ORAL ARGUMENT NOT YET SCHEDULED

12-5286

In the United States Court of Appeals for the District of Columbia Circuit

SECURITIES AND EXCHANGE COMMISSION,
Appellant,

v.

SECURITIES INVESTOR PROTECTION CORPORATION,
Appellee.

On Appeal from the United States District Court for the District of Columbia (No. 11-678, Judge Robert L. Wilkins)

BRIEF OF THE SECURITIES INVESTOR PROTECTION CORPORATION, APPELLEE

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April 12, 2013

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

A. Parties and Amici. The parties who have appeared before the district court are the Securities and Exchange Commission and the Securities Investor Protection Corporation. Richard R. Cheatham moved to intervene in the district court, and the district court denied his motion. The parties in this Court are the Securities and Exchange Commission, Appellant, and the Securities Investor Protection Corporation, Appellee. John Little, the Official Stanford Investors Committee, and the Stanford Victims Coalition have thus far appeared as amici.

B. Rulings Under Review. Appellant seeks review of Judge Wilkins's July 3, 2012 Memorandum Opinion and Order dismissing the SEC's Application. *SEC v. SIPC*, No. 1:11-mc-00678-RLW [Dkt. 34] (D.D.C. July 3, 2012).

C. Related Cases. D.C. Cir. No. 12-5304 was an appeal from the same underlying case by Richard Cheatham, who challenged the denial of a motion to intervene that he filed in the district court after the entry of judgment. This Court summarily affirmed. *SEC v. SIPC*, No. 12-5304 (D.C. Cir. 2013). Counsel for the Securities Investor Protection Corporation are not aware of any other related cases currently pending in this Court or any other court.

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* Authorities upon which we chiefly rely are marked with asterisks.

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GLOSSARY

CD	Certificate of Deposit
Op.	Mem. Op., *SEC v. SIPC*, No. 1:11-mc-00678-RLW [Dkt.34] 6-7 (D.D.C. July 3, 2012)
SEC	Securities and Exchange Commission
SGC	Stanford Group Company
SIBL	Stanford International Bank Ltd.
SIPA	Securities Investor Protection Act of 1970, 15 U.S.C. §78aaa *et seq*.
SIPC	Securities Investor Protection Corporation
STC	Stanford Trust Company

INTRODUCTION

After learning of Allen Stanford's international Ponzi scheme, the Securities Investor Protection Corporation ("SIPC") determined that its statutory mandate did not permit, much less require, the initiation of a liquidation proceeding for Stanford investors because the case did not involve "customers" whose property was left in the custody of a "member" of SIPC—as the Securities Investor Protection Act ("SIPA") requires. The straightforward question in this appeal is whether the SEC has proven that SIPC's determination constituted a failure to "discharge its obligations" under the governing statute. As the district court concluded, the SEC has offered no evidence that warrants overturning SIPC's discretionary determination, and indeed has stipulated to facts that fully support it. That should be the end of the SEC's case.

Congress adopted SIPA to address a *specific* problem: ensuring, within limits, that investors recover property entrusted to the custody of a brokerage that later faces insolvency, given the risk that such property might otherwise be lost or tied up in lengthy bankruptcy proceedings. To do this, SIPA created a mechanism—a liquidation proceeding—in which brokerage "customers" would receive their deposited property or, if missing, recover it though advances made from a statutory reserve fund. By its terms, the statute does not insure against fraud or investment losses, instead protecting only the "customer" property that a SIPC-"member" brokerage firm holds in custody when the brokerage fails.

To administer SIPA, Congress created SIPC, a non-profit corporation governed by a board composed entirely of presidential and executive-branch appointees. 15 U.S.C. §78ccc(c). Upon learning that a member is failing or in danger of failing, SIPC has statutory discretion to determine whether there are "customers" in need of its protection and, therefore, whether to initiate a liquidation. Under Section 78eee, "SIPC *may* ... file an application for a protective decree … *if SIPC determines* that the member … has failed or is in danger of failing to meet its obligations to *customers*." *Id.* §78eee(a)(3)(A). Although Congress gave the SEC plenary authority over some aspects of SIPC's operations, Congress limited the SEC's authority with respect to liquidations to the ability to "apply" to the court for an order compelling SIPC to "discharge its obligations." *Id*. §78ggg(b). Only the SEC has standing to challenge SIPC's determination that a liquidation is unwarranted; investors and receivers may not sue. *See SIPC v. Barbour*, 421 U.S. 412, 425 (1975). In 40 years and over 300 liquidation proceedings—including the recent liquidations of Lehman Brothers Inc., Madoff Investment Securities LLC, and MF Global, Inc.—this is the first time the SEC has ever tried to compel a liquidation.

In this case, investors purchased certificates of deposit ("CDs") issued by Stanford International Bank Ltd. ("SIBL")—an Antiguan bank that was not and is not a member of SIPC. According to a joint stipulation of facts reached by the SEC and SIPC below, SIBL CDs were delivered to investors or their designees. Those CDs therefore were not in the custody of any SIPC member, and written disclosure statements expressly warned that SIBL CDs were not covered by SIPA. Those CDs are thus are beyond the scope of what SIPA protects.

The SEC was well aware of this. Under SIPA, the SEC must notify SIPC "immediately" if it is aware that a customer of a SIPC member is in need of protection, so that SIPC can determine whether to initiate a liquidation. 15 U.S.C. §78eee(a)(1). If the SEC had thought the Stanford fraud was within the scope of what SIPA protects, it was under a legal obligation to notify SIPC "immediately." The SEC did not do so, even though it filed an enforcement action against Stanford and secured the appointment of a receiver over U.S. Stanford assets in February 2009. Several months later, when the SEC-appointed Receiver inquired about the possibility of SIPA protection, SIPC examined the facts and responded, with notification to the SEC, that SIPA did not apply under the circumstances of the Stanford fraud. The SEC did not challenge that conclusion or take any action. In fact, the record shows that the SEC's general counsel *agreed* that SIPA did not apply to the Stanford case. It was only *two years later* that the SEC sought to force SIPC's hand, apparently bowing to pressure from a United States Senator.

The SEC now argues that it makes no difference whether CDs were in the custody of a SIPC "member" (the critical inquiry for determining if an investor is a "customer"), instead asserting that investors can simply be "deemed" customers because proceeds from the sale of SIBL CDs allegedly made their way from SIBL to a SIPC-member brokerage called Stanford Group Company ("SGC"). But nothing in the statute supports the SEC's unprecedented position, which ignores the critical question: whether there are "customers" whose property is in the custody of a "member," as the statute requires. It is for this reason that the SEC devotes most of its brief to an unprecedented plea to this Court to prevail on a "probable cause" standard unknown to the securities laws, or to accord its litigating posture "*Chevron* deference"—notwithstanding the fact that Congress has given the SEC neither rulemaking nor adjudicatory authority on this question. And it is for this reason that the SEC and its amici demand that the Court disregard the stipulated factual record below and instead consider alleged factual findings reached in unrelated proceedings to which SIPC was never a party.

The SEC, however, cannot circumvent the clear requirements of the statute with a "liquidate first, ask questions later" approach based on a probable-cause standard found nowhere in the statute, and supported by hearsay evidence rather than the joint stipulation of facts on which the case was heard in the district court. Nor can the SEC's amici circumvent their own lack of standing by presenting supposed evidence that is not part of the record, and indeed contradicts the stipulated record. This Court should affirm the judgment below.

STATEMENT OF THE ISSUES

1. Whether the district court properly required the SEC to prove its case by the traditional preponderance-of-the-evidence standard rather than an unprecedented probable-cause standard that has no support in SIPA.

2. Whether the SEC is entitled to *Chevron* deference in demanding that SIPC initiate a liquidation for SIBL CD investors, when the SEC does not purport to be interpreting an ambiguous term and its litigation-driven position contradicts its previous view on the matter.

3. Whether, based on the record before it, the district court properly rejected the SEC's claim that SIBL CD investors should be "deemed" customers of a SIPC member, when the SEC stipulated that those CDs were delivered as intended and were not in the custody of a SIPC-member brokerage firm.

STATEMENT OF THE CASE

A. The Relevant Statutory Regime

Congress passed SIPA, 15 U.S.C. §78aaa *et seq.*, after a series of brokerage collapses in which "[c]ustomers of failed firms found their cash and securities on deposit either dissipated or tied up in lengthy bankruptcy proceedings." *Barbour*, 421 U.S. at 415; *see also* H.R. Rep. No. 91-1613, at 1 (1970). The statute authorized the creation of SIPC "for the purpose … of providing financial relief to the *customers* of failing broker-dealers with whom they had left cash or securities *on deposit*." *Barbour*, 421 U.S. at 413; *see also* 15 U.S.C. §78ccc(a)(1).[2] SIPC is governed by a seven-member Board of Directors, five of whom are appointed by the President with the advice and consent of the Senate, and two of whom are appointed by, respectively, the Secretary of the Treasury and the Federal Reserve Board. *See id.* §§78ccc(c)(1), (2).

SIPA's protection extends only to securities or other property that "customers" have placed in the custody of a SIPC "member" to hold on deposit on their behalf. "Customer" is a statutory term of art that is narrower than its common English meaning. It is defined as "any person … who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business … from or for the securities accounts of such person for safekeeping," including "any person who has deposited cash with the debtor for the purpose of purchasing securities." 15 U.S.C. §78*lll*(2). The term does not comprise all clients or investors of a brokerage firm. "[T]he critical aspect of the 'customer' definition is the *entrustment* of cash or securities to the broker-dealer for the purposes of trading securities." *In re Bernard L. Madoff Inv. Sec. LLC* ("*BLMIS*"), 654 F.3d

[2] All emphases added unless otherwise noted.

229, 236 (2d Cir. 2011) (quotations marks and emphasis omitted). "An investor is entitled to compensation from the SIPC only if he has entrusted cash or securities to a broker-dealer who becomes insolvent; if an investor has not so entrusted cash or securities, he is not a customer and therefore not entitled to recover…." *In re Brentwood Sec., Inc.* ("*Brentwood*"), 925 F.2d 325, 327 (9th Cir. 1991).

SIPA's definition of "customer" therefore "precisely delineat[es] the categories of investors it protects," *id.* at 327, and courts uniformly agree that it must be interpreted "narrow[ly]." *In re Stalvey & Assocs., Inc.*, 750 F.2d 464, 472 (5th Cir. 1985); *see also In re Bernard L. Madoff Inv. Secs. LLC* ("*BLMIS II*"), 708 F.3d 422, 426 (2d Cir. 2013); *In re Klein, Maus & Shire, Inc.,* 301 B.R. 408, 418 (Bankr. S.D.N.Y. 2003) ("[C]ourts have consistently taken a restrictive view of the definition of a 'customer' under SIPA[,] and [] the burden is not easily met."). This narrow definition of "customer" corresponds to the specific scope and purpose of SIPA, which does not insure against frauds or worthless investments and instead only protects investors whose property (such as physical stock certificates or cash from selling stocks) remains in the custody of a financially distressed broker-dealer. *See, e.g.*, *Brentwood*, 925 F.2d at 330 (SIPA "does not comprehensively protect investors from the risk that some deals will go bad or that some securities issuers will behave dishonestly.").

To be protected, a loss must accordingly be "occasioned by a broker's liquidation"; losses that would have occurred even if the debtor were not insolvent fall outside the narrow scope of what SIPA protects. *SIPC v. Stratton Oakmont, Inc.*, 229 B.R. 273, 279 (Bankr. S.D.N.Y. 1999) (quotation marks omitted); *In re Oberweis Sec., Inc.*, 135 B.R. 842, 846 (Bankr. N.D. Ill. 1991); *SIPC v. Associated Underwriters, Inc.*, 423 F.Supp. 168, 171 (D. Utah 1975) (SIPA does not "guarantee that customers will recover their investments which may have diminished as a result of … market fluctuations *or broker-dealer fraud*."). "Customers" are entitled only to the return of their securities—not their purchase price. *See In re Atkeison*, 446 F.Supp. 844, 848 (M.D. Tenn. 1977); *SEC v. S.J. Salmon & Co.,* 375 F.Supp. 867, 870-71 (S.D.N.Y. 1974).

B. The Initiation Of A Liquidation Proceeding

SIPC performs its statutory function of "accomplish[ing] … the speedy return of most customer property" by instituting a liquidation proceeding against a failing member firm. *Barbour*, 421 U.S. at 416; *see also* 15 U.S.C. §78fff. SIPA requires the SEC to notify SIPC "immediately" if the SEC becomes "aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty." 15 U.S.C. §78eee(a)(1).

Once SIPC learns a member is financially troubled, the statute vests SIPC with the discretion to determine whether there are "customers" in need of its protection and, therefore, whether to initiate a liquidation. Under Section 78eee, "SIPC *may*, upon notice to a member of SIPC, file an application for a protective decree … *if SIPC determines* that the member … has failed or is in danger of failing to meet its obligations to *customers*." *Id.* §78eee(a)(3)(A). Granting SIPC's application triggers the appointment of a trustee who administers the liquidation of the broker-dealer and satisfies customer claims by distributing property that the trustee assembles for customers, supplemented, as needed, by SIPC advances of funds. *See id.* §78fff-3 (authorizing advances up to $500,000 for loss of cash and securities and up to $250,000 for cash alone). SIPC makes these advances using a fund supported by annual assessments imposed on all SIPC-member brokerage firms. *See id.* §78ddd. "Customers" also receive priority on their claims, which means that conferring customer status on those who do not satisfy the requirements of the statute would directly prejudice a brokerage's general creditors. *See id.* §78fff-2(c).

In order for SIPC to initiate a liquidation under Section 78eee(a)(3)(A), there accordingly must be "customers" as SIPA defines that term. In addition, if investors have no "net equity"—that is, remaining value—in their brokerage accounts when the broker-dealer fails, Section 78eee(a)(3)(A) prohibits SIPC from initiating a liquidation proceeding. *See id.* §78eee(a)(3)(A) (no liquidation application where the only customers are persons ineligible for SIPC advances); *id.*

§78fff-3(a) (providing for allocation of assets to a customer only where his "net equity … exceeds his ratable share of customer property").

A SIPA liquidation entails significant costs, even if none of the asserted claims is meritorious. The mere initiation of the liquidation requires SIPC to assume responsibility for the administration of the broker's estate, to the extent the debtor's general estate is insufficient, and forces SIPC to bear the costs of litigating claims. The Madoff liquidation, for example, imposed administrative costs that exceeded *$100 million* within 21 months and *$738 million* as of December 31, 2012—excluding SIPC advances to customers.[3] The MF Global liquidation cost over $4 million *in its first two months*, 2011 Annual Rep. 30-31, and the Lehman liquidation incurred over *$690 million* in administrative expenses by December 31, 2011, *id.* Here, the district court recognized that costs for a Stanford liquidation would be in the "millions … even if all of the claims were ultimately denied." Mem. Op. & Order 7, *SEC v. SIPC*, No. 1:11-mc-00678-RLW [Dkt.34] (D.D.C. July 3, 2012) ("Op."). These costs reflect SIPC's obligation to cover fees such as for a trustee, counsel, and claims-review and forensic-accounting consultants.

[3] Office of Inspector General, *SEC's Oversight of the Securities Investor Protection Corporation's Activities* 22 (Mar. 30, 2011), *available at* http://www.sec-oig.gov/Reports/AuditsInspections/2011/495.pdf (cited SIPC Opp'n 36, *SEC v. SIPC*, No. 1:11-mc-00678-RLW [Dkt.23] (D.D.C. Feb. 16, 2012) ("SIPC Opp'n")) ("Mar. 30 OIG Rep."); Dec. 31, 2011 SIPC Annual Report 30-31, *available at* http://www.sipc.org/Portals/0/PDF/2011_Annual_Report.pdf ("2011 Annual Rep."); Mot. for Order Approving Allocation Ex. A, *SIPC v. BLMIS*, No. 08-1789-brl [Dkt. 5230] (Bankr. S.D.N.Y. Feb. 13, 2013).

Were the SEC to prevail, these costs would quickly dissipate the debtor's general estate, to the detriment of general creditors.

Although the SEC exercises plenary oversight over some aspects of SIPC decisions—for example, the SEC may require SIPC to pass bylaws, 15 U.S.C. §78ccc(e)(3)—SIPA does not empower the SEC to override SIPC's determination not to initiate a liquidation. The SEC must instead go to court:

> *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 … for *an order requiring SIPC to discharge its obligations* under this chapter and for such other relief as the court may deem appropriate….

15 U.S.C. §78ggg(b). "Thus, the SIPA statute clearly specifies that the SEC must proceed by 'apply[ing] to the district court … for an order requiring SIPC' to comply with the statute." Op. 4 (alteration in original). Because this requires a failure by SIPC to "act for the protection of customers" that warrants an "order requiring SIPC to discharge its obligations," the SEC must establish that there are in fact "customers" of a SIPC "member" that SIPC wrongfully failed to protect.

C. The Stanford Antigua Bank Fraud

This case concerns investors in SIBL CDs. The SEC stipulated during the proceedings below that SIBL is a foreign bank organized under the laws of Antigua, and that SIBL was not a member of SIPC. SIBL, therefore, never paid assessments into SIPC's fund. *See* Op. 10.

Investors purchased CDs from SIBL by opening an account with SIBL and transferring money into that account. *See id*. at 11 ("[I]nvestors' checks were not made out to SGC and were never deposited into an account belonging to SGC."). In return, investors "received the physical CD certificates or had them held by an authorized designee," *id*. at 10 (quoting Stipulated Facts ¶4)—a point the SEC conceded in framing the issues for the Court in the parties' stipulated facts.[4] Upon making purchases, investors received written disclosures warning that "SIBL's products are *not … covered by the investor protection or securities insurance laws of any jurisdiction such as the U.S. Securities Investor Protection Insurance Corporation*." *Id*. (quoting Stipulated Facts ¶6).

[4] The SEC stipulated that "most" investors received their CDs either personally or through authorized designees, and that "[t]o the extent that some … investors did not," it "is not relying on that fact." Stipulated Facts ¶4. For purposes of this litigation, then, the Court may assume that *all* the relevant SIBL investors received their CDs, or that their failure to receive them is irrelevant.

***Figure 1*:**

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We, not SGC, are solely responsible for the contents of this Disclosure Statement and the other Offering Documents, and we, not SGC, will be solely responsible to you for all amounts due in respect of the CD Deposit. In the event of nonpayment of funds due and owing under the CD Deposit for any reason, you will have no claim or right against SGC or any other dealer or sales representative.

Disclosure Statement

U.S. Accredited Investor Certificate of Deposit Program

SIBL'S PRODUCTS ARE NOT SUBJECT TO THE REPORTING REQUIREMENTS OF ANY JURISDICTION, NOR ARE THEY COVERED BY THE INVESTOR PROTECTION OR SECURITIES INSURANCE LAWS OF ANY JURISDICTION SUCH AS THE U.S. SECURITIES INVESTOR PROTECTION INSURANCE CORPORATION OR THE BONDING REQUIREMENTS THEREUNDER. THE CD DEPOSITS AND THE CD CERTIFICATES ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION ("FDIC") OR ANY OTHER AGENCY OF THE UNITED STATES GOVERNMENT OR ANY STATE JURISDICTION, OR BY ANY INSURANCE PROGRAM OF THE GOVERNMENT OF ANTIGUA AND BARBUDA.

STANFORD

STANFORD INTERNATIONAL BANK

HOU 00002

Source: Ex. B to Stipulated Facts.

***Figure 2*:**

CERTIFICATE OF DEPOSIT

NON-NEGOTIABLE

ORIGINAL

STANFORD INTERNATIONAL BANK LTD.

No. 11 Pavilion Drive, P.O. Box 3300, St. John's, Antigua, West Indies

ACCOUNT NUMBER [redacted]

DATE [redacted]

DEPOSITO [redacted]

AMOUNT [redacted]

CURRENC

"We" means the financial institution. "You" means the depositor(s) named above. We will pay this certificate to you when you surrender it to us on the maturity date. If more than one of you are named above, you will own this certificate as joint tenants with right of survivorship (and not as tenants in common). We will treat any one of you as owner for purposes of surrender, payments of principal and interest, presentation (demanding payment of amount due), transfer and any notice for or from you. Each of you appoints the other as your agent for the purposes described above. We will use the address on our records for mailing notices to you. You cannot transfer or assign this certificate or any rights under it without our written consent. This certificate is subject to the Bank's General Terms and Conditions and applicable Deposit Terms, which are incorporated herein by reference. Unless otherwise stated, all amounts specified are in U.S. Dollars or an equivalent amount if deposits are made in currency other than U.S. Dollars.

This FIXED CD - USAI - USD - 60 MONTHS matures on [redacted]

THIS CERTIFICATE MATURES ON THE MATURITY DATE STATED ABOVE; IT WILL BE AUTOMATICALLY RENEWED FOR SUCCESSIVE TERMS, EACH EQUAL TO THE ORIGINAL TERM, UNLESS THE BANK IS ADVISED OTHERWISE FIVE (5) BANKING DAYS PRIOR TO MATURITY.

INTERES DATE WILL ACCRUE AT THE BASE RATE OF [redacted] THE ANNUAL YIELD WILL BE [redacted] %

This rate m nce with the Bank's General Terms and Conditions and applicable Deposit Terms.

Executed at St. John's, Antigua, West Indies

by AUTHORIZED SIGNATORY

Source: SIPC Hearing Exhibits, *SEC v. SIPC*, No. 11-mc-00678-RLW [Dkt. 29-1] (D.D.C.), at 12; *see also* SIPC Opp'n Ex. 18.

SGC is a Houston-based brokerage firm that was registered with the SEC and was a member of SIPC. *See id*. Although SGC marketed SIBL CDs, SGC "[n]ever physically possess[] the investors' funds" or their securities. *Id*. at 11. Instead, SGC acted only as an "introducing" broker-dealer, meaning that it "introduced" clients to other "clearing" firms—here, Pershing and J.P. Morgan Capital—which executed clients' transactions. As an introducing broker, SGC was not authorized to and did not hold customer cash or securities in its custody. *See* 5 Hazen, *Law of Securities Regulation* §14.2[2][B] (6th ed.); Minnerop, *The Role and Regulation of Clearing Brokers*, 48 Bus. Law. 841, 841-43 (1993).

SIBL CD disclosure statements warned that SIBL—"not SGC"—was "solely responsible" for CD deposits. *See, e.g.*, Nov. 15, 2007 Disclosure Statement 17 (SIPC Opp'n Ex. 6); Figure 1, *supra*. As the receiver ultimately appointed to oversee SGC's assets (the "SEC Receiver") explained: "in general, neither SGC, Pershing nor J.P. Morgan maintained custody or possession of any physical certificates that evidenced CDs. Instead, these certificates appear to have been physically held by the owner of the CD." Aug. 12, 2009 Letter from Janvey to Harbeck 3 ("Janvey Ltr."), Martens First Decl. Ex. 1, *SEC v. SIPC*, 1:11-mc-00678-RLW [Dkt.1] (D.D.C. Dec. 12, 2011).

D. The SEC Places SGC Into Receivership But Never Suggests That SIPA Applies To The Stanford Case.

The SEC had been "aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme," but "repeated[ly] deci[ded] not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing."[5] Despite these early warnings, the SEC did not begin enforcement proceedings in the Stanford matter until February 2009, when it filed a complaint in the Northern District of Texas against SIBL, SGC and others. The SEC alleged that the defendants operated a Ponzi scheme by selling CDs with abnormally high returns. *See* Compl. ¶2, *SEC v. Stanford Int'l Bank, Ltd.*, No. 3:09-cv-00298 [Dkt.1] (N.D. Tex. Feb. 17, 2009). By the time the SEC filed suit, SIBL CDs had already lost all or nearly all of their value. *See* Janvey Ltr. 1-2. If any "customer" property had been endangered by SGC's insolvency, the SEC had a statutory obligation to bring this to SIPC's attention "immediately." 15 U.S.C. §78eee(a)(1). The SEC made no such notification.

At the SEC's request, the Northern District of Texas appointed a Receiver to oversee the assets of the Stanford defendants. On August 12, 2009, that Receiver asked SIPC whether SGC clients who had made investments in SIBL's Antiguan

[5] Mar. 31, 2010 Report of Investigation, SEC Office of Inspector General 16-17 (SIPC Opp'n Ex. 2) ("Mar. 2010 Report"); *see also The Stanford Ponzi Scheme: Hearing Before the Subcomm. On Oversight and Investigations of the H. Comm. on Financial Institutions*, 112th Cong. 105-111 (2011).

CDs would be entitled to SIPA protection. *See* Janvey Ltr. 2-3. SIPC responded two days later with a copy to the SEC, explaining that "there is no basis for SIPC to initiate a proceeding" because SIPA does not protect investments with offshore banks, and because investors in the Stanford matter had received the CDs they agreed to purchase—meaning they had no property on deposit with SGC. Aug. 14, 2009 Ltr. from Harbeck to Janvey 3 (SIPC Opp'n Ex. 3).

Far from disputing SIPC's analysis, the SEC's then-general counsel, David Becker, agreed with it:

> Becker testified … that his "view was that SIPA, the statute, did not cover the Stanford situation." This view is consistent with contemporaneous documents indicating that Becker did not believe that SIPA provided coverage to Stanford investors.

Sept. 16, 2011 Report of Investigation, SEC Office of Inspector General 112 (SIPC Opp'n Ex. 4) (citations omitted). Becker's conclusion aligned with earlier findings by SEC Staff that "it did not appear that the Examination Staff could claim SGC had [] custody" over SIBL CDs. Dec. 19, 2002 Mem. from Wright to Office of Compliance 14-15 (SIPC Opp'n Ex. 16).

E. The SEC Flips Its Position.

Nearly two years after SIPC determined that SIPA did not apply to the Stanford case—but only one day after a United States Senator threatened to block confirmation of two SEC Commissioners[6]—the SEC asserted for the first time that investors who had purchased SIBL CDs qualified as SIPA "customers." In a 14-page memorandum dated June 15, 2011, the SEC made the novel argument that SGC clients who purchased these CDs could be "deemed" to have deposited cash with SGC because SGC and SIBL were allegedly operated in an interconnected fashion. *See* June 15, 2011 Analysis of SIPA Coverage (Martens First Decl. Ex. 2). The SEC did not claim, and has never claimed, that there might be "customers" by virtue of any other transactions. *See* Stipulated Facts ¶8. The SEC conducted no hearings and made no findings of fact or conclusions of law in the course of issuing the memorandum.

After receiving the SEC's memorandum and a letter threatening to bring suit, SIPC's Board of Directors carefully reviewed the matter with the assistance of outside counsel, Covington & Burling LLP. Consistent with the conclusion SIPC had expressed to the SEC Receiver in August 2009, SIPC's Board unanimously

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[6] *See* June 14, 2011 Press Release, *available at* http://www.vitter.senate.gov/newsroom/press/vitter-to-block-sec-nominees-until-stanford-victims-get-answers ("U.S. Sen. David Vitter today announced that he will block the nominations of two Securities and Exchange Commission members until the SEC responds to a request by victims of the alleged Stanford Group Co. Ponzi scheme who are seeking to receive Securities Investor Protection Corporation coverage for their losses."); *see also* June 15, 2011 Press Release, *available at* http://www.vitter.senate.gov/newsroom/press/vitter-sec-concludes-stanford-victims-entitled-to-receive-sipc-coverage; SIPC Opp'n 5. Around this time, the SEC Inspector General also criticized the SEC's oversight of various Stanford entities. *See* Mar. 2010 Report 16-28.

reaffirmed that SIPA did not authorize a liquidation in the Stanford case, because there were not "customers" of a "member" that was holding customer property to be returned. Op. 3. This decision reflected the collective judgment of not only five Senate-confirmed presidential appointees, but also representatives of the Department of the Treasury and the Federal Reserve Board.

F. The District Court Proceedings And The Parties' Stipulation Of Facts To Narrow The Issues In Dispute.

On December 12, 2011, the SEC filed a first-of-its-kind "Application" in the U.S. District Court for the District of Columbia, seeking an order under Section 78ggg(b) compelling SIPC to initiate a liquidation. The SEC argued that its June 2011 memorandum constituted a judicially unreviewable determination that should be enforced with no discovery or adversarial process whatsoever. *See* SEC Mem. in Supp. of App. 12, 30, *SEC v. SIPC*, No. 1:11-mc-00678-RLW [Dkt. 1] (D.D.C. Dec. 12, 2011) ("SEC Mem.") (arguing that the SEC's "preliminary determination … is not subject to judicial review," and that "the regular rules of civil procedure do not apply"). The court rejected that position as "untenable" in a decision from which the SEC has not appealed. *See* Feb. 9, 2012 Op. 11.

SIPC then filed an opposition as to the merits of the SEC's Application on February 16, 2012. The SEC filed a reply brief one week later, in which it argued for the first time that the court should use only a probable-cause standard supported by hearsay. In so doing, the SEC relied on the same arguments it had used to support its since-rejected argument that its determination was not judicially reviewable. *Compare, e.g.*, SEC Mem. 12 (arguing that "[judicial] review would be inconsistent with the summary nature of this proceeding"), *with* SEC Reply in Supp. of App. 10, *SEC v. SIPC*, No. 1:11-mc-00678-RLW [Dkt. 25] (D.D.C. Feb. 23, 2012) ("SEC Reply in Supp. of App.") (arguing that a preponderance standard would be inconsistent with "the summary nature of this proceeding"). The SEC also argued in its reply (again for the first time) that its June 2011 memorandum should receive *Chevron* deference.

At the court's request, the SEC and SIPC discussed whether they could stipulate to certain facts to narrow the range of issues for which discovery would be required. The parties agreed that certain facts were undisputed, including:

- "[SIBL] was a bank organized under the laws of Antigua."
- "In order to purchase a SIBL CD, an investor had to open an account with SIBL. CD investors wrote checks that were deposited into SIBL accounts and/or filled out or authorized wire transfer requests asking that money be wired to SIBL for the purpose of opening their accounts at SIBL and purchasing CDs."
- "Most SGC investors either received the physical CD certificates or had them held by an authorized designee, including Stanford Trust Company. To the extent that some SIBL CD investors did not receive the physical certificates, the SEC is not relying on that fact to support its claims in this proceeding."
- "SIBL CD investors received periodic statements from SIBL reflecting the balances in their SIBL accounts, including their CD balances."

- "[D]isclosure statements for SIBL's CDs stated that 'SIBL's products are not subject to the reporting requirements of any jurisdiction, nor are they covered by the investor protection or securities insurance laws of any jurisdiction such as the U.S. Securities Investor Protection Insurance Corporation.'"
- "[T]he SEC is relying on investors' deposit of funds for the purchase of SIBL CDs; it is not relying on transactions involving any other securities (or funds for other securities)."

Stipulated Facts ¶¶2-6, 8. The SEC stipulated to these facts in order to argue that discovery was "unnecessary," under the view that the cases it cited did not "in any way rel[y] on veil-piercing concepts or the corporate structure of the broker-dealer and its affiliated entities." SEC Reply in Supp. of App. 23-24. These stipulations are binding here, as they were below. *See Christian Legal Soc. Chapter of Univ. of Calif. v. Martinez*, 130 S.Ct. 2971, 2983 (2010) (emphasizing that parties may not "suggest, on appeal, that the facts were other than as stipulated or that any material fact was omitted" (quoting 83 C.J.S., *Stipulations* §93 (2000))).

G. The District Court Denies The SEC's "Extraordinarily Broad" Application.

After briefing and argument, the district court issued an order denying the SEC's Application. The court concluded that whether analyzed under a probable-cause standard *or* a traditional preponderance-of-the-evidence standard, the SEC could not "meet its burden … of proving that SIPC has 'refus[ed] . . . to commit its funds or otherwise to act for the protection of customers of any member of SIPC,'" as Section 78ggg(b) required. Op. 18. In light of the parties' stipulations and

SGC's status as an introducing broker, the court held that "the SEC cannot show that SGC ever physically possessed the investors' funds at the time that the investors made their purchases." *Id.* at 11. Accordingly, "the investors who purchased SIBL CDs are not 'customers' of SGC within the meaning of SIPA." *Id.* at 11, 14-16.

The district court also rejected the SEC's request for *Chevron* deference. The court held that such deference would be inappropriate for several reasons, among them that the SEC's new theory departed from its own "nearly 30 year[]" view that "clients of introducing brokers are presumptively not 'customers' within the meaning of the statute." *Id.* at 15. "Because this current SEC interpretation eschews the dispositive nature of 'possession' of the client funds at the time of the investment transaction, contrary to the longstanding view of the SEC," the court held, "it is entitled to little, if any, deference." *Id.* at 15-16.

In concluding that the SEC had not shown there were any "customers" of a SIPC "member," the court emphasized that SIPA was intended to "protect customer interests in securities and cash *left with* broker-dealers," *id.* at 9 (emphasis in original) (quotation marks omitted)—in other words, to protect only property that customers had entrusted to their broker's custody. The SEC's "extraordinarily broad" theory that SIBL investors could be deemed "customers" of SGC, it held, "r[a]n too far afield from [this] key issue," *id.* at 17, and was inconsistent with even the broadest possible interpretations of customer status in *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)—the two cases on which the SEC primarily relied, *see* Op. 16-17.

Finally, although the court held that the SEC's Application failed under either a preponderance-of-the-evidence or a probable-cause standard, it concluded that the former standard was correct. *See id.* at 3-7. The court noted that Section 78u(e)(1) of the Securities Exchange Act—which, like Section 78ggg(b) of SIPA, authorizes the SEC to file an "application" for an "order" compelling certain actions—had long been interpreted to require proof by a preponderance of the evidence. *See id.* at 4-6. Because SIPA states that it should be construed as an "amendment to" the Exchange Act except as otherwise provided, the court found this analogy instructive—particularly absent language altering "the preference for the preponderance standard in civil litigation generally." *Id.* at 4, 6. As the court explained, SIPC was also "entitled to due process" in the resolution of the SEC's Application, especially when a precipitous liquidation would cost millions "even if all of the claims were ultimately denied." *Id.* at 7.

This appeal followed.

SUMMARY OF ARGUMENT

The district court properly rejected the SEC's Application because the SEC could not show, based on the record, that "customers" had cash or securities that a "member" of SIPC was supposed to be holding in custody, so as to support the initiation of a liquidation under the facts of the Stanford fraud. SIPA's definition of "customer" is limited to individuals who have entrusted cash or securities to the custody of a SIPC-member brokerage firm, *see BLMIS*, 654 F.3d at 236—whereas this case concerned money deposited with an Antiguan bank that, in return, issued bank CDs that were delivered to investors or their designees.

The SEC devotes the majority of its brief not to the merits, but to an effort to evade meaningful judicial review. It first argues that its Application should be subject to a probable-cause standard. But that standard—which was not even part of its initial Application—is utterly foreign to the securities laws and is inconsistent with SIPA's language, structure, and purpose. SIPA provides for judicial intervention only if SIPC has failed "to discharge its obligations under this chapter." Statutes are presumed to employ the preponderance-of-the-evidence standard absent evidence to the contrary, and here there is none. Rather, courts have long interpreted provisions of the securities laws that have nearly identical language as Section 78ggg(b) to require a preponderance standard.

Contrary to the SEC's depiction of itself as SIPC's "plenary supervisor," moreover, Congress delegated to *SIPC* the statutory authority to "determine" whether there are customers in need of the protection of a SIPA liquidation proceeding, and delegated to the SEC *only* the authority to seek judicial review of SIPC's determination. Nowhere in the entire field of administrative law may the determination of a board comprised of executive-branch appointees and federal government representatives be overruled on a matter within the express terms of its statutory discretion, based only on "probable cause."

The SEC similarly attempts to evade the statutory standard by requesting *Chevron* deference. Congress, however, has not delegated interpretive authority concerning SIPA to the SEC. The SEC has not issued regulations or engaged in an adjudication regarding the meaning of the statutory term "customer," and could not because terms that the statute expressly defines may not be redefined by agency rule. *See* 15 U.S.C. §78ccc(b)(4)(A). Indeed, the SEC's current interpretation of "customer"—which amounts only to a request for the "flexibility" to disregard the plain meaning—is nothing but a litigation-driven position unsupported by any exercise of interpretive authority. SEC Br. 45. The SEC's position is all the more unworthy of *Chevron* deference because it contradicts the agency's prior considered views, without any explanation for the change.

On the merits, the SEC cannot show that there are "customers" of a SIPC "member," as the plain language of Section 78ggg(b) requires, for the straightforward reason that it has stipulated that SIBL investors received the securities they purchased and held those securities in *their own custody*. As an introducing broker, SGC did not itself hold *any* customer cash or securities on deposit. The SEC's effort to "deem" non-customers to be "customers" would be unprecedented under these facts, and would fundamentally transform SIPC into an insurer against fraud by every kind of financial institution, including banks, contrary to the very purpose of the statutory regime. Moreover, the SEC's argument that the Court can pierce the corporate veil between SIBL and SGC is unfounded, was expressly waived below, and cannot be resurrected here.

ARGUMENT

I. THE DISTRICT COURT CORRECTLY APPLIED A TRADITIONAL PREPONDERANCE-OF-THE-EVIDENCE STANDARD.

The SEC devotes the majority of its brief to arguing that its Application should be governed by a probable-cause standard. As a threshold matter, it bears emphasis that the SEC's Application fails regardless of the answer to that question: the district court properly held that "because the issue turns on uncontested facts and an interpretation of law, … the SEC would have failed to meet even the lesser burden of probable cause." Op. 18.

Even on its own terms, the SEC's standard is without foundation. Neither the SEC's June 2011 memorandum nor its ensuing Application initiating this litigation asserted that a probable-cause standard should be used. It was only in a reply brief that the SEC for the first time sought a probable-cause standard—*after* the district court had denied the SEC's original argument that its "customer" determination should be exempt from judicial review. The SEC relies on the same arguments to support its probable-cause standard that it invoked for its no-judicial-review standard, and those arguments fare no better now. Adopting a probable-cause standard in this context would be unprecedented, and nothing in the text, structure, or purpose of SIPA supports altering the traditional preponderance-of the-evidence standard that the Supreme Court has recognized to be the "default" in civil litigation. *See CIGNA Corp. v. Amara*, 131 S.Ct. 1866, 1881 (2011). To the contrary, SIPA's statutory regime establishes that the SEC must do more than provide reason to *think* there *may* be "customers" in order to overturn SIPC's determination.

A. The Language And Context Of Section 78ggg(b) Do Not Support The Adoption Of An Unprecedented Probable-Cause Standard.

The SEC is asking this Court to adopt an evidentiary standard premised in the language of the Fourth Amendment and used almost exclusively for pretrial proceedings in criminal litigation (and not mentioned in the securities laws, much less SIPA). This would be unprecedented—as the SEC conceded during argument below, H'rg Tr. 19:20-24, Mar. 5, 2012 ("THE COURT: Do you have any authority for a summary proceeding in federal court that has been adjudicated based on the probable cause standard? [SEC]: I didn't find any case law addressing that point…."). It should be rejected.

1. Congress's Failure To Articulate A Different Standard In Section 78ggg(b)'s Text Plainly Supports Applying A Preponderance Standard.

The district court correctly held that Section 78ggg(b) is subject to a preponderance-of-the-evidence standard. That standard is the "default rule" in civil cases and SEC administrative proceedings, and is presumed to apply absent evidence to the contrary. *CIGNA Corp.*, 131 S.Ct. at 1881; *see also Dixon v. United States*, 548 U.S. 1, 17 (2006) ("[W]e presume that Congress intended the petitioner to bear the burden of proving the defense … by a preponderance of the evidence."); *Grogan v. Garner*, 498 U.S. 279, 287 (1991) ("[W]e presume that th[e] [preponderance] standard is applicable in civil actions."); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387-91 (1983) ("The [preponderance] standard applies in administrative proceedings before the SEC and has been consistently employed by the lower courts in private actions under the securities laws."); *In re Chreky*, 450 B.R. 247, 253 n.3 (D.D.C. 2011) (same).

In light of this presumption, the absence of any language in Section 78ggg(b) even implying—let alone expressly adopting—a lower standard requires application of the default rule. "This silence is inconsistent with the view that Congress intended to require a special [] standard of proof." *Grogan*, 498 U.S. at 286; *see also Dixon*, 548 U.S. at 17; *United States v. Phelps*, 955 F.2d 1258, 1266-67 (9th Cir. 1992); *United States v. Bestfoods*, 524 U.S. 51, 62 (1998) ("[A]gainst this venerable common-law backdrop, the congressional silence is audible.").

Relying primarily on two due-process cases from the 1970s, the SEC now argues that "probable cause is an appropriate standard in preliminary proceedings such as this that do not lead to definitive resolution of the merits of the underlying claim." SEC Br. 31 (citing *Bell v. Burson*, 402 U.S. 535, 542 (1971), and *Gerstein v. Pugh*, 420 U.S. 103, 121 (1975)). Neither of those cases supports using a probable-cause standard here.

To begin, this is emphatically *not* a "preliminary proceeding[]." SEC Br. 31. The Court's decision here will resolve, once and for all, whether the SEC's demand that SIPC initiate a liquidation should be granted. As the SEC itself conceded at oral argument before the district court: "the first decision the Court makes about whether a liquidation proceeding must begin *really decides the issue*, because it would be very hard, once the liquidation proceeding is under way, to unwind such a proceeding." H'rg Tr. 8:15-19, Jan. 24, 2012. The ensuing liquidation in the Northern District of Texas would be brought under Section 78fff, not Section 78ggg(b), and would entitle SIBL investors to make claims that would have to be litigated individually. Litigating those claims would likely cost tens of millions of dollars, even if every claim was rejected. *See supra* 10; *see also* H'rg Tr. 7:16-17, Mar. 5, 2012.

Whether alleged customers who file claims in a Section 78fff proceeding ultimately recover is a different question, governed by different standards and with different consequences. It is in no way "duplicative" of the determination that this Court must make, as the SEC now suggests. SEC Br. 30. A Section 78ggg(b) action is litigation between SIPC and the SEC in "the district court … [of] the principal office of SIPC," to determine whether SIPC has an obligation to initiate a liquidation. 15 U.S.C. §78ggg(b). A Section 78fff proceeding, in contrast, involves SIPC as overseer of the liquidation proceeding, the SIPA trustee for the estate of the broker-dealer as administrator of the liquidation, and individual claimants—and is meant to determine the amount of each individual person's recovery based on the facts of his or her claim.

Bell and *Gerstein* accordingly are distinguishable, to the extent they are even relevant. *Bell* held that a state could not refuse to consider liability for an accident in a driver's-license suspension proceeding when a subsequent adjudication of non-liability would lift that suspension. 402 U.S. at 541. That conclusion is of no moment here, but, if anything, is telling to the extent the court ordered *more* process, not less. Similarly, the question in *Gerstein* was whether an individual could be held before trial without a probable-cause hearing. Contrary to the SEC's claim, the Court held that probable cause was the governing standard in that situation simply because the Fourth Amendment and its "common-law antecedents" had allowed arrests upon that showing for hundreds of years. 420 U.S. at 111. The SEC's other cases are no more relevant. *See* SEC Br. 31 n.8.

The SEC's cases, moreover, only address the question whether probable cause satisfied the minimum requirements of due process in a given context; they do not address the antecedent issue of *when* that standard applies. This separate, threshold question depends on the language and purpose of the statute for which the standard would be used. *See, e.g.*, *Dwyer v. United States*, 716 F.Supp. 1337, 1340-41 (S.D. Cal. 1989) ("The issue before the Court is one of statutory construction—not due process. Congress is free to draw requirements which are more demanding than the minimum requirements of due process…."); *Phelps*, 955 F.2d at 1266 ("Allocation of the burden of proof … is a question of statutory construction….").

2. Other Provisions Of The '34 Act Support Application Of A Preponderance Standard.

Section 78ggg(b)'s context reinforces this conclusion. Section 78ggg(b) authorizes the SEC to "apply to the district court … for an order requiring SIPC to discharge its obligations under this chapter." This language mirrors that of Section 78u(e)(1) of the Exchange Act, which similarly authorizes the SEC to file an "application" for an "order[] commanding any person to comply with [its] provisions." 15 U.S.C. §78u(e).

As the district court recognized, Section 78u(e)(1) has long been interpreted to require proof by a preponderance of evidence. *See SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1169 (D.C. Cir. 1978); *SEC v. Int'l Loan Network, Inc.*, 770 F.Supp. 678, 688 n.10 (D.D.C. 1991); *SEC v. Tome*, 638 F.Supp. 596, 620 n.45 (S.D.N.Y. 1986). How courts have interpreted Section 78u(e)(1) is thus instructive, both because Congress is presumed to be aware of how courts interpret the language it chooses, *see Midlantic National Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 501 (1986) ("[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." (citation omitted)), and because SIPA instructs that it should be construed as if it were an "amendment to" and "included as a section of" the Exchange Act, unless otherwise provided. 15 U.S.C. §78bbb.

There is no merit to the SEC's argument that Section 78u(e)(1) is not analogous to Section 78ggg(b) because Section 78u(e)(1) involves "permanent injunction[s]," whereas the action here "would not finally determine whether there are any valid customer claims." SEC Br. 41. That argument assumes that a Section 78ggg(b) action is entirely duplicative of a Section 78fff liquidation proceeding. As explained above, it is not. This action involves different parties and relief, and its outcome will "finally determine" whether to grant the SEC's demand that SIPC initiate a liquidation proceeding under Section 78ggg(b). In contrast, Section 78fff requires SIPC to have already made the determination that there *are* customers that it can protect.

The SEC's distinction that Section 78u(e)(1) implicates "civil law enforcement," whereas Section 78ggg(b) has a "regulatory" function is equally unavailing. SEC Br. 40. Both provisions authorize the SEC to seek injunctions compelling certain parties to undertake particular actions. The only difference asserted by the SEC is that Section 78ggg(b) applications are to be "resolved in a summary proceeding intended to be expeditious," whereas Section 78u(e)(1) applications are not. SEC Br. 40-41. This misses the point. The issue here is not about the *speed* of a Section 78ggg(b) proceeding, but what *burden of proof* should apply. A Section 78ggg(b) application can still be "expeditious" and resolved in a summary proceeding even under a preponderance standard. Nothing in that provision authorizes giving the burden of proof short-shrift.

3. SIPC's Statutorily Prescribed Relationship With The SEC Favors A Preponderance Standard.

Contrary to the SEC's argument, a probable-cause standard would also be at odds with the statutorily prescribed relationship between the SEC and SIPC. Although the SEC repeatedly asserts that it is SIPC's "plenary supervisor," the statute vests the discretion regarding whether to initiate a liquidation *with SIPC*.

Far from authorizing the use of a *lesser* probable-cause standard to override SIPC's discretionary determination, if anything, the statutory framework supports placing a *higher* burden on the SEC to prove an abuse of discretion by SIPC.

Section 78eee(a)(3) states that SIPC "*may*" initiate a liquidation "*if SIPC determines*" that one is warranted. Section 78ggg(b) does not authorize the SEC to reverse that determination at will as SIPC's "plenary supervisor," and instead states only that the SEC may "*apply*" to the court for an order that SIPC "discharge its obligations" (which necessarily asks whether a failure to discharge those obligations has occurred, not whether the two sides have disagreed). While the SEC now demands carte blanche to ignore SIPC's discretion regarding whether to seek a liquidation, "[t]he short answer is that Congress did not write the statute that way." *United States v. Naftalin*, 441 U.S. 768, 773 (1979).

Section 78ggg(b) thus stands in sharp contrast to other SIPA provisions, which *do* allow the SEC to "require" SIPC to take certain actions. *See, e.g.*, 15 U.S.C. §78ccc(e)(3) (giving the SEC rulemaking authority to "*require* SIPC to adopt, amend, or repeal any SIPC bylaw…."); §78ggg(c)(1) ("The Commission may … *require* SIPC to furnish it with such reports and records ….."). Unlike those provisions, Section 78ggg(b) merely provides a means by which the SEC may "apply" for such an order—which in turn requires the SEC to prove that SIPC is not "discharg[ing] its obligations." *Id.* §78ggg(b).

This makes sense. SIPC is a congressionally-created entity governed by presidential appointees, as well as Treasury and Federal Reserve Board representatives. SIPC has expertise in applying SIPA, whereas the SEC, in its own words, "merely … provides notice to SIPC in order for [SIPC] to decide whether to seek to initiate a liquidation." SEC 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). Congress would not have intended to allow one set of presidential appointees to overturn the considered determination of another set of presidential appointees, joined by the representatives of not one, but two, executive agencies, on the basis of a *lower* rather than a *higher* standard, let alone under a probable-cause standard derived from criminal law. *See FMC Corp. v. Holliday*, 498 U.S. 52, 66 (1990) (Stevens, J., dissenting) ("If Congress had intended such an irrational result, surely it would have expressed it in straightforward English.").

If anything, the language and structure of SIPA suggest that SIPC's liquidation determinations should not be overturned absent an abuse of discretion. SIPA vests *SIPC* with the discretion to "determine" whether a liquidation is warranted, and it simply permits rather than requires SIPC to initiate a liquidation under those circumstances. As the district court held, "Congress specified that the SEC would have to 'apply' to this district court to overturn the SIPC, and it is fitting that Congress wanted the SEC to meet a *higher* burden to overturn the conclusion of the SIPC (who has the authority in the first instance to make the determination)." Op. 6 n.4.

B. The SEC's Arguments In Favor Of A Probable-Cause Standard Misread SIPA And The Regulatory Scheme.

1. SIPC Does Not Initiate Liquidations Based On Mere Probable Cause.

The SEC insists that it should be subject to only a probable-cause standard because "courts have granted SIPC's applications based on that standard," and, "as SIPC's plenary supervisor," the SEC should be held to a lower standard. SEC Br. 28. This argument relies on a faulty premise: SIPC cannot initiate a liquidation by probable cause alone and must instead show by a preponderance of the evidence that there are "customers" in need of protection (assuming the issue is contested). *SEC v. Alan F. Hughes, Inc*., 461 F.2d 974 (2d Cir. 1972), makes this clear. The SEC claims that *Hughes* requires only "a reasonable showing" of customer need to initiate a liquidation, SEC Br. 34, but that selective quotation derives from the district court's *remarks from the bench*. A complete reading reveals that the court conducted a far deeper review than probable cause. *See Hughes*, 461 F.2d at 982 ("[T]here is *more than* a reasonable showing that this application should be granted. *There is clear present danger*."). And far from lowering the standard of review, on appeal the Second Circuit held that due process required vigorous *de novo* review of SIPC's "customer" determination:

> [D]ue process is satisfied as long as the district court … makes its own determination that the broker-dealer has failed or is in danger of failing to meet its obligations to its customers…. [S]uch a determination must result from a *de novo* proceeding in the district court rather than from some lesser process merely involving judicial review of the initial administrative determination.

Id. at 979; *see SIPC v. Charisma Sec. Corp.*, 506 F.2d 1191, 1194 (2d Cir. 1974).[7]

The SEC's citation of *C.J. Wright, Inc.*, No. 5:91-cv-92 (M.D. Fla.), is no more helpful. *See* SEC Br. 35-36. The liquidation in that case was *unopposed*, with the appointment of a trustee and entry of a consent order the same day as SIPC's application. *See* Apr. 24, 1991 Consent of C.J. Wright & Co., Inc. (SIPC Sur-Reply Ex. A, *SEC v. SIPC*, 1:11-mc-00678-RLW [Dkt.28] (D.D.C. Mar. 2, 2012); Apr. 24, 1991 Consent Order (Sur-Reply Ex. B). The unopposed papers in one case do not establish a practice by SIPC—let alone a standard that courts have adjudicated. Nor does the SEC's unsupported assertion that SIPC has filed "conclusory" and "boilerplate" applications prove anything, as many of those applications were unopposed, and, for those that were not, the affected brokers had the right to full *de novo* review. *See Hughes*, 461 F.2d at 979 & n.8.

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[7] The SEC also points to language in *Hughes* that SIPC must show only "'a danger that [the broker-dealer] would fail to meet its obligations.'" SEC Br. 34 (quoting *Hughes*, 461 F.2d at 982). This argument ignores that under Section 78eee(a)(3) there must be a danger *to customers*. "Danger," as used in Section 78eee(a)(3), refers to risk posed by a broker-dealer's financial condition; it does not modify the word "customers." And this case involves Section 78ggg(b), which does not use the word "danger" at all.

2. SIPA's Goal Of "Speedy" Relief Does Not Justify An Unprecedented Probable-Cause Standard.

Without any statutory hook for its probable-cause theory, the SEC relies on abstractions about SIPA's "customer-protection intent" and "goal of speedy relief," arguing that a probable-cause standard better aligns with those purposes. SEC Br. 31, 32. The SEC's course of conduct, however, belies the primacy it now attaches to these goals: despite learning of the Stanford fraud as early as 1997, the SEC waited 14 years—and some two years after SGC was placed into receivership in 2009—before bringing this case against SIPC, and it has not asked to expedite this appeal. The reason why, as the SEC explained below, is that "there's no emergency today." Hr'g Tr. 6:13-14, Jan. 24, 2012.

In all events, while "speedy relief" is one of SIPA's aims, no statute pursues its goals at all costs. *See Freeman v. Quicken Loans, Inc.*, 132 S.Ct. 2034, 2044 (2012). Especially with respect to initiating liquidations, SIPA strikes a careful balance between the rights of the SEC, SIPC, claimants, and brokers in order to avoid "unnecessarily engendering the costs of precipitate liquidations." *Barbour*, 421 U.S. at 422. The SEC's attempt to lower the evidentiary standard to allow liquidations without proof of "customers" is at odds with this balance, with the contrary notion that SIPA's definition of "customer" should be construed narrowly, *see supra* 7, and with the speed and frequency with which SIPC has initiated liquidations when there really are "customers."

Finally, the SEC has not pointed to a single instance in which a court has applied a probable-cause standard to make a proceeding quicker. That is because burdens of proof are never calculated in such fashion. Courts are able to expedite proceedings and discovery as they see appropriate, *see, e.g.*, *AF Holdings LLC v. Doe*, 2012 WL 3204888, at *1-2 (E.D. Cal. Aug. 2, 2012)—and can do this without changing the burden of proof. Notably, when courts do allow early and speedy relief to litigants—through preliminary injunctions, for example—the standard is far more reaching than probable cause.

II. THE SEC'S ASSERTION THAT THERE ARE "CUSTOMERS" UNDER SIPA IS NOT ENTITLED TO ANY DEFERENCE.

The SEC also makes another half-hearted attempt to curtail judicial review by arguing in three paragraphs at the end of its brief that the Court should accord *Chevron* deference to the SEC's interpretation of the statute. That argument appeared for the first time in a reply brief below and is without merit.

First, *Chevron* deference is appropriate only when Congress has delegated interpretive authority to the agency. *See Carcieri v. Salazar*, 555 U.S. 379, 396-97 (2009). Here, Congress delegated the authority to "determine" whether liquidation is warranted *to SIPC*, not the SEC. 15 U.S.C. §78eee(a)(3). The SEC has neither rulemaking nor adjudicatory power over liquidation determinations. Instead, Congress has provided that the SEC may only "apply" for an order seeking to overturn SIPC's "determinations"—thus leaving it to the *courts*, not the SEC, to referee disputes regarding SIPA. The SEC is merely the body given standing to take SIPC to court. That is not the stuff of *Chevron* deference.

Second, the SEC lacks any particular expertise that would rationalize deference. SIPA is administered by SIPC in the main, with specified oversight by the SEC. "When a statute is administered by more than one agency, a particular agency's interpretation is not entitled to *Chevron* deference." *Proffitt v. FDIC*, 200 F.3d 855, 860 (D.C. Cir. 2000); *see also In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 82 (2d Cir. 2004) ("[T]he SEC's 'expertise' in this context is arguably less compelling than it would be with respect to those portions of the Securities Exchange Act as to which it takes a more proactive day-to-day role."); *BLMIS*, 654 F.3d at 234 (finding the views of *both* the SEC and SIPC "entitled to respect"). SIPC's Board includes representatives of the Treasury and the Federal Reserve Board, both of whom agreed with the determination not to initiate a liquidation here. There is no reason to suppose Congress wished the opinion of the SEC to outweigh that of SIPC, whose views are informed by those of the Treasury, the Federal Reserve Board, and Senate-confirmed presidential appointees.

Third, as the Supreme Court has noted, "the overwhelming number of our cases applying *Chevron* deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication." *United States v. Mead Corp.*, 533 U.S. 218, 230 (2001). The SEC's application to the district court was neither—and was never subject to adversarial process or public comment before the SEC filed suit. The Commission's briefs—the only places disclosing its thinking except for a memorandum authorizing this litigation—are not entitled to *Chevron* deference. *See Christensen v. Harris Cty*., 529 U.S. 576, 587 (2000) ("Interpretations such as those in opinion letters … do not warrant *Chevron*-style deference."); *see also In re New Times*, 371 F.3d at 81-82 (rejecting request for *Chevron* deference to SEC position that had "never been articulated in any rule or regulation," where *SIPC* "arguably [has] greater familiarity with the provisions of SIPA").

Fourth, the SEC has not purported to define an ambiguous phrase and has agreed in other cases that SIPA's definition of "customer" is unambiguous. *See Aozora Bank Ltd. v. SIPC*, 480 B.R. 117, 121 (S.D.N.Y. 2012). The SEC is instead asking for deference to its interpretation of case-law and application of a substantive-consolidation doctrine to the facts of this case. The SEC has no expertise in this area and is not entitled to deference. *See W. Va. Highlands Conservancy, Inc. v. Norton*, 343 F.3d 239, 245 (4th Cir. 2003) ("When the administrative interpretation … is based on general common law principles, great deference is not required." (quotation marks omitted)).

Finally, the SEC's position reflects a reversal of both its initial position agreeing that SIPA did not apply to the Stanford fraud and a near-30-year position that clients of fully-disclosed introducing brokers like SGC are presumed, for purposes of SIPA, to be "customers" of the *clearing* broker. As early as 1985, the SEC stated in a letter to stock-market representatives that an "introducing broker-dealer's customers are *presumed to be customers of the carrying broker-dealer*" for purposes of SIPA. Jan. 14, 1985 Letter from Ketchum to Marcus, *available at* http://www.sec.gov/divisions/marketreg/mr-clearing011485.pdf. It has repeatedly affirmed that position since. *See* Net Capital Rule, SEC Release No. 34-31511, 57 Fed. Reg. 56973, 56980 (Dec. 2, 1992); Designation of Small Bus. Compliance Guides, SEC Release Nos. 33-7382 *et al.*, 63 SEC Docket 1669 (Jan. 22, 1997); Broker-Dealer Reports, SEC Release No. 34-64676, 76 Fed. Reg. 37572, 37585 n.130 (June 27, 2011) ("[C]ustomers of introducing broker-dealers are presumed to be customers of the clearing broker-dealer….").

The SEC responds that this presumption does not apply when an introducing broker itself holds customer property. SEC Br. 55. But the SEC stipulated that SIBL CDs were delivered to investors or their designees rather than being held by SGC. Stipulated Facts ¶4. Its claim for deference should accordingly be denied. *See Watt v. Alaska*, 451 U.S. 259, 273 (1981) ("The [] current interpretation, being in conflict with its initial position, is entitled to considerably less deference."); *Pfizer, Inc. v. Heckler*, 735 F.2d 1502, 1510 (D.C. Cir. 1984) ("[T]he amount of deference to be accorded … depends upon … consistency with prior and subsequent interpretations….").

III. THE DISTRICT COURT PROPERLY HELD THAT THE SEC HAS FAILED TO SHOW, UNDER ANY STANDARD OF PROOF, THAT SIBL CD INVESTORS QUALIFY AS "CUSTOMERS" OF A SIPC "MEMBER" IN NEED OF SIPC's PROTECTION.

Section 78ggg(b) states that the SEC may "apply … for an order requiring SIPC to discharge its obligations" "[i]n 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." 15 U.S.C. §78ggg(b). This language plainly requires *the SEC*—not SIPC—to show that there are (1) "customers" (2) of a SIPC "member" (3) in need of "protection," before the SEC may compel SIPC to initiate a liquidation.[8] The SEC cannot begin to make that showing here.

A. Protected "Customers" Must Be Owed Cash Or Securities Entrusted To A "Member" Brokerage Firm.

As always, this Court must "begin with the language employed by Congress." *Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist.*, 541 U.S. 246, 252 (2004). SIPA defines the term "customer" as "any person … who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business … from or for the securities accounts of such person for safekeeping," including "any person who has deposited cash with the debtor for the

[8] The district court held—in an order the SEC has not appealed—that "the SEC must … demonstrate that it is entitled to relief" under Section 78ggg(b). Feb. 9, 2012 Op. 11. Accordingly, the SEC has waived any argument that SIPC has the burden of proof. *See Marymount Hosp., Inc. v. Shalala*, 19 F.3d 658, 663 (D.C. Cir. 1994).

purpose of purchasing securities." 15 U.S.C. §78*lll*(2). The plain meaning of this language—for which courts have "consistently taken a restrictive view," *In re Klein, Maus & Shire*, 301 B.R. at 418; *see also In re Stalvey*, 750 F.2d at 472; *SIPC v. Jacqueline Green Rollover Account*, 2012 WL 3042986, at *4 (S.D.N.Y. July 25, 2012)—thus requires that the claimant have cash or securities held *in the custody* of a SIPC *member*. *See BLMIS*, 654 F.3d at 236; *Brentwood*, 925 F.2d at 327; *SEC v. Kenneth Bove & Co.*, 378 F.Supp. 697, 700 (S.D.N.Y. 1974). In other words, SIPA protects only a broker's "lockbox" function. If the broker is not serving that function when it becomes insolvent, a claimant is "not a customer and therefore not entitled to recover." *Brentwood*, 925 F.2d at 327.[9]

It is not enough that the victims of the Ponzi scheme were clients of SGC or investors in a Stanford entity. Whether a claimant is a customer is measured transaction-by-transaction, and "customer status in the course of some dealings with a broker will not confer that status upon other dealings, no matter how intimately related, unless those other dealings also fall within the ambit of the statute." *In re Stalvey*, 750 F.2d at 471; *see also id.* at 470-71 (rejecting "once a

[9] The SEC asks this Court to "recognize[] that SIPA is remedial legislation that should be construed flexibly," SEC Br. 49 n.19, but, during argument below, offered no reason why the term "customer" should be interpreted in this fashion. *See* H'rg Tr. 32:14-17, Mar. 5, 2012 ("Has any court that you're aware of said that SIPA's definition of customer should not be construed narrowly? [SEC]: I'm not aware of a contrary decision."). The term is to be read narrowly, *see In re New Times Sec. Servs., Inc.,* 463 F.3d 125, 127 (2d Cir. 2004), even if SIPA has remedial aspects.

customer, always a customer" argument); *SEC v. F.O. Baroff Co.*, 497 F.2d 280, 282 n.2 (2d Cir. 1974). Thus, the question is whether—*at the time of SGC's insolvency*—investors had cash or securities on deposit with SGC.

Whether SIBL later paid SGC or any other introducing broker commissions following the sale of these Antiguan CDs thus makes no difference. The SEC stipulated that SIBL CDs were delivered to investors or their designees, thus completing the transaction. The money investors paid to SIBL became part of SIBL's capital; it was not on "deposit" and was not being "held for" a customer by SGC. *See Aozora Bank*, 480 B.R. at 124-26 (investor cash became an asset of an intermediary before being deposited with SIPC member); *Jacqueline Green*, 2012 WL 3042986, at *5. Whether SGC advisors were rewarded for marketing SIBL CDs is irrelevant: "even if true, [this] run[s] too far afield from the key issue, which is whether the investor entrusted cash to SGC for the purpose of effecting a securities transaction." Op. 17.

B. The SEC Cannot Establish That There Are "Customers" In Need Of SIPC's Protection.

The SEC cannot show that there are *any* customers under SIPA's plain meaning. SGC acted only as an introducing broker and thus did not serve any custodial function or hold CDs or cash on behalf of its clients. Instead, SIBL investors did so by transferring funds *to SIBL*, after which CDs were delivered to investors or their designees. That is the end of the case.

1. As An Introducing Broker, SGC Did Not Have Custody Of SIBL CDs.

As an initial matter, there cannot be any "customers" here because SGC did not hold (nor was it supposed to be holding) any cash or securities in its custody. SGC was an introducing broker, meaning that while it solicited and accepted orders from clients, it did not itself clear transactions or hold customer property. *See supra* 14; *In re Adler, Coleman Clearing Corp*., 263 B.R. 406, 429 (S.D.N.Y. 2001) ("[F]or SIPA purposes customers introduced to a clearing broker are deemed customers of the *clearing broker*, and not of the introducing broker."). Instead, SIBL delivered those CDs to the purchasers themselves, or to an authorized designee like Stanford Trust Company ("STC") (which is not a SIPC member). *See* Stipulated Facts ¶¶4, 7; Janvey Ltr. 3; *see also* Figure 2, *supra*; SIPC Opp'n Ex. 17 (citing SEC Receiver's website explaining how "[t]o transfer your STC trust or other fiduciary account" to a different custodian). "To the extent that some SIBL CD investors did not receive the physical certificates, the SEC is not relying on that fact to support its claims." Stipulated Facts ¶4.

Because individual investors never entrusted their CDs to SGC, they cannot be considered "customers" under SIPA. *See BLMIS*, 654 F.3d at 236 (entrustment is "the critical aspect of the 'customer' definition" (quotation marks omitted)); *Brentwood*, 925 F.2d at 327; *Kenneth Bove*, 378 F.Supp. at 700. Where, as here, the certificates "are securities, then [an investor] has already received the benefit of her bargain, albeit a bad one, for she has the securities themselves." *In re Atkeison*, 446 F.Supp. at 848. Investors have the securities they purchased; there is nothing more SIPC is permitted to do under the statutory regime.

The SEC asserts in response that the CDs here are "nothing more than participatory interests in a Ponzi scheme" and thus "should be disregarded." SEC Br. 54. It does not and cannot cite any authority, however, suggesting that the CDs at issue here can simply be dismissed as "fictitious." *See id.*[10]

To begin, SIBL's investors did not receive an "undivided interest in a Ponzi scheme." They received physical CD certificates. *See* Figure 2. Although those securities lost value, "SIPA … does not comprehensively protect investors from the risk that some deals will go bad or that some securities issuers will behave dishonestly." *Brentwood*, 925 F.2d at 330. SIBL investors may have fraud claims against SGC and/or SIBL, but those claims do not make them "customers." *S.J. Salmon & Co.*, 375 F.Supp. at 871; *see also SEC v. Packer, Wilbur & Co.*, 498 F.2d 978, 983 (2d Cir. 1974); *In re Klein, Maus & Shire*, 301 B.R. at 421; *In re MV Sec., Inc.*, 48 B.R. 156, 160 (Bankr. S.D.N.Y. 1985). Even "if a broker used fraudulent means to convince a customer to purchase a stock …, SIPC would be required by SIPA only to return the stock to the customer. The customer would

[10] The SEC commonly argues that securities linked to Ponzi schemes are nonetheless "securities" under the securities laws. *See, e.g.*, *SEC v. Better Life Club of Am., Inc.,* 995 F.Supp. 167, 173-74 (D.D.C. 1998).

retain any securities fraud claim against the broker for inducing the purchase." *SIPC v. Vigman*, 803 F.2d 1513, 1517 n.1 (9th Cir. 1986) (citations omitted).[11]

The SEC's theory would transform SIPC into an insurer against every fraudulent scheme implicating a broker-dealer. SIPC is not equipped to serve that function, nor did Congress intend it to do so. *See In re Stalvey*, 750 F.2d at 473 ("Congress believed that the SIPA was only an 'interim step' that would not provide complete protection for losses occasioned by the failure of broker-dealer firms."); *Packer, Wilbur & Co.*, 498 F.2d at 983 ("SIPA was not designed to provide full protection to all victims of a brokerage collapse."). Indeed, Congress rejected a bill that would have amended SIPA to apply to Stanford victims, *see* Ponzi Scheme Investor Protection Act of 2011, H.R. 1987, 112th Cong. §8a(d) (2011), and is currently considering another, *see* Improving Security for Investors and Providing Closure Act of 2013, H.R. 827, 113th Cong. (2013)—underscoring that this is a matter for Congress and not the courts.

The SEC's claim that "the issuance of [] securities [has] [been] disregarded" in other Ponzi-scheme cases is similarly unfounded. SEC Br. 54. In *BLMIS*, for

[11] The SEC, SEC Receiver, and Antiguan authorities who had been supervising SIBL's liquidation recently reached a proposed settlement that will distribute around "$300 million in foreign Stanford assets to the creditor-victims of the Stanford Ponzi scheme." Am. Joint Mot. to Approve Settlement Agreement 1, *SEC v. Stanford Int'l Bank*, Ltd., No. 09-cv-00298-N [Dkt.1793] (N.D. Tex. Mar. 12, 2013). The SEC's position that CD holders should recover as creditors is inconsistent with its theory that these securities should be disregarded.

example, a SIPC member accepted customer cash for the purpose of buying securities, sent statements to investors indicating that it had purchased those securities, but, in reality, never completed those purchases. 654 F.2d at 231-32. That is the quintessential deposit of funds to the custody of a broker that SIPA protects: until the broker has used those funds to purchase the specified securities and conveyed those securities to the investor, the broker is holding the customer's assets in custody. Here, investors tendered their cash to SIBL and received the CDs they purchased. They had nothing on deposit with SGC.[12]

2. Investors Deposited Funds With SIBL, Not SGC.

The SEC cannot show there are "customers" for the additional reason that claimants purchased SIBL CDs by directing cash *to SIBL*—which is not and never was a SIPC member. Stipulated Facts ¶7. As the SEC stipulated, investors "had to open an account with SIBL" to purchase a CD from it, and did so by "[writing] checks that were deposited into SIBL accounts and/or … asking that money be wired to SIBL." *Id.* ¶3. Thus, "[p]ursuant to the stipulated facts, the SEC cannot show that SGC ever physically possessed the investors' funds at the time that the investors made their purchases." Op. 11.

[12] *In re Old Naples Securities, Inc.*, 311 B.R. 607 (M.D. Fla. 2002), and *In re C.J. Wright & Co.,* 162 B.R. 597 (Bankr. M.D. Fla. 1993), are no more help. Both involved transactions that were never completed. Indeed, the court in the latter case *agreed* there would *not* be a customer claim where the claimant "received the specifically identifiable securities they had purchased." 162 B.R. at 609.

The SEC has conceded, moreover, that investors knew or should have known they were sending cash to an organization that was not subject to SIPA. *See* Stipulated Facts ¶¶3, 5-6. To purchase CDs, investors had to open accounts with SIBL and transfer money to those SIBL accounts. In so doing, disclosure statements warned that "'SIBL's products are not … covered by the investor protection or securities insurance laws of any jurisdiction such as the U.S. Securities Investor Protection Insurance Corporation.'" *Id.* ¶6. Marketing brochures similarly stated that SIBL CDs "'are not subject to the reporting requirements of any jurisdiction outside of Antigua and Barbuda, nor are they covered by the investor protection or securities insurance laws of any jurisdiction such as the U.S. Securities Investor Protection Insurance Corporation,'" and that "'[t]here is no guarantee investors will receive interest distributions or the return of their principal.'" *Id.* To the extent investors received interest on their CDs, SIBL never provided Form 1099s. *See* Additional Stipulated Facts [Dkt.31] ¶1.

3. ***Old Naples* And *Primeline* Do Not Allow The SEC To "Deem" Statutory Perquisites Met.**

Absent any textual basis for its argument, the SEC asks this Court to "deem" SIBL investors customers of SGC, relying on two out-of-circuit cases: *Old Naples* and *Primeline*. The SEC's approach, however, improperly asks this Court to disregard SIPA's plain limitation of "customers" to persons who have "deposited cash [or securities] *with the debtor*." 15 U.S.C. §78*lll*(2)(B)(i).

To begin, *Old Naples* and *Primeline* are distinguishable on their facts, and neither supports the SEC's wholesale expansion of SIPA. *First*, "[i]n each of those cases, the claimants provided money to an ostensible agent of a broker-debtor for the purpose of investing their money through the broker-debtor, but the agent instead misappropriated their funds." *BLMIS II*, 708 F.3d at 428; *see also Jacqueline Green*, 2012 WL 3042986, at *14. That situation does not exist here: as the SEC stipulated, CD purchasers knowingly gave cash to SIBL, not SGC, and were warned that SIPA would not protect their investments. *See supra* 11-14, 48-49. This is not a case, like *Old Naples* and *Primeline*, where an introducing broker failed to clear a transaction with its closing broker. As *Primeline* notes, "claimants who invest directly in a third-party company are not protected by SIPA, even if their broker suggested the investment." 295 F.3d at 1107.

Second, in *Old Naples* and *Primeline*, the investors never received the securities they intended to purchase. At the time of insolvency, the broker-dealers still had their money and had given them no property in exchange.[13] Here, the SEC stipulated that investors intended to purchase SIBL CDs—and received them. It therefore makes no difference whether those purchasers are "deemed" to have

[13] The SEC claims that investors in *Primelime* received the securities they intended to purchase. *See* SEC Br. 53-54. The question in that case, however, was only whether cash given to an individual broker could be considered on deposit with the SIPC-member for whom that particular broker worked. Whether securities were actually received and who had custody over them was not at issue.

been dealing with SGC, SIBL, or anyone else. They are not "customers" because they did not have property left on deposit with a broker-dealer.

In all events, *Old Naples* and *Primeline*'s expansive view of who qualifies as a SIPA "customer" disregards the narrow scope of the statutory text, and thus contradicts the weight of authority. *See supra* 7. In *Aozora Bank*, for example, investors in feeder funds that in turn invested in Madoff Securities (a SIPC member) claimed to qualify as SIPA "customers" by virtue of "an agency or conspiratorial relationship between the Feeder Funds and [Madoff Securities]." 480 B.R. at 128. The court found this insufficient: the claimants had entrusted money with firms that were not SIPC "members," and the fact that the firms used those monies to invest with Madoff Securities made no difference: "SIPA simply 'does not protect against all cases of alleged dishonesty and fraud.'" *Id*. at 128-29 (quoting *In re New Times*, 463 F.3d at 130); *see also Jacqueline Green*, 2012 WL 3042986, at *4.

Similarly, in *Brentwood*, a claimant purchased shares in a company called AMR from her broker at Brentwood Securities, Inc., a SIPC member. Notably, the broker was also Chairman of AMR's Board, and the claimant paid for the shares by check made out to both the broker and AMR. 925 F.2d at 329. Even though AMR never issued the shares, the Ninth Circuit held that the claimant did not qualify as a "customer," explaining that her funds "never passed through

Brentwood's hands" and her "shares also never passed through Brentwood's hands because they never came into existence." *Id.* Thus, "[r]egardless of what [she] thought was in her Brentwood trading account, it did not in fact ever contain either her securities or her cash" and was not protected by SIPA. *Id.*; *see also Kenneth Bove*, 378 F.Supp. at 699-700 (claimants were not "customers" because they delivered their securities to a second firm at their broker's request).

4. The SEC And Its Amici Cannot Create New "Customers" Through Veil-Piercing Or Substantive Consolidation.

Finally, the SEC claims that because SGC and SIBL operated in an interconnected fashion, this Court should treat deposits made with SIBL as if they were really deposits with SGC. This argument was never raised below and should be rejected as waived. *See, e.g.*, *Marymount Hosp.*, 19 F.3d at 663. Indeed, the SEC opposed SIPC's request for discovery regarding the relationship between SGC and SIBL by arguing that the SEC's theory did not "in any way rel[y] on veil-piercing concepts or the corporate structure of the broker-dealer and its affiliated entities." SEC Reply in Supp. of App. 24; *see also id.* at 20. The SEC cannot foreswear an argument for the purpose of averting discovery and then attempt to rely on that argument on appeal. Its substantive-consolidation argument is thus not only forfeited but also affirmatively waived. *See United States v. Zubia-Torres*, 550 F.3d 1202, 1205-06 (10th Cir. 2008).

The SEC's attempt to treat SIBL as if it were part of SGC also conflicts with the statute, which expressly excludes claims "aris[ing] out of transactions with a foreign subsidiary of a member." 15 U.S.C. §78*lll*(2)(C)(i). Congress created this exclusion to allocate risk, recognizing that SIPC's statutory reserve fund does not consider foreign subsidiaries' revenues when determining the assessments that SIPC members must pay. *See* H.R. Rep. No. 95-746, at 25 (1977). This exclusion is fundamental to the regulatory scheme—both because the SEC cannot "immediately notify SIPC" when foreign entities are in danger, *see* 15 U.S.C. §78eee(a)(1), and because SIPC has no realistic avenue for recouping expenses from a foreign affiliate regulated by a foreign sovereign (as SIBL was here), *see Cunard S.S. Co. v. Salen Reefer Servs. AB*, 773 F.2d 452, 458 (2d Cir. 1985) ("American courts have consistently recognized the interests of foreign courts in liquidating … their own domestic business entities.").[14] Americans who invest abroad take a certain risk in doing so. If Congress deliberately excluded even a wholly-owned subsidiary of a SIPC member from the reach of SIPA protection, it makes no sense for the SEC to assert that less closely related affiliates should be included. Any contention that SIBL was simply a conduit for SGC thus fails under 15 U.S.C. §78lll(2)(C)(i). Congress concluded that investments with a foreign

[14] SIBL was placed under receivership by Antiguan authorities. The SEC Receiver tried and failed to assert control of the receivership. *See Fundora v. Stanford Int'l Bank Ltd.*, No. ANUHCV 2009/0149, at *4, *10-11, *18 (E. Caribbean Sup. Ct., Antigua & Barbuda, Apr. 17, 2009) (SIPC Opp'n Ex. 21).

subsidiary are excluded *even when* a SIPC member concededly controls the foreign firm. Investments with a foreign entity that was not even a subsidiary of a SIPC member cannot support the SEC's case.

The SEC also relies on factual "findings" that differ dramatically from the stipulated facts below, gleaned from cases presenting different issues where SIPC was not a party—even including decisions *after* the district court dismissed the SEC's Application. *See* SEC Br. 48. This they cannot do. This Court cannot take notice of factual "findings" made by other courts in different cases involving different parties, nor are those findings preclusive. *See Christian Legal Soc.,* 130 S.Ct. at 2983; *Defenders of Wildlife v. Gutierrez*, 532 F.3d 913, 919 (D.C. Cir. 2008); *Wyatt v. Terhune*, 315 F.3d 1108, 1114 n.5 (9th Cir. 2003).

The SEC's amici offer arguments even farther afield from the record in this case. The brief filed by those amici brazenly attempts to relitigate this case on an entirely different set of facts. *See* Corrected Br. of Examiner, SIC & SVC 6, 12, No. 12-5286 (D.C. Cir. Jan. 23, 2013) ("Amicus Brief") (stating intention to "contradict many of the 'facts' upon which the district court apparently relied"). That is not permitted for any amicus, but it is especially inappropriate here, where Congress barred investors and receivers from bringing suit against SIPC to force a liquidation. *See Barbour*, 421 U.S. at 425. It would make no sense to confine such litigation to the SEC, and then allow third parties to invade the lawsuit as amici, offering different facts and different theories. Amici, like the SEC, are bound by the factual stipulations entered in district court. *See supra* at 20. Moreover, even apart from their amicus status, the amici are wrong to suggest this Court may rely on "findings" from proceedings to which SIPC was never a party, arising under laws other than SIPA, to conclude that SIBL was "one and the same" as SGC for purposes of SIPA. Factual findings in other courts are outside the scope of judicial notice, and it would violate due process to give those findings legal effect in a case involving different parties. *See Blonder-Tongue Labs. v. Univ. of Ill. Foundation*, 402 U.S. 313, 329 (1971).

In any event, the amici (like the SEC) concede that investors "*intended to purchase*" SIBL CDs. Amicus Br. at 15. This concession precludes SIBL investors from establishing "customer" status. The amici's recitation of "findings" that Stanford operated a "fraudulent enterprise," *id.* at 13, changes nothing because SIPA does not protect against fraud. *See supra* 7-8.[15]

[15] Straying from the record, the amici argue that some investors purchased CDs by writing checks to "Stanford" instead of writing out "Stanford International Bank Ltd." Amicus Br. 26. Even if true, this would not establish that SIBL and SGC were the same, any more than it would make Stanford University a part of the fraud if some students make their tuition checks out to "Stanford." Although the amici assert that some investors may not have understood the distinction between SIBL and SGC, *see id.* at 15-17, the statute turns not on a person's subjective understandings or mistaken beliefs, but on whether he is a "customer." The amici simply ignore the undisputed fact that SIBL disclosure documents warned investors that their funds would be sent to SIBL, that SIBL accounts would be

Even on its own terms, the SEC and its amici's effort to conflate SIBL and SGC fails. *First*, substantive consolidation is an equitable doctrine traditionally employed to prevent a *culpable* party from avoiding the debts of an entity it controls. That rationale does not apply here, where the SEC is using the theory to impose *new liabilities* on SIPC, a third party unconnected to the Stanford fraud. *See In re First Sec. Grp. of Cal.*, 1996 WL 92115, at *2 (9th Cir. Mar. 4, 1996) (holding that the "court erroneously applied the alter ego doctrine to shift liability to an innocent third party").

Second, applying substantive consolidation would be inconsistent with SIPA itself, which recognizes the importance of corporate formalities—for example, by excluding claims arising out of transactions with foreign subsidiaries. *See* 15 U.S.C. §78*lll*(2)(C)(i). And while the SEC claims that SIPC has "supported such consolidation in other SIPA liquidations," SEC Br. 47, SIPC has only done so to increase the assets available for customers—never to create new "customers" or to initiate a liquidation in the absence of "customers" of a "member."

Finally, SIPA's definition of "customer" excludes persons whose "claim for cash or securities … is part of the capital of the debtor," whether "by contract, agreement, or understanding, or by operation of law." 15 U.S.C. §78*lll*(2)(C)(ii). If SGC and SIBL were *in fact* consolidated, funds given to that entity in exchange

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opened on their behalf, and that their investments would *not* receive SIPC protection. *See* Figure 1, *supra*.

for CDs would become part of its capital. In other words, CD purchasers would have invested "*in* the debtor," rather than "*through* the debtor," and would occupy the position of a creditor rather than a "customer." *In re Brittenum & Assocs., Inc.*, 82 B.R. 64, 68 (Bankr. E.D. Ark. 1987). SIPA intended for creditors to recover from the general estate in the event the issuer became insolvent (like any other CD purchaser)—not to receive preferential treatment. *See SIPC v. Exec. Sec. Corp.*, 556 F.2d 98, 99 (2d Cir. 1977) (per curiam); *see also* 9 C.J.S. *Banks & Banking* §309.[16]

At bottom, SIPA cannot function as Congress intended if the scope of its obligations to "customers" of "members" is uncertain and subject to alteration by the ex-post misapplication of equitable doctrines. Whether there are customers must be decided at the time of insolvency, taking corporate formalities as they existed. *See Packer, Wilbur & Co.,* 498 F.2d at 983 (courts "cannot simply rely on … the existence of some equities in its favor; its task is to demonstrate that its transaction … comes within [SIPA's] protection"); *In re Carolina First Sec. Grp., Inc.*, 173 B.R. 884, 889 n.7 (Bankr. M.D.N.C. 1994) ("Relief under the SIPA is predicated on a specific transaction, not the prior relationship between the parties

[16] The SEC claims this exception is inapplicable where "claimants did not intend to loan money to the broker-dealer." SEC Br. 49 n.20. But SIBL investors *would have intended* to loan money to the broker-dealer if SGC and SIBL were consolidated, because those investors intended to loan money to SIBL. And SIPA's language expressly states that the exception applies whether "by contract, agreement, or understanding, *or* by operation of law." 15 U.S.C. §78*lll*(2)(C)(ii).

involved."). Courts disregard corporate forms only in the rarest circumstances. *See Pardo v. Wilson Line of Wash., Inc.*, 414 F.2d 1145, 1149-50 (D.C. Cir. 1969). Doing so here would undermine the proper functioning of SIPC as well as the structure and purpose of SIPA itself.

CONCLUSION

For the foregoing reasons, this Court should affirm the district court's order dismissing the SEC's Application.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitations of FRAP 32(a)(7)(B) because:

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STATUTORY ADDENDUM

15 U.S.C. §78bbb

Application of Securities Exchange Act of 1934

Except as otherwise provided in this chapter, the provisions of the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq.] (hereinafter referred to as the "1934 Act") apply as if this chapter constituted an amendment to, and was included as a section of, such Act.

15 U.S.C. §78eee

Protection of Customers

(a) Determination of Need of Protection

(1) Notice to SIPC

If the Commission or any self-regulatory organization is aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty, it shall immediately notify SIPC, and, if such notification is by a self-regulatory organization, the Commission.

15 U.S.C. §78fff

General provisions of a liquidation proceeding

(a) Purposes

The purposes of a liquidation proceeding under this chapter shall be—

(1) as promptly as possible after the appointment of a trustee in such liquidation proceeding, and in accordance with the provisions of this chapter—

(A) to deliver customer name securities to or on behalf of the customers of the debtor entitled thereto as provided in section 78fff–2 (c)(2) of this title; and

(B) to distribute customer property and (in advance thereof or concurrently therewith) otherwise satisfy net equity claims of customers to the extent provided in this section;

(2) to sell or transfer offices and other productive units of the business of the debtor;

(3) to enforce rights of subrogation as provided in this chapter; and

(4) to liquidate the business of the debtor.

(b) Application of title 11

To the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of title 11. For the purposes of applying such title in carrying out this section, a reference in such title to the date of the filing of the petition shall be deemed to be a reference to the filing date under this chapter.

(c) Determination of customer status

In a liquidation proceeding under this chapter, whenever a person has acted with respect to cash or securities with the debtor after the filing date and in a manner which would have given him the status of a customer with respect to such cash or securities had the action occurred prior to the filing date, and the trustee is satisfied that such action was taken by the customer in good faith and prior to the appointment of the trustee, the date on which such action was taken shall be deemed to be the filing date for purposes of determining the net equity of such customer with respect to such cash or securities.

(d) Apportionment

In a liquidation proceeding under this chapter, any cash or securities remaining after the liquidation of a lien or pledge made by a debtor shall be apportioned between his general estate and customer property in the proportion in which the general property of the debtor and the cash and securities of the customers of such debtor contributed to such lien or pledge. Securities apportioned to the general estate under this subsection shall be subject to the provisions of section 78lll (5)(A) of this title.

(e) Costs and expenses of administration

All costs and expenses of administration of the estate of the debtor and of the liquidation proceeding shall be borne by the general estate of the debtor to the extent it is sufficient therefor, and the priorities of distribution from the general estate shall be as provided in section 726 of title 11. Costs and expenses of administration shall include payments pursuant to section 78fff–2 (e) of this title and section 78fff–3 (c)(1) of this title (to the extent such payments recovered securities which were apportioned to the general estate pursuant to subsection (d) of this section) and costs and expenses of SIPC employees utilized by the trustee pursuant to section 78fff–1 (a)(2) of this title. All funds advanced by SIPC to a trustee for such costs and expenses of administration shall be recouped from the general estate under section 507 (a)(2) of title 11.

15 U.S.C. §78ggg

(b) Enforcement of actions

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. §78*lll*(2)

Definitions

For purposes of this chapter, including the application of the Bankruptcy Act to a liquidation proceeding:

* * *

(2) Customer

(A) In general

The term "customer" of a debtor means any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral, security, or for purposes of effecting transfer.

(B) Included persons

The term "customer" includes--

(i) any person who has deposited cash with the debtor for the purpose of purchasing securities;

(ii) any person who has a claim against the debtor for cash, securities, futures contracts, or options on futures contracts received, acquired, or held in a portfolio margining account carried as a securities account pursuant to a portfolio margining program approved by the Commission; and

(iii) any person who has a claim against the debtor arising out of sales or conversions of such securities.

(C) Excluded persons

The term "customer" does not include any person, to the extent that--

(i) the claim of such person arises out of transactions with a foreign subsidiary of a member of SIPC; or

(ii) such person has a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor, or is subordinated to the claims of any or all creditors of the debtor, notwithstanding that some ground exists for declaring such contract, agreement, or understanding void or voidable in a suit between the claimant and the debtor.

15 U.S.C. §78u(e)

Mandamus

Upon application of the Commission the district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this chapter, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm, the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, (2) any national securities exchange or registered securities association to enforce compliance by its members and persons associated with its members with the provisions of this chapter, the rules, regulations, and orders thereunder, and the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.

CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of April, 2013, I served the foregoing brief as follows:

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