstance. Moreover, the only case SIPC cites to support its argument on this issue, the unpublished Ninth Circuit opinion in *In re First Securities Group*, was decided not on the merits of a corporate disregard theory, but rather because the claimants had "abandoned" their alter ego argument on appeal. 1996 WL 92115, at *1 (9th Cir. Mar. 4, 1996). And the Ninth Circuit in another case has acknowledged: "Because [the broker-dealer] and [the issuer of securities] were not totally unrelated entities, it is conceivable that funds held by [the issuer] could be attributed to [the broker-dealer] under some alter ego or agency theory." *In re Brentwood Securities, Inc.*, 925 F.2d 325, 328 n.4 (9th Cir. 1991).

Second, contrary to SIPC's argument that the substantive consolidation doctrine is inconsistent with SIPA because SIPA recognizes "the importance of corporate formalities" (Br. 56), SIPA—like most any legal provision—speaks of separate corporate entities on the assumption that such separateness is lawful and genuine. Nowhere does SIPA indicate that the substantive consolidation doctrine may *not* apply to determine the nature of the entities referred to in the Act. Significantly, SIPA directs that the bankruptcy court overseeing a SIPA liquidation has all of the powers of a court hearing a case under Title 11, except as inconsistent with the provisions of SIPA. *See* SIPA Section 5(b)(2)(A)(iii), 15 U.S.C. 78eee(b)(2)(A)(iii). And both the Fifth Circuit and this Court have held that bankruptcy courts have the equitable authority to invoke the substantive consolidation doctrine. *See* SEC 47 n.16.

SIPC argues that consolidation with SIBL is barred by SIPA Section 16(2)(C)(i), 15 U.S.C. 78*lll*(2)(C)(i), which precludes persons from being "customers" based on transactions with a foreign subsidiary of a SIPC member. Br. 53. But SIBL is not a subsidiary of SGC. SIPC thus contends that if Congress intended to exclude transactions with a foreign subsidiary, then it necessarily intended to exclude transactions with a foreign affiliate, which is less closely related than a parent and subsidiary. Br. 53-54. But if, as the Commission has shown, there is sufficient cause to believe the purported legal separateness of SGC

and SIBL should be disregarded, then they might be treated by the Receivership Court as the same entity, and necessarily *more* closely related than a parent and subsidiary.

Third, SIPC argues that, in the event of consolidation, CD investors' cash would become part of the capital of SGC, and preclude their customer status. Br. 56-57. The Commission fully explained in its Analysis the reasons this argument is mistaken, including the fact that the CD investors had an investment intent.[5] The only case SIPC cites in response, *In re Brittenum & Associates, Inc.*, 82 B.R. 64 (Bankr. E.D. Ark. 1987), is plainly inapposite. The claimants held not to be "customers" there lacked securities accounts with the brokerage firm, did not deposit cash with it but indirectly loaned securities to it knowing the purpose was to increase its capital base, and had no view to a sale of those securities or purpose to purchase other securities. *See* 82 B.R. at 65-66, 68. Moreover, funds given to a consolidated entity in exchange for SIBL CDs should not become part of that entity's capital because the SIBL CDs were merely participatory interests in a Ponzi scheme and should be disregarded. SEC 54.[6]

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[5] Analysis of Securities Investor Protection Act Coverage for Stanford Group Company, attached to letter from Murphy to Johnson, dated June 15, 2011, Declaration of Matthew T. Martens ("Martens First Decl.") Exh. 2, at 11-12 ("Analysis").

[6] SIPC perceives an inconsistency between the Commission's position that the SIBL CDs should be disregarded and a proposed settlement between U.S.

SIPC next claims that "SIPA cannot function as Congress intended if the scope of [SIPC's] obligations" is uncertain and subject to change through later application of the substantive consolidation doctrine. Br. 57. But SIPC itself has supported substantive consolidation in the past. *See* SEC 47-48 & n.17. SIPC asserts that it has done so only to increase the assets available for customers and not to create new customers. Br. 57. If, however, substantive consolidation can gain assets for the estate of the SIPC member for purposes of paying customer claims, it stands to reason that substantive consolidation may also result in liabilities of the SIPC member to persons who would otherwise meet the requirements for customer status.

Moreover, SIPC's past support for substantive consolidation has been broader than it now contends. For example, the acknowledged effect of the consolidation that SIPC supported in the *In re New Times Securities Services, Inc.* ("*New Times*") litigation, was "to ease the burden upon [P]onzi scheme victims

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authorities and Antiguan authorities providing for a future distribution of assets to Stanford victims. Br. 47 n.11. But there is nothing inconsistent in referring to the Stanford victims as creditors in a receivership and arguing that they may be "customers" under SIPA—customers are creditors in a SIPA liquidation, albeit ones given preferential treatment. And the Receiver intends to make distributions to victims based on a "money in, money out" formula, which in fact disregards the CDs (including any fictitious interest previously paid or purportedly still owed to the investor). *See* Motion for Approval of Interim Distribution Plan, *SEC v. Stanford Int'l Bank, Ltd., et al.*, No. 3:09-CV-0298-N, at 16-19 [Dkt. 1766] (N.D. Tex. Jan. 11, 2013).

who are asserting customer status in [the liquidation] proceeding so that they may, in many cases, be eligible for SIPC advances." Trustee's motion for substantive consolidation, *New Times*, No. 8-00-8178-jbr, at ¶ 89 [Dkt. 43] (Bankr. E.D.N.Y. Nov. 7, 2000); *see id.* at ¶ 97. Because substantive consolidation was considered appropriate, claims for "customer status" were urged to be determined as if the entities were "a single broker-dealer," *id.* at ¶ 89, and claimants who would not have been "customers" based on transactions with the SIPC member were nevertheless to be treated as potential "customers," *see, e.g.*, *id.* at ¶ 92; *New Times*, No. 8-00-8178-jbr [Dkt. 47] (Bankr. E.D.N.Y. Nov. 27, 2000).

SIPC also points out that the disregard of legal separateness should occur rarely. Br. 58. The Commission agrees; it has shown that there is sufficient cause to believe that this case is one of those rare cases. *See* SEC 45-48. And SIPC does not directly challenge the Commission's factual showing supporting such disregard. Br. 54. Rather, it suggests that the Commission cannot argue any facts omitted from the parties' stipulation. Br. 20. But the parties did not intend that stipulation to be a closed universe of facts "on which the case was heard in the district court." Br. 5. The purpose was to narrow the factual issues—to the extent possible—to avoid unnecessary discovery, not avoid fact finding altogether. *See* Op. 9. The stipulation accordingly does not contain any language expressing or

implying such an intent. And the district court itself considered evidence regarding facts beyond the stipulation. *See* Op. 13, 17.

SIPC criticizes the Commission for citing the Receivership Court's ruling that these entities should be substantively consolidated. Br. 54. But the Commission need not and is not relying on any factual findings in that decision. Rather, it appropriately informed this Court of the Receivership Court's legal conclusion, which is relevant to the argument that a similar conclusion may be reached on the facts here. And while SIPC asserts that the findings in that case "differ dramatically from the stipulated facts below" (Br. 54), it fails to explain or elaborate on any supposed difference. Nor does it point to any of the stipulated facts here that would preclude substantive consolidation.

Finally, SIPC erroneously contends that the Commission waived any argument regarding corporate disregard. Br. 52. The Commission expressly concluded in its Analysis that the purported "separate existences" of SGC and SIBL "should be disregarded," (Analysis at 11-12), submitted that Analysis to the district court as an exhibit in support of its application, (*see* Martens First Decl. Ex. 2), *and* addressed the issue in the briefing below (SEC Reply in support of application [Dkt. 25] at 8-16, 19, 24).[7] Nor did the Commission "affirmatively

[7] Indeed, corporate disregard theories have been at issue in this matter since as early as August 14, 2009, when SIPC's President sent a letter to the Receiver

waive[]" (Br. 52) its corporate disregard argument by stating that neither *Old Naples* nor *Primeline* "in any way relied on veil-piercing concepts" (SEC Reply in supp. of app. at 24; *see id.* at 20). That was an accurate description of those decisions and was plainly not intended to be a comprehensive description of the Commission's position or a waiver of its corporate disregard argument.

B. Even apart from the lack of separateness of SGC and SIBL, the Commission's application should be granted under the *Old Naples* and *Primeline* cases.

The Commission's position here is also supported by two court of appeals cases expressly holding that customer status under SIPA "does not … depend simply on to whom the claimant handed her cash or made her check payable, or even where the funds were initially deposited." *Old Naples*, 223 F.3d at 1302; *see Primeline*, 295 F.3d at 1107. Relying on a different opinion's erroneous description of those cases, SIPC argues that the customers in those case provided money "to an ostensible agent of a broker-debtor." Br. 50 (quoting *In re Bernard L. Madoff Inv. Secs., LLC*, 708 F.3d 422, 428 (2d Cir. 2013)). In fact, the claimants in *Old Naples* provided money to a "separate company" that was owned by the same person who owned the SIPC-member introducing broker. 223 F.3d at 1299-1300. And in *Primeline*, at least some of the claimants provided money

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arguing that even "if SIBL and SGC were [substantively] consolidated" CD investors would not qualify as "customers." Letter from Harbeck to Janvey at 3 (dated Aug. 14, 2009), Martens First Decl. Ex. 6 to Ex. 3.

directly to companies separately owned by a sales representative of the broker-dealer. *See* 295 F.3d at 1104.

SIPC also argues that *Old Naples* and *Primeline* are distinguishable because they involved a broker that failed to clear a transaction with its clearing broker. Br. 50. But this is a distinction without a difference. As the Commission concluded, what matters is that depositing money with SIBL was "in reality no different than depositing it with SGC." Analysis at 8-9; *see* SEC 51-54.

Similarly unpersuasive is SIPC's attempt to distinguish *Old Naples* and *Primeline* on the ground that the investors there "never received the securities they intended to purchase." Br. 50. The court in *Primeline* expressly noted that some investors "received fraudulent 'Debenture Certificates'" "[i]n exchange for their cash." 295 F.3d at 1109. Moreover, the physical CDs should be disregarded here. *See* SEC 54.

Finally, SIPC urges this Court to reject *Old Naples* and *Primeline* as being against the supposed "weight of authority." Br. 51. But those cases involved facts most similar to those presented in this case, and SIPC points to no contrary authority in analogous circumstances. For example, in *Aozora Bank Ltd.*, 480 B.R. 117 (S.D.N.Y. 2012), *aff'd*, 708 F.3. 422 (2d Cir. 2013), cited by SIPC, the investors at issue did not have accounts with the broker-dealer, and did not intend to open accounts with the broker-dealer. *See* 480 B.R. at 123-24, 128. Rather,

their dealings were with independent entities which were not under common ownership and control with the broker-dealer. *See id.* at 121; *see also SEC v. Kenneth Bove & Co., Inc.*, 378 F. Supp. 697, 698-99 (S.D.N.Y. 1974) (claimants, allegedly at debtor's direction, sent shares of stock to an independent, third-party broker). The Ninth Circuit's decision in *Brentwood Securities*—which both *Old Naples* (223 F.3d at 1300) and *Primeline* (295 F.3d at 1106) cited—is similarly far afield. Unlike here, the investor funds in *Brentwood Securities* did not get funneled back to the broker-dealer and "[n]othing in the record establishe[d]" that the broker-dealer "had any role at all" in the transactions at issue. 925 F.2d at 328.

* * * * *

SIPC and its *amici* argue that ruling in the Commission's favor would "transform SIPC into an insurer against every fraudulent scheme implicating a broker-dealer." Br. 47; *see* SIFMA Br. 20-21; Law Professors Br. 19-20. But the Commission's position depends on the rare factual situation where, among other circumstances, there is a sufficient basis both (1) to disregard the corporate form of the broker-dealer and (2) to disregard the issuance of the purported security to the investor. Moreover, this scenario is substantially similar to recognized "customer" situations, such as where a broker-dealer misappropriates cash deposited with the broker-dealer or takes a deposit of cash but does not purchase any securities for the depositor. *See, e.g.*, *In re Bernard L. Madoff Inv. Secs. LLC*, 654 F.3d 229, 236

(2d Cir. 2011). *Amicus* Financial Services Institute ("FSI") contends that covering "all" of the SIBL CD investors' losses would exhaust SIPC's reserve fund (FSI Br. 5), but FSI fails to take account of the facts that (1) many investors did not buy SIBL CDs through SGC and (2) the statute caps at $500,000 each customer's potential SIPC advancement (*see* 15 U.S.C. 78fff-3(a)).[8]

III. In any event, the Commission's interpretation of SIPA's "customer" definition is at least reasonable and warrants *Chevron* deference.

The district court also erroneously declined to give deference to the Commission's interpretation of SIPA under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). SEC 54-57. SIPC's arguments to the contrary are without merit.

SIPC first argues (Br. 38) that *Chevron* applies "only when Congress has delegated interpretive authority to the agency" and that the Commission has no

[8] FSI separately argues (FSI 4-5) that the Commission's position would lead to increased assessments on SIPC members that would harm the securities industry and investors. But SIPA disallows assessments above ½ of 1% of a member's gross revenues from its "securities business" unless SIPC determines that the increase "will not have a material adverse effect on the financial condition of its members or their customers," and caps the rate at 1%. *See* 15 U.S.C. 78ddd(c)(3)(B)-(C). Currently, each member is assessed ¼ of 1% of net operating revenues from its securities business. SIPC 2012 Annual Report at 21 (available at http://www.sipc.org/Portals/0/PDF/2012AnnualReport.pdf (Apr. 30, 2013). Moreover, FSI cites no evidence to support its view that increased SIPC assessments in 2009 led to a decline in the number of independent, small broker-dealers (*see* FSI Br. 4), and ignores the separate effects of the financial crisis, *see* Paul Menchaca, *Survivor Island*, 40 Fin. Planning 6, 2010 WLNR 11212081 (June 2010) (describing effect of crisis on independent broker-dealers).

relevant rulemaking authority. This ignores the Commission's authority to implement the provisions of the Exchange Act, including by classifying persons and transactions (Exchange Act Section 23(a)(1), 15 U.S.C. 78w(a)(1)), and to define any terms used in the Exchange Act even if already defined (Exchange Act Section 3(b), 15 U.S.C. 78c(b); *see* S. Rep. No. 94-75, 94th Cong., 1st Sess. 94 (1975)). In any event, to the extent that SIPC is suggesting that a delegation must be express, it is mistaken. *Chevron*'s premise is that "a statute's silence or ambiguity as to a particular issue means that Congress has not 'directly addressed the precise question at issue' (thus likely delegating gap-filling power to the agency)." *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836, 1843 (2012) (plurality opinion) (quoting *Chevron*, 467 U.S. at 483); *see City of Arlington v. FCC*, --- S.Ct. ----, 2013 WL 2149789, at *8-10 (U.S. May 20, 2013). The applicability of *Chevron* turns on whether SIPA's "customer" definition regarding cash deposited for the purpose of purchasing securities is ambiguous, and that definition simply does not address the issue whether "deposited" means only actual and direct deposits.[9]

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[9] For the first time, SIPC argues that SIPA Section 3(b)(4)(A), 15 U.S.C. 78ccc(b)(4)(A), bars the Commission from "redefin[ing]" the statutory term "customer." Br. 24. The terms of that section, however, limit only the rulemaking powers of "SIPC." Section 3(b)(4)(A). Moreover, the Commission is not redefining "customer," but rather is arguing that the Commission's reasonable interpretation of the ambiguous provision is entitled to controlling weight. *See NRDC v. EPA*, 571 F.3d 1245, 1272 (D.C. Cir. 2009) (per curiam).

Moreover, contrary to SIPC's assertion (Br. 40), the purpose of the Commission's Analysis was not to "authorize[e] this litigation." Rather, the Analysis is a statement of the Commission's considered views justifying its formal request that SIPC apply to initiate a liquidation of SGC. That the Analysis also supported litigation after SIPC refused to act does not remove the applicable deference. *Cf. Barnhart v. Walton*, 535 U.S. 212, 221 (2002).

SIPC also argues that Congress delegated authority to administer the statute to SIPC, not the Commission, and claims that there is "no reason to suppose Congress wished the opinion of the SEC to outweigh that of SIPC." Br. 39. SIPC made a similar argument in *New Times*, and the Second Circuit rightly rejected it, reasoning that SIPA's framework shows that "Congress deliberately limited the authority of SIPC relative to the SEC." *In re New Times*, 371 F.3d 68, 77 (2d Cir. 2004). As the court explained, "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." *Id.* at 80 (internal editing omitted); *see also Barbour*, 421 U.S. at 422-23.

Nor is SIPC's contrary statutory interpretation entitled to *Chevron* deference. SIPC is a private corporate entity, not "an agency or establishment of the United States Government" (SIPA Section 3(a)(1)(A), 15 U.S.C.

78ccc(a)(1)(A)), has no final rulemaking authority under SIPA, and is subject to the Commission's plenary supervision. *See New Times*, 371 F.3d at 78. Thus, the principle that a particular agency's statutory interpretation may not be entitled to *Chevron* deference when the statute is administered by more than one agency (Br. 39), is inapposite.

SIPC also is mistaken in arguing that deference is inappropriate because the Commission's Analysis was not the result of notice-and-comment rulemaking or formal adjudication. Courts have "found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded." *United States v. Mead Corp.*, 533 U.S. 218, 231 (2001); *see Walton*, 535 U.S. at 221-22; *see AstraZeneca Pharms. LP v. FDA*, --- F.3d ----, 2013 WL 1776473, at *4 (D.C. Cir. Apr. 26, 2013); *California Valley Miwok Tribe v. United States*, 515 F.3d 1262, 1266 (D.C. Cir. 2008); *Mylan Labs., Inc. v. Thompson*, 389 F.3d 1272, 1277, 1279-80 (D.C. Cir. 2004). Because the Commission's Analysis reflects its careful consideration of the statute and the facts, the views articulated by SIPC, and the public interest (*see* Analysis), deference is warranted here.[10]

[10] *Christensen v. Harris Cty.*, 529 U.S. 576 (2000), cited by SIPC (Br. 40), is far afield from this case because there the agency position was expressed in a single opinion letter signed by the acting administrator of a division of the Department of Labor. *Id.* at 586-87; *see id.* at 590 (Scalia, J., concurring).

SIPC's remaining arguments likewise fail. The Commission is not "asking for deference to its interpretation of case-law and application of a substantive-consolidation doctrine to the facts of this case." Br. 40. At issue in this case is the Commission's interpretation of the statutory definition of "customer." That the Commission's Analysis cited case law shows that the Commission approached the issue with care; and the fact that the Commission's position finds support in the case law is not a valid reason to give the Analysis less respect. *See Mylan Labs.*, 389 F.3d at 1277-78, 1280.[11]

Finally, the Commission's position here is fully consistent with its prior statements regarding introducing brokers. *See* SEC 55. As the Commission has acknowledged (Analysis at 6), there is a general presumption that investors are not customers of an introducing broker for SIPA purposes. But the Commission has

[11] Contrary to SIPC's assertion (Br. 40), the Commission's position here also is consistent with its arguments in *Aozora Bank*, 480 B.R. at 117. The Commission argued in that case that its position: (1) was based on "its expertise in this area and its analysis of the statute, relevant legislative history, and cases as applied to the facts"; (2) correctly applied the statutory definition of "customer"; and, (3) in any event, was entitled to deference. Brief of the Securities and Exchange Commission, *SIPC v. Bernard L. Madoff Inv. Secs., LLC*, No. 11-cv-6565, at 3, 5, 7-8, & n.1 [Dkt. 10] (S.D.N. Y. Nov. 4, 2011). Moreover, the Commission in *Aozora Bank* addressed the question whether the investors in feeder funds were required to have securities accounts with the debtor to qualify as "customers" under SIPA. Although the Commission argued that the "customer" definition was unambiguous in that respect (*id.* at 5), it did not argue that the definition was unambiguous in all respects, much less that it was clear with regard to the different questions presented here—*e.g.*, whether money must be actually and directly deposited with a SIPC member for customer status to exist.

long taken the view that there are exceptions to this presumption and has never indicated that the exceptions it has described represented an exhaustive list. Here, an exception is appropriate because the presumption would elevate form over substance where a deposit with an affiliated company was, in effect, the same as a deposit with the introducing broker. And this is consistent with the Commission's position in the *New Times* case. SEC 56. SIPC does not (and cannot) point to any Commission statement taking the contrary view. And SIPC's argument that this case does not come within a different exception—arising when an introducing broker itself holds customer property—does not establish any inconsistency.[12] Finally, even if the Commission had changed its position, *Chevron* deference would still be appropriate because the Analysis reasonably justifies the views of the Commission. *See FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

[12] SIPC maintains that the Commission has taken an inconsistent position in this particular matter, but the prior statements that SIPC cites (Br. 16) were made only by members of the staff and did not represent or purport to represent the views of the Commission. *See Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 257 (2d Cir. 1994); *Board of Trade of City of Chicago v. SEC*, 883 F.2d 525, 529 (7th Cir. 1989). Moreover, none of those statements joined issue with the Commission's reasoning as articulated in the Analysis.

CONCLUSION

For the foregoing reasons, and those set forth in the Commission's opening brief, the order of the district court should be reversed.

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Dated: May 24, 2013

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