ORAL ARGUMENT NOT YET SCHEDULED

No. 12-5286

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, Hon. Robert L. Wilkins

BRIEF OF FORMER SEC OFFICIALS AND PROFESSORS OF LAW AS AMICI CURIAE IN SUPPORT OF APPELLEE AND AFFIRMANCE

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April 19, 2013

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Parties and Amici

Except for the amici curiae listed below, all parties, intervenors, and amici appearing before the District Court and this Court are listed in the briefs for Appellant and Appellee:

Former SEC Officials and Professors of Law

Financial Services Institute, Inc.

Securities Industry and Financial Markets Association

Rulings Under Review

Reference to the ruling under review appears in the briefs for Appellant and Appellee.

Related Cases

Reference to the related case in this Court appears in the briefs for Appellant and Appellee.

Statutes and Regulations

All applicable statutes and regulations are set forth in the Addenda to the briefs for Appellant and Appellee.

D.C. CIRCUIT 29(d) STATEMENT

Amici curiae Former SEC Officials and Professors of Law—including the Honorable Joseph A. Grundfest and the Honorable Paul S. Atkins, former Commissioners of the SEC; the Honorable Simon M. Lorne, former General Counsel of the SEC; and Professors William J. Carney and Kenneth E. Scott—are filing a separate brief in support of Appellees and affirmance from the Financial Services Institute, Inc. (FSI) and the Securities Industry and Financial Markets Association (SIFMA).

Amici are former SEC regulators and highly regarded legal scholars in the field of securities law and regulation (among many other subjects). This brief thus presents the Court with a perspective gleaned from decades of experience as securities regulators and scholars. FSI and SIFMA, by contrast, are both associations of *regulated* entities that may be either subject to the Securities Investor Protection Act of 1970 (SIPA), regulated by the SEC, or both: FSI is an independent association of financial advisors and broker-dealers, and SIFMA is an association of hundreds of securities firms, banks, and asset managers. Counsel for Amici understands that the separate briefs of FSI and SIFMA will principally address issues of concern to their members as entities subject to SIPA and regulated by the SEC.

Counsel for Amici certifies that this separate brief amici curiae is necessary to permit them, as former securities regulators and current academics, to provide the Court with a historical and contextual perspective on securities regulation.

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GLOSSARY

CD	Certificate of Deposit
FSI	Financial Services Institute, Inc.
SEC	Securities and Exchange Commission
SGC	Stanford Group Company
SIBL	Stanford International Bank Ltd.
SIFMA	Securities Industry and Financial Markets Association
SIPA	Securities Investor Protection Act of 1970
SIPC	Securities Investor Protection Corporation

INTEREST OF AMICI CURIAE

Amici curiae are two former Commissioners of the SEC, a former General Counsel of the SEC, as well as two highly regarded law professors with expertise in securities law and regulation, capital markets, corporate governance, and corporate finance. Amici have devoted much of their careers to securities law and regulation—including the drafting, implementation, and interpretation of federal securities laws—with a view toward promoting efficient and competitive capital markets while protecting investors. Amici thus provide the Court with a historical and contextual perspective on securities regulation and investor protection, gleaned from decades of experience as regulators and academics, which the Court may consider in deciding the novel question regarding the interpretation of the Securities Investor Protection Act of 1970 (SIPA) presented in this case.

Amici have no personal interest, whether financial or professional, in the outcome of this case and represent no party either directly or indirectly. This brief is submitted solely as a friend of the court and addresses whether the District Court correctly rejected Appellant's claim that investors who purchased and received certificates of deposit from a foreign bank should be "deemed" customers of a registered broker-dealer under SIPA. In light of the experience and expertise of the amici, this brief reflects their consensus view that this Court should affirm the

District Court's judgment.[1] Each individual amicus, however, may not endorse every argument presented in this brief.

The amici joining this brief are listed below:

The Honorable Joseph A. Grundfest served as a Commissioner of the SEC from 1985 to 1990. He is currently the W. A. Franke Professor of Law and Business at Stanford Law School. Professor Grundfest is a nationally prominent expert on securities litigation and regulation, capital markets, and corporate governance.

The Honorable Paul S. Atkins served as a Commissioner of the SEC from 2002 to 2008, during which he advocated better transparency and consistency in the SEC's decisionmaking and enforcement activities, as well as smarter regulation that considers costs and benefits. Mr. Atkins is currently the Chief Executive Officer of Patomak Global Partners, LLC (a specialized consulting firm), and is an independent director and non-executive Chairman of the Board of BATS Global Markets, Inc. (a leading operator of securities markets in the United States and Europe).

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[1] Counsel for Appellant the Securities and Exchange Commission and Counsel for Appellee the Securities Investor Protection Corporation consent to the filing of this brief. *See* Fed. R. App. P. 29(a); D.C. Cir. R. 29(b).

No party's counsel authored this brief in whole or in part, and no person—other than amici curiae or their counsel—contributed money that was intended to fund preparing or submitting this brief. *See* Fed. R. App. P. 29(c)(5).

The Honorable Simon M. Lorne served as the General Counsel of the SEC from 1993 to 1996. He is currently the Vice Chairman and Chief Legal Officer of Millennium Management LLC (a global investment firm), a Co-Director of Stanford Law School's Directors' College, and an adjunct professor at New York University School of Law.

Professor William J. Carney is the Charles Howard Candler Professor Emeritus of Law at Emory Law School. He has expertise in the fields of business associations, securities regulation, and corporate law and is the author of two leading casebooks, *Corporate Finance* and *Mergers and Acquisitions*, as well as several other books and more than 50 articles and book chapters.

Professor Kenneth E. Scott is the Ralph M. Parsons Professor of Law and Business Emeritus at Stanford Law School and a senior research fellow at the Hoover Institution. He has expertise in banking and financial institutions and securities regulation and is a leading scholar in the fields of corporate finance reform and corporate governance. Professor Scott has written extensively on federal deposit insurance issues and federal banking regulation.

SUMMARY OF ARGUMENT

The Securities and Exchange Commission seeks to force the Securities Investor Protection Corporation (SIPC) to initiate a liquidation of Stanford Group Company (SGC), a SIPC-member broker-dealer, for the benefit of investors who

purchased and received certificates of deposit (CDs) from Stanford International Bank Ltd. (SIBL), an Antiguan bank. *See SEC v. SIPC*, 872 F. Supp. 2d 1, 2-3 (D.D.C. 2012). The investors lent money to the offshore bank, which is a foreign institution that is not a member of SIPC and was not subject to regulation under United States law. Yet the SEC contends that the investors should be "deemed" to be "customers" of the domestic broker-dealer under SIPA.

The SEC's efforts to so dramatically expand the scope of persons covered through SIPC should be rejected for at least three distinct reasons. First, the SEC's proposal to "deem" purchasers of CDs issued by a foreign bank to be "customers" of a domestic broker-dealer contravenes the plain language of the statute, conflicts with the relevant statutory history, and is at odds with more than 40 years of judicial precedent.

Second, the SEC's unwarranted expansion of the definition of the term "customer" would substantially increase the financial exposure of the SIPC Fund. Yet the SEC has presented no economic analysis considering the financial implications of this expanded coverage for (1) the industry that must pay fees in order to support the SIPC Fund; (2) the United States Treasury, which is statutorily required to provide a line of credit to help support the SIPC Fund (which line of credit is more likely to be drawn down if the scope of coverage is expanded as the SEC requests); and (3) the federal taxpayers who might be called upon to bear

some of these potential losses. The SEC's proposed expansion of SIPC protection, absent even the most rudimentary consideration of any financial consequences, would radically transform SIPA and threaten SIPC's ability to function as Congress intended.

Third, the SEC's proposed redefinition of the term "customer" does not warrant *Chevron* deference. Where a statute is administered by more than one entity, no single entity can claim *Chevron* deference. Here, the relevant statute is also administered by SIPC, a body governed by a seven-member board composed of presidential and executive branch appointees. SIPC's views are diametrically opposed to the SEC's and, given the facts and circumstances of these proceedings, should be accorded more deference.

Therefore, Amici respectfully submit that the Court should reject the SEC's unprecedented interpretation of the term "customer" and affirm the District Court's judgment.

ARGUMENT

I. SIPC HAS NO AUTHORITY TO PROVIDE FINANCIAL RELIEF TO INVESTORS WHO DEPOSITED FUNDS WITH AND RECEIVED CDS FROM A FOREIGN BANK NOT SUBJECT TO SIPA

As SIPA's plain language makes clear, to be eligible for SIPC's protection, an investor must first qualify as a "customer" of a SIPC-member broker-dealer. 15 U.S.C. § 78eee; *see In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 236 (2d

Cir. 2011) (if claimants "are not 'customers,' 15 U.S.C. § 78*lll*(2)(A), they are not entitled to the protection of SIPA at all"). The District Court correctly rejected the SEC's argument that SIPC was obligated to liquidate SGC for the protection of investors who purchased and received SIBL CDs because those investors were not "customers" of SGC. There is no statutory or legal basis for the SEC's novel theory that SIPC's obligations apply wherever a customer may be "deemed" to be a customer (even though not, in fact, actually a customer).

A. The Origins And Context Of SIPA Establish That It Does Not Protect All Investors

"Customer," as defined by SIPA, is a term of art, narrowly crafted by Congress in response to a crisis in the late 1960s in which "customers" of failed broker-dealers "found their cash and securities on deposit either dissipated or tied up in lengthy bankruptcy proceedings." *SIPC v. Barbour*, 421 U.S. 412, 415 (1975). The circumstances of that crisis and the contemporaneous history of SIPA's enactment in the early 1970s are instructive in understanding the context in which Congress established an investor-protection scheme that was limited to "customers."

The period of 1967 to 1970 "was one of crisis for the securities industry and for the investing public." H.R. Rep. No. 92-1519, at 3 (1972). The crisis had two phases: first, a back-office crisis, during which "the so-called paperwork problem was predominant"; and second, "a period of financial distress during which many

firms reached the brink of disaster and many, in fact, failed, causing financial hardship for the public investors whom they served." *Id.*; *see* Seligman, *The Transformation of Wall Street* 450-452 (3d ed. 2003).

From 1967 to 1969, "'brokerage firms [found] themselves in the paradox of being forced out of business by having too much business.'" Seligman, *supra*, at 451 (alteration in original). The securities industry had experienced "a period of great expansion in the 1960s," *Barbour*, 421 U.S. at 415, but brokerage firms had failed to upgrade their back-office infrastructures, *see* H.R. Rep. No. 92-1519, at 4-6. Firms "concentrated on exploiting demand … by expanding their sales forces," but "were slow to automate their back office procedures and continued to rely on outdated methods." Joo, *Who Watches the Watchers?*, 72 S. Cal. L. Rev. 1071, 1076 (1999); *see* Don & Wang, *Stockbroker Liquidations Under the Securities Investor Protection Act and Their Impact on Securities Transfers*, 12 Cardozo L. Rev. 509, 510-511 (1990). "Thus, firms accepted more and more trade orders while failing to upgrade their 'back offices'—the personnel and facilities for trade processing and record-keeping." Joo, 72 S. Cal. L. Rev., at 1076-1077.

Broker-dealers were "responsible for safeguarding billions of dollars in cash and securities which belong to investors." H.R. Rep. No. 91-1613, at 2 (1970). But the outdated and understaffed back offices were quickly overwhelmed: "'Stock certificates and related documents were piled "halfway to the ceiling" in

some offices; clerical personnel were working overtime, six and seven days a week, with some firms using a second or even a third shift to process each day's transactions.'" Seligman, *supra*, at 451. "[W]orking conditions deteriorated," H.R. Rep. No. 92-1519, at 4, "[e]rrors were rampant and chaos ensued as a result of the failure of record-keeping procedures," Joo, 72 S. Cal. L. Rev., at 1077.

Broker-dealers commonly lost securities or otherwise failed to complete trades and deliver funds or securities. *See* S. Rep. No. 91-1218, at 3 (1970); H.R. Rep. No. 92-1519, at 5-6. In 1969, there were 12,494 customer complaints to the SEC, 90% of which described back-office problems, "'particularly the failure to deliver customer funds and securities' in a timely manner." Seligman, *supra*, at 451. And instances of malfeasance, such as the theft of securities from broker-dealers, multiplied. *See* S. Rep. No. 91-1218, at 3. In short, there was an "industrywide loss of control of recordkeeping procedures," Seligman, *supra*, at 451, and an ensuing loss or theft of customer funds and securities, Don & Wang, 12 Cardozo L. Rev., at 511.

Beginning in 1969 and continuing into 1970, just as brokerage firms were slowly beginning to update their methods of tracking and processing trades, "the securities industry experienced a business contraction that led to the failure or instability of a significant number of brokerage firms." *Barbour*, 421 U.S. at 415; *see* S. Rep. No. 91-1218, at 3. "The securities industry's prolonged unprofitability,

coupled with the financial losses created by the … back-office operations breakdown, set in motion the greatest rash of broker-dealer firm failures in Wall Street's history." Seligman, *supra*, at 452; *see* H.R. Rep. No. 92-1519, at 1. Congress responded by enacting SIPA, an act with the stated aim of "provid[ing] greater protection for customers of registered brokers and dealers and members of national securities exchanges." Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 84 Stat. 1636 (codified at 15 U.S.C. §§ 76aaa *et seq.*).

"SIPA was not designed to provide full protection to all victims of a brokerage collapse." *SEC v. Packer, Wilbur & Co.*, 498 F.2d 978, 983 (2d Cir. 1974). In enacting SIPA, Congress responded to the precise crisis confronting it: "Customers 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. SIPA's purpose is therefore carefully delineated and limited to protecting only "customers of failing broker-dealers with whom they had left cash or securities on deposit." *Id.* at 413; *see In re Bernard L. Madoff Inv. Sec. LLC*, 708 F.3d 422, 426 (2d Cir. 2013); *see also* 1-12 *Collier on Bankruptcy* ¶ 12.01, at 12-4 (16th ed. 2012) (SIPA protects "against losses stemming from the failure of an insolvent or otherwise failed broker-dealer to properly perform its role as the custodian of customer cash and securities.").

As its central feature, SIPA created "a new form of liquidation proceeding, applicable only to member firms, designed to accomplish the completion of open transactions and the speedy return of most customer property." *Barbour*, 421 U.S. at 416. The Act contemplates the distribution of "customer name securities" and "customer property" "as promptly as possible." 15 U.S.C. § 78fff(a). Unlike "the stockbroker liquidation provisions of the Bankruptcy Code, which require that customer securities be reduced to cash, to the greatest extent practicable, SIPA requires the satisfaction of customer claims for securities through the distribution of securities." 1-12 *Collier on Bankruptcy* ¶ 12.02, at 12-7.

Congress created SIPC as a nonprofit, private membership corporation to which most registered broker-dealers are required to belong, for the purpose of "administer[ing] SIPA through statutory assessments of SIPC members." S. Rep. No. 95-763, at 1 (1978); *see Barbour*, 412 U.S. at 415-416. And Congress established the "SIPC Fund," 15 U.S.C. § 78ddd(a)(1), "a substantial reserve fund in order to provide financial protection to the customers of SIPC-member broker-dealers," 1-12 *Collier on Bankruptcy* ¶ 12.03[2], at 12-15.

Through the SIPC Fund, every customer of a SIPC-member is protected up to $500,000 against the loss of securities (including up to $250,000 for cash) deposited with the broker-dealer for that customer's account. 15 U.S.C. § 78fff-3(a), (d). If the SIPC Fund becomes inadequate for the purposes of SIPA, SIPC

may borrow, through the SEC and against the United States Treasury, up to $2.5 billion. *Id.* § 78ddd(h). Since its creation in 1970, however, "SIPC has never drawn on that line of credit." *The Securities Investor Protection Corporation: Past, Present, and Future: Hearing Before Subcomm. on Capital Markets & Government Sponsored Enterprises of the H. Comm. on Financial Services*, 112th Cong. 12 (2012) (statement of Sharon Y. Bowen, Acting Chair of SIPC).

B. SIPA Authorizes SIPC To Protect Only "Customers" Against The Loss Of Money Or Securities In The Custody Of Failing Or Insolvent Broker-Dealers

"'Customer' … is a statutorily defined term of art as used in SIPA." *In re Stalvey & Assocs., Inc.*, 750 F.2d 464, 468 (5th Cir. 1985) (Wisdom, J.). "It is not used in the colloquial sense of 'one who buys and trades,'" but rather is "meant as a shorthand designation for those eligible under SIPA to receive special protection for their investments." *Id.* Specifically, the Act defines a "customer" of a SIPC-member broker-dealer to mean:

> any person … 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.

15 U.S.C. § 78*lll*(2)(A). This definition is further refined to include, as relevant here, "any person who has deposited cash with the debtor for the purpose of purchasing securities." *Id.* § 78*lll*(2)(B)(i); *see SIPC*, 872 F. Supp. 2d at 7 (SEC

stipulated that it relies only on "investors' deposit of funds for the purchase of SIBL CDs" in support of its claim that such investors qualify as "customers" under SIPA).

"'[J]udicial interpretations of "customer" status support a narrow interpretation of SIPA's provisions.'" *In re Bernard L. Madoff Inv. Sec. LLC*, 708 F.3d at 426 (quoting *In re New Times Sec. Servs., Inc.*, 463 F.3d 125, 127 (2d Cir. 2006)). The "'critical aspect of the "customer" definition'" is "'the entrustment of cash or securities to the broker-dealer for the purposes of trading securities.'" *Id.* (quoting *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 236 (2d Cir. 2011)); *In re Brentwood Sec., Inc.*, 925 F.2d 325, 327 (9th Cir. 1991) ("An investor is entitled to compensation from the SIPC only if he has entrusted cash or securities to a broker-dealer who becomes insolvent[.]"). As the Supreme Court recognized long ago, SIPA "provid[es] financial relief to the customers of failing broker-dealers *with whom they had left cash or securities on deposit*." *Barbour*, 421 U.S. at 414 (emphasis added).[2]

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[2] *See also* Loss et al., VII *Securities Regulation* 254 (4th ed. 2006) ("[C]ustomer" under SIPA "consistently has been construed to include persons who entrust either cash or securities to a broker-dealer for securities trading, but does not include persons who lend cash or securities to broker-dealers for other purposes"); 1-12 *Collier on Bankruptcy* ¶ 12.12[2], at 12-50 ("Under the 'bright-line rule' applied by courts, a claimant will not be entitled to customer protection under SIPA unless the debtor actually receives the claimant's cash or securities; the debtor must actually have come into possession or control.").

Customer status under SIPA is determined as of the statutorily defined "filing date," which is usually the date on which SIPC files its application to place a failing or failed broker-dealer into liquidation, but is sometimes even earlier, relating back to the date of a receiver's appointment. *See* 15 U.S.C. § 78*lll*(7); *see also In re New Times Sec. Servs.*, 463 F.3d at 128-129; *SIPC v. Vigman*, 803 F.2d 1513, 1517 n.1 (9th Cir. 1986). The investors in SIBL's CDs had no cash or securities on deposit *with SGC*—the only SIPC-member broker-dealer at issue in this case—at the time SGC failed. *See SIPC*, 872 F. Supp. 2d at 7. Accordingly, the SEC does not seek the return of any cash on deposit with SGC for the purpose of purchasing SIBL CDs because there is none—it is undisputed that the investors in SIBL CDs had purchased and received those CDs at the time SGC failed. *See id.*[3] Instead, the SEC essentially seeks to force SIPC to generate rescission damages for CDs already purchased and received. *See Koenig v. Smith*, 88 F.R.D. 604, 608 (E.D.N.Y. 1980) (rescission damages remedy "'the evil … of being induced to buy'"). But SIPC has no such authority. *See Vigman*, 803 F.2d at 1517 n.1 ("[I]f a broker used fraudulent means to convince a customer to purchase a stock and the customer left that stock with the broker, who subsequently became

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[3] As the SEC has stipulated in this litigation: "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." *SIPC*, 872 F. Supp. 2d at 7.

insolvent, SIPC would be required by SIPA only to return the stock to the customer.”).

C. The SEC’s Substantive-Consolidation Theory Cannot Transform SIBL Investors Into SGC “Customers”

Because SIBL investors had no funds on deposit with SGC for the purchase of securities at the time SGC failed, the SEC argues that such investors should be “*deemed* to have deposited funds” with SGC. Br. 44 (emphasis added). Relying on the bankruptcy doctrine of substantive consolidation, the SEC asserts that SGC and SIBL “were operated in a highly interconnected manner and corporate formalities were not respected,” *id.* at 46, such that a deposit of funds with SIBL should become an “effective[] deposit[]” with SGC, *id.* at 45, thereby rendering such investors “customers” of SGC under SIPA. The SEC’s argument is without statutory merit, for several reasons.

First, the SEC ignores the issue of timing. The rule is not “[o]nce a customer, always a customer.” *In re Stalvey & Assocs., Inc.*, 750 F.2d at 470. As discussed above, *see supra* p. 13, customer status under SIPA is determined as of the “filing date,” usually the date on which SIPC files its application to place a failing or failed broker-dealer into liquidation. *See* 15 U.S.C. § 78*lll*(7). Even if consolidation were appropriate, the question for purposes of determining customer status is whether a SIBL investor could be deemed to have “deposited cash with the” consolidated-debtor entity “for the purpose of purchasing securities,” *id.*

§ 78*lll*(2)(B)(i), *at the time SGC failed*, *id.* § 78*lll*(7). The answer is no: Neither SGC nor SIBL held any investors' funds on deposit for the purchase of securities at the time SGC failed. On the contrary, the SEC has stipulated that SIBL investors purchased and received their CDs. *See SIPC*, 872 F. Supp. 2d at 7.

Second, SIPA expressly excludes from its definition of "customer" any person 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 consolidated, funds given to that consolidated entity by SIBL investors for CDs would become part of its capital, such that those investors would be expressly precluded from qualifying as customers by statute. *Cf. In re Brittenum & Assocs., Inc.*, 82 B.R. 64, 68 (Bankr. E.D. Ark. 1987) (those who invest "*in* the debtor"—rather than "*through* the debtor"—are not entitled to SIPA protection).

Third, on its own terms substantive consolidation is unwarranted here. It is established that substantive consolidation, through veil-piercing, should be "'used sparingly.'" *In re Cont'l Vending Mach. Corp.*, 517 F.2d 997, 1001 (2d Cir. 1975); *Pardo v. Wilson Line of Wash., Inc.*, 414 F.2d 1145, 1149 (D.C. Cir. 1969) ("Piercing a corporate veil is a task which a court undertakes reluctantly[.]"); 1-12 *Collier on Bankruptcy* ¶ 12.02, at 12-7 n.11 ("There is nearly unanimous consensus among Courts of Appeal that substantive consolidation is a remedy to be used

sparingly." (quotations omitted)). "The power to consolidate is one arising out of equity, enabling a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of *debts of a related corporation*." *In re Cont'l Vending Mach. Corp.*, 517 F.2d at 1000 (emphasis added). Here, however, the SEC is inappropriately attempting to use this equitable doctrine to expand the scope of a statutory term and impose new liabilities on SIPC—an unrelated third party. *Cf. Liberty Prop. Trust v. Republic Props. Corp.*, 577 F.3d 335, 340 (D.C. Cir. 2009) (veil piercing is a "'step to be taken cautiously'" and is not typically used to resolve questions of statutory interpretation (quoting *Quinn v. Butz*, 510 F.2d 743, 759 (D.C. Cir. 1975))).

D. Neither *Primelime* Nor *Old Naples* Provides A Basis To Conclude That SIBL Investors Are "Customers" Under SIPA

The SEC contends that even if this Court were to reject its substantive-consolidation argument, it could still conclude that the SIBL investors qualify as "customers" of SGC under the agency-theory rationale set forth in *In re Primeline Securities Corp.*, 295 F.3d 1100 (10th Cir. 2002), and *In re Old Naples Securities, Inc.*, 223 F.3d 1296 (11th Cir. 2000). Neither case supports the SEC's position.

As the Second Circuit recently described, in both *Primeline* and *Old Naples*, "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 the funds." *In re Bernard L. Madoff Inv. Sec. LLC*, 708 F.3d at 428. The courts in *Primeline* and *Old Naples* "concluded that the claimants were 'customers' of the broker-debtor because, in each case, they intended to deposit their money with the broker-debtor; they followed the agent's instructions for doing so; and, at least in *Old Naples*, the broker-debtor ultimately acquired control over the claimants' funds." *Id.*

In contrast, the SEC's own analysis—set forth in the memorandum giving rise to this litigation—concluded that the "investors with accounts at SGC who purchased SIBL CDs *deposited funds with SIBL*" and "*clearly had the purpose of purchasing SIBL CDs*." Analysis of Securities Investor Protection Act Coverage for Stanford Group Company at 7, Dec. 12, 2011, ECF No. 1-3 (emphasis added). And the disclosure statements for the SIBL CDs expressly stated that those deposits were not covered by SIPC, *see* SIBL Disclosure Statement at 4, Feb. 16, 2012, ECF No. 23-6, and that SIBL was "solely responsible" for "all amounts due in respect of the CD Deposit," *id.* at 17.

Unlike in *Primeline* and *Old Naples*, the SIBL investors could not reasonably have thought that their funds were left on deposit with SGC, given that they had obtained SIBL CDs. *See In re Bernard L. Madoff Inv. Sec. LLC*, 708 F.3d at 428. Thus, the District Court correctly concluded that the SEC's argument "seeks to expand 'customer' status even beyond the circumstances that were

present in *Old Naples* and *Primeline*," and should be rejected. *SIPC*, 872 F. Supp. 2d at 11.

II. THE SEC'S INTERPRETATION OF "CUSTOMER" WOULD RADICALLY TRANSFORM SIPA'S SCOPE AND THREATEN SIPC'S ABILITY TO FUNCTION AS CONGRESS INTENDED

The SEC's novel interpretation of the term "customer" contradicts SIPA's text and conflicts with more than 40 years of precedent. That dooms the SEC's appeal. But there is yet another reason to reject the SEC's unprecedented expansion of SIPC protection: The SEC has not considered the economic ramifications of its newly discovered interpretation of SIPA. The record in this case reveals no indication that the SEC engaged in the rigorous economic analysis necessary to take such a momentous step in the nature of the SIPC Fund's duties. Yet even the most rudimentary economic analysis makes clear that the consequences of the SEC's position would be significant: The SEC's approach here would radically transform SIPA and threaten SIPC's ability to function as Congress intended. *Cf. Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (vacating SEC rule as arbitrary and capricious where it "failed once again … adequately to assess the economic effects of [its] new rule"); *American Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178-179 (D.C. Cir. 2010) ("[T]he SEC's analysis is incomplete because it fails to determine whether, under the existing regime, sufficient protections existed to enable investors to make informed

investment decisions and sellers to make suitable recommendations to investors."); *Chamber of Commerce v. SEC*, 412 F.3d 133, 136, 143 (D.C. Cir. 2005) (the SEC "violate[d] the APA by failing adequately to consider the costs … and by failing adequately to consider a proposed alternative").

Under the SEC's interpretation, SIPC would become another version of the Federal Deposit Insurance Corporation (FDIC), with SIPC obligated to provide blanket protection against investment fraud. *But see SIPC v. Morgan, Kennedy & Co.*, 533 F.2d 1314, 1318 (2d Cir. 1976) ("SIPA and the [Federal Deposit Insurance Act] are independent statutory schemes, enacted to serve the unique needs of the banking and securities industries, respectively."). The SEC's proposed rule would require SIPC to cover investments in banks (instead of transactions through brokers) that are not subject to SIPA, or even FDIC, oversight. *But see In re Bernard L. Madoff Inv. Sec. LLC.*, 654 F.3d at 236 ("SIPA does not—and cannot—protect an investor against all losses[.]"). The SEC's proposed rule has no limiting principle and would produce unreasonable consequences.[4]

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[4] *Cf. In re Aozora Bank Ltd.*, 480 B.R. 117, 126 (S.D.N.Y. 2012) ("Under appellants' reading, *any* investor who intentionally invests in a corporate entity that has a legal obligation to invest a significant portion of its assets with a third party would qualify as a 'customer' of the third party. Presumably, if this third-party entity were required to invest its funds with a fourth party and the claimants intended that such investments take place, the claimants would be 'customers' of this fourth party as well. Such a reading stretches the term customer 'wholly

Investment fraud in the United States totals around $40 billion a year. *See, e.g.*, FBI Financial Crimes Report to the Public, Fiscal Year 2006, *available at* http://www.fbi.gov/stats-services/publications/fcs_report2006. Market manipulation schemes alone generate an estimated $6 billion in losses a year. *See id.* These amounts *vastly* exceed SIPC's available resources: With a reserve fund under $2 billion, *see* 2011 SIPC Annual Report at 8, *available at* http://www.sipc.org/Portals/0/PDF/2011_Annual_Report.pdf, SIPC could not continue operations for long if its purpose was to compensate all victims with losses from investment fraud. Even if SIPC tapped its $2.5 billion line of credit, it could not provide the liquidity that would be necessary if SIPA were interpreted to make SIPC the insurer of every investor victimized by fraud who could be "deemed" to be a customer by virtue of the SEC's veil-piercing or agency theory.[5]

Moreover, SIPC cannot just increase the size of its Fund by fiat. SIPC's authority to impose assessments on its members is limited by statute. *See* 15 U.S.C. § 78ddd(c)(3) ("[N]o assessments shall be made … upon a member which require payments during any [12-month] period which exceed in the aggregate one per centum of such member's gross revenues from the securities business for such

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beyond its limits.' Clearly, the drafters of SIPA did not intend such an absurd result." (quoting *Morgan, Kennedy & Co.*, 533 F.2d at 1318)).

[5] SIPC's ability to obtain a loan would be of no help because it "ultimately would have to repay any such loan … , resulting in costs that would be ultimately borne by SIPC members." *SIPC*, 872 F. Supp. 2d at 5.

period[.]"); *see also Touche Ross & Co. v. Redington*, 442 U.S. 560, 565 n.5 (1979). And even if SIPC were to increase assessments to their statutory limit, under the SEC's proposed rule SIPC-member broker-dealers would be forced to subsidize and insure against the actions of nonmembers, who make no contributions to the Fund.

That still leaves the matter of liquidation costs. Those administrative costs—arising from, for example, processing of customer claims, often involving litigation; lawsuits filed by the trustee against third parties; transferring securities and cash to customers; and closing out open securities transactions—can be substantial, easily amounting to hundreds of millions of dollars. *See* SIPC Brief in Opposition to SEC's Application at 36, Feb. 16, 2012, ECF No. 23 (Lehman Brothers liquidation incurred $642 million in administrative fees over a three-year period; Madoff liquidation incurred costs of $102 million over a 21-month period, a fraction of what will eventually be spent). SIPA can recover such costs from the debtor's general estate, over the priority of general unsecured creditors, but such costs frequently exhaust those general estates. *See* Joo, 74 S. Cal. L. Rev., at 1118 (noting that SIPC Special Task Force concluded in 1997 that administrative expenses "frequently" exhaust general estates of debtors and preclude recovery by general creditors, and that "[t]his exhaustion appears to continue today").

"Unlike the FDIC, SIPC cannot rehabilitate an insolvent member firm, but must liquidate it." Joo, 72 S. Cal. L. Rev., at 1105-1106. Thus, "[o]nce the SEC or [a self-regulatory organization] inform[s] SIPC of a member's insolvency, SIPC's only discretion lies in initiating a SIPA liquidation or doing nothing." *Id.* at 1106; *see* 1-12 *Collier on Bankruptcy* ¶ 12.02, at 12-7 ("SIPA provides only for liquidation, not reorganization." (citing 15 U.S.C. § 78fff(b))). Adopting the SEC's definition of the term "customer" to include investors harmed by investment fraud would substantially increase the number of potential SIPA claims and liquidations, placing SIPC in the position of having to decide whether to initiate such liquidations—with the knowledge that it might not have the resources to cover the required administrative costs—or do nothing.

Finally, as a matter of international comity, there is a distinct possibility that SIPA liquidations involving foreign nonmember institutions could give rise to conflicts with the decisions of foreign courts. "American courts have consistently recognized the interests of foreign courts in liquidating or winding up the affairs of their own domestic business entities." *Cunard S.S. Co. v. Salen Reefer Servs. AB*, 773 F.2d 452, 458 (2d Cir. 1985); *cf. Canada S. Ry. Co. v. Gebhard*, 109 U.S. 527, 539 (1883) ("[T]he true spirit of international comity requires that [bankruptcy or liquidation] schemes … , legalized at home, should be recognized in other countries."). Accordingly, American courts "ordinarily decline to adjudicate

creditor claims that are the subject of a foreign bankruptcy proceeding." *JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V.*, 412 F.3d 418, 424 (2d Cir. 2005). The SEC's position here ignores this practice, seeking to treat a foreign bank and a domestic broker-dealer as one and the same. This would create unnecessary foreign tension and risk American court orders being held unenforceable by foreign courts.

III. THE SEC'S INTERPRETATION OF "CUSTOMER" IS NOT ENTITLED TO DEFERENCE

The SEC's interpretation of "customer" in SIPA is precluded by the unambiguous terms of the Act and four decades of precedent. But even if the term "customer" is susceptible of more than one interpretation—and, to be sure, it is not—the SEC's novel interpretation of the term is not entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984).

A. The SEC's Memorandum, Adopted In Anticipation Of Litigation, Deserves No Deference

To begin with, the SEC's most recent interpretation of a SIPA "customer" is not entitled to *Chevron* deference because the SEC did not have a "lawmaking pretense in mind" when it drafted its analysis memorandum. *United States v. Mead Corp.*, 533 U.S. 218, 233 (2001). The SEC's memorandum here did not emerge from any of the formal rulemaking procedures that typically merit *Chevron*

deference. It is not binding on third parties and was not undertaken in a notice-and-comment fashion. And, as discussed above, there is no indication that the SEC grappled with the economic consequences of its interpretation of SIPA, which would have come out had the SEC engaged in a rulemaking proceeding or pursued other more deliberate avenues to arrive at a reasoned decision on the issue. Rather, the memorandum was written to bolster the SEC's litigating position for this specific case. Courts, however, "do not … defer to post hoc interpretations contained in agency briefs." *Miller v. Clinton*, 687 F.3d 1332, 1340 (D.C. Cir. 2012); *see also Martin v. Occupational Safety & Health Rev. Comm'n*, 499 U.S. 144, 156 (1991) ("Our decisions indicate that agency 'litigating positions' are not entitled to deference when they are merely appellate counsel's 'post hoc rationalizations' for agency action, advanced for the first time in the reviewing court."); *Village of Barrington v. STB*, 636 F.3d 650, 660 (D.C. Cir. 2011) ("[W]e give no deference to agency 'litigating positions' raised for the first time on judicial review."); *Landmark Legal Found. v. IRS*, 267 F.3d 1132, 1135-1136 (D.C. Cir. 2001) (same); *Fogg v. Ashcroft*, 254 F.3d 103, 109 (D.C. Cir. 2001) (same); *St. Agnes Hosp. v. Sullivan*, 905 F.2d 1563, 1568 (D.C. Cir. 1990) (same).

Furthermore, deference is unwarranted where, as here, the SEC has had an oscillating interpretation of the term "customer." As recently as 2011, the SEC advanced a litigating position of "customer" that is, in fact, diametrically opposed

to the expansive interpretation it advances in this case. *See In re Aozora Bank Ltd.*, 480 B.R. 117 (S.D.N.Y. 2012). *Aozora* also involved a Ponzi scheme, deceived investors, and shuffling of funds. *Id.* at 121. Specifically, the SEC (along with SIPC) argued that the claimants whose funds were sent to a third party, and from there had those funds sent to a SIPC-member institution, were not actually "customers" under SIPA. *See id.* at 120-123. The court agreed with the SEC and SIPC that these defrauded investors were not "customers" of the SIPC-member broker-dealer, concluding that SIPA's definition of a "customer" is not "broad enough to cover customers of third party entities." *Id.* at 123. The SEC now takes the opposite position: that "customer" *should* be read broadly enough to cover customers of third-party entities.

These "gyrating agency" positions go against the very purpose of according agencies deference under *Chevron*—that is, that their experience with particular statutes will allow them to make wiser interpretations of the laws they administer. *Sepulveda v. Allen Family Foods, Inc.*, 591 F.3d 209, 216 n.3 (4th Cir. 2009); *see also Price v. Stevedoring Servs. of Am., Inc.*, 697 F.3d 820, 830-831 (9th Cir. 2012) (en banc) (according deference to agency litigating positions could "severely undermine the notice and predictability to regulated parties that formal rulemaking is meant to promote"). This is why "interpretations contained in policy statements, agency manuals and enforcement guidelines, all of which lack the force of law—

do not warrant *Chevron* style deference." *Christensen v. Harris Cnty.*, 529 U.S. 576, 587 (2000); *see also Public Citizen, Inc. v. HHS*, 332 F.3d 654, 660 (D.C. Cir. 2003).

In sum, the SEC's litigating position in this case was not the product of any formal deliberation, will not apply to third parties, and goes directly against the SEC's definition of a SIPA "customer" taken as recently as two years ago. The SEC's memorandum thus lacks all the normal bases upon which courts accord deference to agencies, and its litigating position is "beyond the *Chevron* pale." *Mead*, 533 U.S. at 234.

B. SIPC, Not The SEC, Has The Expertise To Interpret SIPA

If any deference is appropriate in this case, it should be accorded to SIPC, and not the SEC. SIPC was expressly created to "administer SIPA through statutory assessments of SIPC members." S. Rep. No. 95-763, at 1 (1978). To that end, SIPC initiates liquidations "designed to accomplish the completion of open transactions and the speedy return of most customer property" and "is required to establish and maintain a fund for customer protection[.]" *Barbour*, 412 U.S. at 416. SIPC is governed by a seven-member board composed of presidential and executive branch appointees. 15 U.S.C. § 78ccc(2). Although the SEC possesses potential managerial control over some (but not all) aspects of SIPC's operations, *see id.* § 78ggg(c), SIPC was endowed with the day-to-day operations of

administering SIPA liquidations and ensuring that customers of SIPC members are appropriately protected.

SIPC's extensive experience with SIPA militates in favor of according it the *Chevron*-style deference that has been given to analogous quasi-governmental entities before. *See, e.g.*, *Pension Benefit Guar. Corp. v. LTV Corp.*, 496 U.S. 633, 651-652 (1990) (recognizing that "practical agency expertise is one of the principle justifications behind *Chevron* deference"); *Texas Rural Legal Aid, Inc. v. Legal Servs. Corp.*, 940 F.2d 685, 689-690 (D.C. Cir. 1991) (according *Chevron* deference to the Legal Services Corporation, even though it is not a formal governmental agency); *see also Velazquez v. Legal Servs. Corp.*, 164 F.3d 757 (2d Cir. 1999) (same). In these cases, the crucial determination was whether "Congress intended that [the entity] be treated … like an agency of the government." *Texas Rural Legal Aid*, 940 F.2d at 690.

With the Legal Services Corporation, this Court was particularly impressed by "Congress's decision to create [the Legal Services Corporation] as an independent corporation." *Texas Rural Legal Aid*, 940 F.2d at 690. Although SIPC is not completely independent from political control, SIPA's plain text makes clear that Congress explicitly decided SIPC would "not be an agency or establishment of the United States Government," 15 U.S.C. § 78ccc(a)(1)(A),

making it more akin to an independent operation like the Legal Services Corporation. SIPC thus deserves similar consideration.

SIPC has initiated 324 liquidations over 43 years. Its expertise relates to the precise issue before the Court, and its interpretation of a SIPA "customer" is consistent with established precedent. Since SIPC's inception, the SEC's role in the statutory scheme has always involved "more removed oversight" than SIPC's day-to-day administration of SIPA liquidations. *In re New Times Sec. Servs. Inc.*, 371 F.3d 68, 82 (2d Cir. 2004) (noting "the SEC generally adopts a hands-off approach with respect to SIPC liquidations" and, "[a]s a result, the SEC's 'expertise' in this context is arguably less compelling"). As SIPC is the only entity in this case with a consistent record of administering SIPA, SIPC's interpretation should control.

At a minimum, Congress envisioned roles for both the SEC and SIPC in administering the statute. *See, e.g.*, 15 U.S.C. §78eee(a)(3) (granting SIPC, not the SEC, the discretion to file applications for a protective decree); *see also* 12 U.S.C. § 5385 (Supp. 2010) (granting SIPC specific powers to determine the terms of protective decrees in liquidations of covered brokers); Hazen, 5 *The Law of Securities Regulation* § 14.24, at 581 (6th ed. 2009). To the extent that both SIPC and the SEC have been authorized to interpret and implement SIPA, this is a case where *Chevron* deference is inappropriate. As this Court has repeatedly stated:

"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).[6] The SEC ignores this rule, claiming that its definition is "at least reasonable," and merits *Chevron* deference. Br. 54. Amici respectfully submit that this Court should not sway from its past precedents and should reject the SEC's overreach.

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[6] *See also Bowen v. American Hosp. Ass'n*, 476 U.S. 610, 643 n.30 (1986) (noting that where the Department of Health and Human Services was one of 27 agencies responsible for promulgating regulations forbidding discrimination, "there is ... not the same basis for deference predicated on expertise as we found [in *Chevron*]"); *Salleh v. Christopher*, 85 F.3d 689, 692 (D.C. Cir. 1996) ("Where, as here, the premise is in dispute because two executive branch entities (in this case a department and an independent adjudicatory body) claim conflicting administrative authority, it would be inappropriate to defer to either's statutory interpretation as to the issue of basic authority.").

CONCLUSION

For the foregoing reasons, the judgment of the District Court should be affirmed.

Respectfully submitted,

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/s/ Steven P. Lehotsky
STEVEN P. LEHOTSKY

April 19, 2013

CERTIFICATE OF SERVICE

I hereby certify that on this 19th day of April, 2013, I electronically filed the foregoing Brief of Former SEC Officials and Professors of Law as Amici Curiae in Support of Appellee and Affirmance using the Court's CM/ECF system. I certify that the following counsel for the parties or amici are registered as ECF users and that they will be served electronically by the CM/ECF system:

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