IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Securities and Exchange Commission, Plaintiff/Applicant, v. Securities Investor Protection Corporation, Defendant/Respondent.	)	Misc. No. 11-MC-678-RLW Oral Hearing Requested Under LCvR 7(f)

SECURITIES INVESTOR PROTECTION CORPORATION'S REPLY BRIEF IN SUPPORT OF ITS (1) MOTION TO STRIKE SECURITIES AND EXCHANGE COMMISSION'S *EX PARTE* MOTION FOR ORDER TO SHOW CAUSE, AND (2) MOTION FOR CASE MANAGEMENT CONFERENCE

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INTRODUCTION

The Securities and Exchange Commission's ("SEC" or "Commission") continued insistence that this unprecedented lawsuit should begin on a summary basis with a show-cause order is—with respect—astonishing. The SEC's entire approach to this case would turn the Securities Investor Protection Act ("SIPA") on its head—and then dispense with the Federal Rules of Civil Procedure to rubber-stamp the SEC's say-so with "no judicial review." That is decidedly not the law.

The overarching question presented is whether the Securities Investor Protection Corporation ("SIPC")—a congressionally-created non-profit body whose board includes five Senate-confirmed presidential appointees and representatives from Treasury and the Federal Reserve—has failed to "discharge its obligations" in concluding that SIPA does not authorize a liquidation under the facts of the Stanford fraud. 15 U.S.C. § 78ggg(b). Under the law, SIPC may commence a liquidation only if a "Member" has failed (or is in danger of failing) to meet its obligations to its "Customers," *id*. § 78eee(a)(3)—terms that have specific meanings under the statute (not just a rule) and that courts have emphasized to be narrow in scope. SIPC concluded ***two years ago*** that SIPA does not apply to the Stanford case, which is about offshore CDs that are not in the custody of a SIPC-Member brokerage firm, such that there are no "Customers" within the specialized meaning of what the statute does and does not protect.

The SEC expressed no disagreement with SIPC until June 2011, when a United States Senator announced a hold on two nominees to become SEC Commissioners while the SEC considered this issue—and the Commission abruptly flipped its position on SIPC and Stanford the next day.[1] The SEC then concluded that it disagreed with SIPC's determination—***but no***

[1] *Compare* June 14, 2011 Senator David Vitter Press Release, available at http://www.vitter.senate.gov/public/index.cfm?FuseAction=PressRoom.PressReleases&ContentRecord_id=8f2e

adjudication of the SEC's position has ever occurred. The factual underpinnings of the SEC's conclusory assertions have never been established, and there has been no adjudication of these critical and contested issues before any court. For a number of reasons, the SEC cannot now simply demand that an Article III court adopt the Commission's untested views, much less make it SIPC's burden to disprove the SEC's position without any factual record for this Court to assess.

First, the SEC is fundamentally wrong in arguing that a show-cause mechanism is necessary to commence a summary proceeding—because that begs the question whether this really is and should be a "summary proceeding" at all. The SEC rests on a claimed distinction between "applications" and "actions," but its own June 15, 2011 analysis authorizing this lawsuit used the two terms as if they were one in the same.[2] And although the SEC also relies heavily on an analogy to "subpoena enforcement" proceedings under the Exchange Act of 1934 and under Federal Rule of Civil Procedure 45, the issuance of a subpoena is meant to ***start*** a fact-finding process—not to ***avoid*** all discovery as the SEC seeks to do here. In the SEC's view, SIPC would bear the burden of disproving an alleged failure to discharge its obligations, but would be prohibited from taking any discovery to test the factual allegations behind the SEC's case.

And to be clear, that is all they are—allegations. The self-serving "facts" set forth in the SEC's papers simply bootstrap citations to other unproven allegations, assertions by the Stanford

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65df-802a-23ad-458d-e0eb0391d4ef&Region_id=&Issue_id= ("*Vitter to Block SEC Nominees Until Stanford Victims Get Answers*"), *with* June 15, 2011 Senator David Vitter Press Release, available at ttp://www.vitter.senate.gov/public/index.cfm?FuseAction=PressRoom.PressReleases&ContentRecord_id=94d9898a-e3f7-d209-fd93-8135fd77c2b8&Region_id=&Issue_id= ("*[SEC] Ruling on SIPC coverage comes day after Vitter blocked SEC nominations*.").

[2] *Compare* June 15, 2011 Analysis memo enclosed with Letter from E. Murphy of the SEC to O. Johnson of SIPC (the "June 15, 2011 Analysis") (Ex. 2 to Dec. 12, 2011 Decl. of Matthew Martens ("Martens Decl.")) at 1 ("the Commission has authorized its Division of Enforcement to bring ***an action*** in district court"), with *id*. at 14 ("the Commission has authorized its staff to file in district court ***an application***") (emphases added).

Victim's Coalition and other special interest groups, or a report issued by the SEC's own Receiver (not an Article III court). (*See* Dec. 12, 2011 SEC's Mem. of P&A in Supp. of Appl. ("SEC Mem.") at 6-7.) That is not sufficient for this Court to compel the relief that the SEC seeks—especially when a liquidation would force SIPC to litigate over one billion dollars in unauthorized claims and jeopardize the SIPC Fund's availability in cases that are covered by the statute, for "Customer" property in the custody of SIPC "Members" like Lehman Brothers, Madoff and MF Global.

Second, deciding whether this case should begin with a show-cause procedure is not simply about "how the [SEC's] Application should be served and the date by which SIPC must respond." (Dec. 19, 2011 SEC Opp'n Br. ("SEC Opp'n") at 4.) The SEC's demand for a show-cause procedure instead represents an effort to stack the deck to its benefit, by creating a presumption in favor of liquidation proceedings and by requiring SIPC to bear the burden of showing why a liquidation should not begin. The problem for the SEC, however, is that its approach to SIPA is exactly backwards. The statute vests SIPC (not the SEC) with the discretion to determine whether a liquidation is warranted and requires the SEC (not SIPC) to go to court if it disagrees. *See* 15 U.S.C. § 78eee(a)(3)(A) ("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." (emphasis added)). And while the statute authorizes a three-day timetable when SIPC starts a liquidation of a SIPC "Member" brokerage, it (unsurprisingly) does not authorize a rush-to-judgment for unprecedented disputes between SIPC and the SEC.

Third, these are questions for now, not later as the SEC wrongly contends. After all, determining how this unprecedented case should unfold going forward—including whether the

SEC can refuse any discovery because "the regular rules" do not apply—logically should be addressed at the outset, despite the SEC's desire to defer those issues in the hope of pushing its "application" through. The SEC does not identify any cases that support wholesale abandonment of the Federal Rules of Civil Procedure, nor can it defend that remarkable proposition when Federal Rules of Civil Procedure 1, 2 and 3 say that the rules apply to "*all civil actions*" and that cases should start with a Complaint. Indeed, if the SEC's case were as clear-cut as its papers try to suggest, then:

- why not withdraw its effort to start on an *ex parte* basis;
- why not start with a Complaint and a Rule 16 Conference as lawsuits ordinarily do;
- why still insist that the "regular rules of civil procedure do not apply";
- why still insist that there can be "no judicial review"; and
- why file a 36-page brief for an "Application" that it claims to be beyond any dispute?

At bottom, the approach the SEC suggests is based on the erroneous premise that the only function of the Court under 15 U.S.C. § 78ggg(b) is to enforce whatever the SEC demands. There is no basis whatsoever for that dictatorial approach—and it is irreconcilable with how civil litigation works in U.S. federal courts.

For these reasons and as explained further below, SIPC respectfully submits that the SEC's motion for a show-cause procedure should be stricken or simply denied, and that the SEC should begin this case by filing a Complaint.[3]

[3] For the avoidance of doubt for purposes of docketing, SIPC opposes the SEC's Ex Parte Motion for Order to Show Cause, and incorporates the grounds stated in SIPC's December 13, 2011 Motion to Strike, its opening memorandum, and this reply brief.

ARGUMENT

I. This Is Not A Summary Proceeding That May Be Initiated Through A Show Cause Order.

A. The SEC Does Not Have Unfettered Authority To Compel SIPC Action Through Summary Show-Cause Proceedings.

The SEC's position is predicated on the wrongheaded notion that it has the legal authority to compel SIPC to take whatever action the SEC says it must take—regardless of whether such action is allowed by the statute and regardless of whether the SEC's position is correct on the facts. SIPA, however, does not give the SEC license to compel SIPC to take action contrary to the statute. And it certainly does not permit the SEC to obtain a court order to that effect by summary proceedings with "no judicial review." Indeed, as SIPC explained in its opening brief, the Second Circuit has roundly rejected the notion that the SEC's views are even entitled to *Chevron* deference—which belies the SEC's claim that it can summarily demand a liquidation proceeding with no record and no judicial review to test whether the SEC's ***allegations*** are right. *See In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 80-82 (2d Cir. 2004). As discussed below, it is incumbent upon the SEC, as the party seeking relief by instituting a judicial proceeding, to demonstrate affirmatively that the action it seeks to compel is required, both on the facts and on the law. *Accord* 21B Charles Alan Wright, et al., *Fed. Prac. & Proc. Evid.* § 5122 (2d ed.).

Despite the SEC's generic claims of "plenary"[4] authority over SIPC, the SEC seeks relief under a ***specific*** provision of SIPA: § 78ggg(b). But the text of § 78ggg(b) makes clear that the Court cannot grant the SEC the relief it requests—to compel SIPC to undertake a particular act—unless the statute itself imposes an obligation on SIPC:

[4] While *SIPC v. Barbour*, 421 U.S. 412 (1975), described the SEC's authority in plenary terms, the SEC admits that the *Barbour* Court's description was based "on the extensive and ***specific*** powers ***conferred on the Commission by the statute***." (SEC Mem. at 14 (emphases added).) The SEC's "plenary" authority can go only so far as its statutory grant will take it, and the statute provides plenary authority only in specific areas that do *not* include § 78ggg(b). *See infra* pp. 7-8.

> 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 to carry out the purposes of this chapter.

15 U.S.C. § 78ggg(b) (emphases added). The provision thus authorizes the SEC only to "***apply***" to this Court for an order directing SIPC to "discharge its obligations" under SIPA—and only if SIPC has failed "to act for the protection of customers of any member of SIPC." It neither "requires" SIPC to follow the SEC based only on its say-so, nor obligates this Court to accede to the SEC's demands. Rather, the SEC must prove that SIPC is failing to discharge its statutory obligations to invoke this provision. As the Supreme Court has described it, § 78ggg(b) provides the SEC with a "right of action" against SIPC, *see Barbour*, 421 U.S. at 421 & n.3, if it believes that SIPC is not "discharg[ing] its obligations" under SIPA "to act for the protection of customers of any member of SIPC," *see* 15 U.S.C. § 78ggg(b). And to prove that SIPC is failing to discharge a statutory obligation, the SEC must demonstrate—as a threshold matter—that the predicate facts for such an obligation exist in this case: that there ***in fact*** exist both a SIPC "Member" and covered "Customers" as the statute defines them. *See* 15 U.S.C. §§ 78ccc(a)(2), 78lll(2). It is passing strange to insist—as the SEC does—that Congress specifically directed that the SEC initiate proceedings in this Court to adjudicate disputes between the two sides, only to have the Court ***refrain*** from engaging in full and meaningful judicial review.

Moreover, as the party seeking relief, it is the SEC that bears the burden of proving that it is entitled to the ultimate relief it seeks: an order requiring SIPC to commence a liquidation proceeding. That is hornbook law. *See generally* 2 J. Strong, *McCormick on Evidence* § 337, pp. 412 (6th ed. 2009) ("The burdens of pleading and proof with regard to most facts have been and should be assigned to the plaintiff who generally seeks to change the present state of affairs and who therefore naturally should be expected to bear the risk of failure of proof or persuasion."). Nothing in SIPA suggests the burden should be flipped. Rather, courts have repeatedly confirmed that the party seeking to establish that SIPA applies bears the burden of establishing "Customer" status, and here that party is the SEC. *See In re Klein, Maus & Shire, Inc*., 301 B.R. 408, 418-19 (Bankr. S.D.N.Y. 2003); *In re Adler Coleman Clearing Corp.*, 204 B.R. 111, 115 (Bankr. S.D.N.Y. 1997). The SEC cites no rule, statute, or case that would sanction the upside-down, burden-shifting framework it asks this Court to apply here.

Nor is the SEC's interpretation of SIPA authoritative or unreviewable as the SEC wrongly suggests. SIPA expressly places the power to make a liquidation "determination" with SIPC (not the SEC). *See* 15 U.S.C. § 78eee(a)(3)(A). The fact that a liquidation determination is a case-by-case assessment also shows why the SEC's show-cause approach is wrong—especially where, as here, there has been no adversarial adjudication to test the factual basis for the SEC's claims.

Congress's express decision to require the SEC to institute a judicial action in this Court cannot be ignored. Congress did not create the § 78ggg(b) process to function as a *pro forma* stamp for the SEC's positions regardless of whether those positions are right. Of course, if that is what Congress had intended, it could have provided that the SEC "may require SIPC to institute a liquidation proceeding whenever the Commission determines that SIPC has failed to discharge its obligations"—in other words, why would the statute enlist the courts at all? Section 78ggg(b), thus, stands in stark contrast to other provisions of SIPA, which ***do*** give the SEC plenary authority to compel SIPC to undertake specific actions without the need for court intervention. Section 78ccc(e)(3), for example, states that "[t]he Commission may … ***require*** SIPC to adopt, amend, or repeal any SIPC bylaw or rule, whenever adopted." 15 U.S.C. § 78ccc(e)(3) (emphasis added). And § 78ggg(c)(1) states that "[t]he Commission may …

require SIPC to furnish it with such reports and records or copies thereof as the Commission may consider necessary or appropriate in the public interest …." *Id*. § 78ggg(c)(1).

Tellingly, SIPA does not grant the SEC direct authority to require SIPC to institute a liquidation proceeding, nor does it permit the SEC to institute its own liquidation proceeding. *See Barbour*, 421 U.S. at 417 (The SEC "may participate in any liquidation proceeding initiated by the SIPC."); 15 U.S.C. § 78eee(c). That is because SIPA grants SIPC, ***not the SEC***, the authority to determine whether a liquidation proceeding is required under law. Section 78eee makes this clear:

> SIPC may, upon notice to a member of SIPC, file an application for a protective decree with any court of competent jurisdiction …, if ***SIPC*** determines that —
>
> (A) the member … has failed or is in danger of failing to meet its obligations to customers ….

15 U.S.C. § 78eee(a)(3)(A) (emphasis added). The SEC's show-cause approach would turn SIPA on its head: SIPC would have to disprove the SEC's allegations or assertions that SIPC is obligated to act, and do so without the benefit of any discovery of the very facts underlying the SEC's claim. This cannot be the law.

In short, nothing in SIPA gives the SEC an unfettered right to overturn SIPC's determination that it is not authorized to start a liquidation and thus cannot apply for a protective decree under the facts of a particular case. Indeed, the only authority the SEC has in this circumstance is to initiate a lawsuit and ***seek*** judicial relief. As such, SIPC is entitled to the same rights and process as every other defendant in a civil case.

B. The SEC's Distinction Between An "Application" And An "Action" Is Supported By Neither Its Own Caselaw Nor Its Own Prior Statements.

Rather than provide an argument specific to the text and structure of SIPA, the SEC instead relies on cases which it claims are "analogous" and which supposedly support the notion that "applications" must result in summary proceedings. But the SEC's cases are inapposite, and the SEC wholly fails to account for the fact that the few courts to discuss the specific "application" under § 78ggg(b) have referred to it as a "suit" or a "cause of action"—not a summary proceeding. In so doing, the SEC places far too much weight on the word "apply" and on arguing that it means something other than an "action." After all, whether or not styled as an "action," there is no question this still is a civil "proceeding," and the Federal Rules apply to ***both*** "actions" and "proceedings." Fed. R. Civ. P. 1 ("These rules govern the procedure in all civil actions and proceedings in the United States district courts."). Tellingly, the U.S. Code is filled with statutes that allow a party to "apply" for judicial relief without stripping away the applicability of the Federal Rules of Civil Procedure. *Compare* 12 U.S.C. § 1818(c)(2) (party aggrieved by administrative cease-and-desist order "may apply" in district court for an order setting aside the order), *with Lenz v. F.D.I.C.*, 251 F. Supp. 2d 121, 123 (D.D.C. 2003) (aggrieved party initiated civil action by filing complaint pursuant to 12 U.S.C. § 1818(c)(2)); *see also United States v. Roberts & Oake*, 65 F.2d 630, 631 (7th Cir. 1933) (government "brought suit" under 7 U.S.C. § 216, which provides that Secretary of Agriculture "may apply" in district court for enforcement of certain orders).

The SEC most heavily relies upon the Ninth Circuit's decision in *SEC v. McCarthy* for the proposition that "applications" are distinct from "actions" and do not "necessarily include or trigger 'all the formal proceedings in a court of justice'" as does the filing of an 'action.'" (SEC Mem. at 29 (quoting *SEC v. McCarthy*, 322 F.3d 650, 656-57 (9th Cir. 2003)); *see also* SEC Opp'n at 6.) But a more careful reading of *McCarthy* demonstrates not only that the circumstances of that case are far removed from this case, but also that the Ninth Circuit

specifically rejected summary proceedings that would have prevented the defendant from the opportunity to be fully heard.

Although the court analyzed the difference between an "application" and an "action" under the statutory scheme created by § 21(e)(1) of the Exchange Act and concluded that particular section permitted summary proceedings, the court did so only after a close review of the "plain meaning" and structure of the Exchange Act itself. 322 F.3d at 655-57. The *McCarthy* court emphasized that a summary proceeding was permissible only because in that case (unlike this case) there had already been a full opportunity to litigate the law and the facts: "Appellants have received four different opportunities to litigate the merits of this case." *Id.* at 657-58. The court explained further that summary proceedings may be appropriate where the merits have already been litigated and "where the only remedy sought is enforcement of the previously upheld order." *Id.*

Here, of course, nothing of the sort has occurred. There has been no litigation. SIPC has had no hearing. And no court has made any findings. And even though there had been such process in the previous adjudication of the merits in *McCarthy*, the Ninth Circuit nonetheless insisted that on remand any "summary proceedings" still employ "procedure[s] consistent with local and federal rules to ensure that Appellants ha[ve] the opportunity to be heard." *Id.* at 659. In any event, other courts have denied significance to *McCarthy*'s distinction between "applications" and "actions" in the context of the Exchange Act. *See SEC v. J.W. Barclay & Co.*, 442 F.3d 834, 844 (3d Cir. 2006) ("At that point, the SEC had a ***cause of action*** against Barclay arising under a provision of the Exchange Act because § 21(e) provides in part that the district courts of the United States, ***upon application by the SEC***, shall have jurisdiction to issue orders commanding any person to comply with the SEC's orders." (emphasis added)); *see also* *id.* at 844 n.16 (considering *McCarthy*'s reliance on Black's Law Dictionary and noting that "[t]he 'special proceedings' in a district court following an SEC application brought under § 21(e) fit this general definition of an 'action' … because they are judicial proceedings which terminate in a judgment or decree").

The SEC's reliance on subpoena cases (*see* SEC Opp'n at 8, 11) similarly underscores the need for more formal procedures here. An action under § 78ggg(b) is simply not analogous to a subpoena enforcement request. Subpoenas are only ***investigative***—they request documents or testimony at the start of an inquiry, rather than adjudicate disputed questions of law or fact at the end. For example, in *SEC v. Lines Overseas Management, Ltd.*, Civ. No. 04-302, 2005 WL 3627141 (D.D.C. Jan. 7, 2005)—a case the SEC cites favorably—this Court noted that "'the very purpose of the subpoena … is to discover and procure evidence, ***not to prove a pending charge or complaint***, but upon which to make one if, in the Administrator's judgment, the facts thus discovered should justify doing so.'" 2005 WL 3627141 at *3 (quoting *Okla. Press Publ'g Co. v. Walling*, 327 U.S. 186, 201 (1946)) (emphasis added); *see also SEC v. Sprecher*, 594 F.2d 317, 320 (2d Cir. 1979) (concluding without significant analysis that the enforcement of investigatory subpoenas could be effectuated through summary proceedings). For an agency to "prove a pending charge or complaint," it must initiate a formal adjudication or litigation, which would eventually entitle the subpoena target to process and judicial review. Here, however, the SEC is ***not*** trying to "discover and procure evidence" by acting under § 78ggg(b)—it is trying to shut down all fact-finding and to have this Court summarily adopt the SEC's "pending charge." Given this function, the more limited procedural protections traditionally afforded subpoenas are inapposite—and the SEC errs in its attempt to conflate the process afforded a subpoena and this very different substantive dispute.

Moreover, the SEC ignores the fact that courts that have analyzed § 78ggg(b) have described it as a "suit" or a "cause of action," not a summary adjudication. For example, the Supreme Court in *Barbour* described § 78ggg(b) in the terms customary to a civil action: as creating an express "right of action" against SIPC on behalf of the SEC and as "governing ***suits to compel*** the SIPC to act for the benefit of investors." *See Barbour*, 421 U.S. at 418; *id.* at 421 & n.3 (emphasis added). Moreover, the Court viewed the SEC's right to sue SIPC through the same lens as the impermissible suits attempted by investors—in the context of a standard civil action, without drawing the distinction between "applications" and "actions" that the SEC relies on here:

> Respondent argues that because Congress provided that the SIPC can 'sue and be sued, complain and defend, in its corporate name and through its own counsel, in any court, State, or Federal,' 15 U.S.C. § 78ccc(b)(1), it must have contemplated occasions when an aggrieved customer of a member firm would be able to sue. In light of the specific terms of the more relevant section governing suits to compel the SIPC to act for the benefit of investors, that conclusion is unwarranted. It is also incompatible with the limitation of SEC actions 'to the district court of the United States in which the principal office of SIPC is located.' 15 U.S.C. § 78ggg(b). ***It would be anomalous for Congress to have centralized SEC suits for the apparent convenience of SIPC while exposing the corporation to substantively identical suits by investors*** 'in any court, State or Federal.'

421 U.S. at 421 n.3 (emphasis added).

The Supreme Court is not the only court to describe the nature of §78ggg(b) in these terms. In *Bohart-McCaslin Ventures, Inc. v. Midwestern Securities Corp.*, 352 F. Supp. 937 (N.D. Tex. 1973), for example, the court described the SEC's right to bring suit under § 78ggg(b) the same way the *Barbour* court would two years later: "this Court holds that plaintiffs have no standing ***to bring suit*** against any defendant under the Act by virtue of section 7(b) of the Act, 15 U.S.C. § 78ggg(b)." 352 F. Supp. at 940 (emphasis added). In rejecting private plaintiffs' attempt to enforce §78ggg(b), the court emphasized that it viewed that section as creating a civil cause of action (which the SEC could then invoke): "The Court interprets this subsection to mean that only ***the SEC may bring suit*** such as that in the present case." *Id.* at 940 (citing 15 U.S.C. § 78ggg(b)) (emphasis added).

It is no surprise that courts have characterized § 78ggg(b) as a provision authorizing an "action" because—until now—the SEC itself has framed its statutory right in those exact terms. In *Barbour*, the SEC framed its central argument to the Supreme Court as follows:

> THE STATUTORY AUTHORITY OF THE SECURITIES AND EXCHANGE COMMISSION TO INSTITUTE ***AN ACTION*** TO COMPEL THE SECURITIES INVESTOR PROTECTION CORPORATION TO DISCHARGE ITS OBLIGATIONS UNDER THE SECURITIES INVESTOR PROTECTION ACT IS THE EXCLUSIVE MEANS BY WHICH THAT CORPORATION CAN BE COMPELLED TO TAKE ACTION.

Br. for Resp. SEC, 421 U.S. 412 (1972) (No. 73-2055), 1974 WL 186093, at *5 (capitalization in original; emphasis added). The SEC then went on to present the "primary question" in *Barbour*: "whether there is an implied private right of action under the Securities Investor Protection Act in addition to the ***right of action*** expressly granted to the Commission under Section 7(b) of the Act." *Id.* (emphasis added).

The SEC has also used similar terminology in describing its current dispute with SIPC. On June 15, 2011, the SEC notified SIPC by letter that it would "bring a ***court action*** against SIPC" if SIPC did not initiate a liquidation proceeding. (*See* June 15, 2011 Letter from E. Murphy of the SEC to O. Johnson of SIPC (Martens Decl. Ex. 2) at 1 (emphasis added).) That same day, the SEC issued a press release to similar effect. (*See* June 15, 2011 SEC Press Release at 1, available at http://www.sec.gov/news/press/2009/2009-26-update.htm ("The Commission authorized its staff to ***file an action*** in federal district court." (emphasis added).) The SEC's analysis (which was the result of neither a notice-and-comment process nor any adjudicatory hearing) likewise used "actions" and "application" interchangeably. (*Compare*

June 15, 2011 Analysis at 1 ("the Commission has authorized its Division of Enforcement to bring ***an action*** in district court"), *with id*. at 14 ("the Commission has authorized its staff to file in district court ***an application***" (emphases added)).) These statements highlight the folly in the SEC's post-hoc attempt to strip away full judicial review over a dispute between the SEC and SIPC about the statutory limits of SIPA—based entirely on the word "apply." Given its prior arguments in the Supreme Court and other statements, the SEC cannot now purport to read the "may apply" language in §78ggg(b) as a rubber-stamp procedural mechanism foreign to civil proceedings in federal court.

C. Section 78ggg(b) Is Not Analogous To Provisions Governing SIPC's Initiation Of A Liquidation Proceeding.

The SEC's attempt to equate its right to "apply" for an order requiring SIPC to start a liquidation under § 78ggg(b), with an application by SIPC for a protective decree under § 78eee(b)(1), is doubly wrong. First, the two procedures are hardly comparable in light of SIPA's text and structure. And second, the SEC is incorrect in asserting that the process by which SIPC applies for a protective decree under § 78eee(b)(1) requires summary proceedings.

The SEC wrongly assumes that SIPA's use of the words "*may apply*" in §78ggg(b), and "*file an application* for a protective decree" in § 78eee(b)(1), necessarily means that the SEC may use summary proceedings to compel SIPC to act. As an initial matter, the nature of the two proceedings squarely forecloses any argument that these processes are the same. Section 78eee(b)(1) permits SIPC to apply for a protective decree which will ***begin*** the judicial process of liquidation proceedings against a SIPC "Member," whereas the SEC's application against

SIPC under § 78ggg(b) seeks an order to definitively compel SIPC to act.[5] *See* S. Rep. No. 91-1218, p. 284 (1970).

Moreover, § 78eee sets forth the relief a court must grant, and the timetable in which it must do so. *See* 15 U.S.C. § 78eee(b)(1) ("Upon receipt of an application by SIPC . . . the court ***shall forthwith issue a protective decree*** if the debtor consents thereto, if the debtor fails to contest such application, or if the court finds that such debtor" meets one of four enumerated factors.) (emphasis added). Section 78eee(b)(1) also provides that "[u]nless the debtor consents to the issuance of a protective decree, the ***application shall be heard three business days after the date on which it is filed***, or at such other time as the court shall determine, taking into consideration the urgency which the circumstances require." *Id.* § 78eee(b)(1) (emphasis added).

By contrast, Section 78ggg(b) says nothing of the sort, nor does it incorporate the procedures set forth in § 78eee(b)(1). Congress did not construct § 78ggg(b)(1) to require this Court to act without the opportunity to conduct a full review of a dispute between SIPC and the SEC. This makes sense: the exigent need for a rapid response when SIPC fears that a SIPC-"Member" brokerage may literally go under, and the risk that "Customer" assets could literally disappear, are simply not present in this case. SIPC, of course, is in no danger of disappearing. Moreover, both the Stanford Group Company and Stanford International Bank Ltd. in Antigua, along with their assets, are already in the hands of U.S. and Antiguan Receivers. Simply put, there is no exigency where a receiver is already in place, and the matter has been ongoing for years.

5 It is also critical that not all § 78ggg(b) applications brought by the Commission will be for the ultimate purpose of forcing SIPC to institute a liquidation proceeding. Indeed, the text of § 78ggg(b) provides that the SEC may seek an order to compel "[i]n the event of the refusal of SIPC to commit its funds or otherwise act" where SIPC has failed "to discharge its obligations under" SIPA. 15 U.S.C. § 78ggg(b). This language contemplates the possibility of other more substantive compulsory acts—including the commitment of funds—***for which there may be no subsequent judicial process***. All of this underscores why the SEC's claimed right to an order just on its say-so cannot be correct.

The SEC's claimed need for prompt action in this case is also belied by its own pattern of delay. Since 2009, the SEC knew of SIPC's position that SIPA did not authorize a liquidation under the facts of the Stanford fraud. It was only two years later, in 2011, that the SEC suddenly reversed course—only because a U.S. Senator blocked two nominees to become SEC Commissioners. (*See* SIPC Opening Br. at 3.) And although the statute requires the SEC to "immediately notify" SIPC if the Commission believes a SIPC-"Member" brokerage is in danger of failing such that a liquidation may be needed, *see* 15 U.S.C. § 78eee(a)(1), the SEC's June 15, 2011 demand that SIPC start a liquidation was made without any warning to or discussion with SIPC first. Congress, however, vested SIPC—not the SEC—with the discretion to make a protective decree determination. *See id.* § 78eee(a)(3)(A). Indeed, SIPA provides that even a SIPC "Member" brokerage that has "Customers" cannot be placed into receivership "without the specific consent of SIPC," *id.* § 78eee(B), except in the inapplicable circumstance of firms considered too-big-to-fail under Dodd-Frank. Plainly the statute does not contemplate that the SEC, based on nothing more than its say-so, has unfettered discretion to override SIPC by suddenly claiming it was wrong. Rather, that is precisely what this Court should decide at the end of this lawsuit—after full and fair development of both the law ***and the facts***.

Even if the Court were to view the procedural mechanisms in § 78eee(b)(1) and § 78ggg(b) as similar, the SEC's analogy still fails because SIPC generally initiates an application for a protective decree by also filing a ***complaint*** in district court, thereby triggering a civil action for which there is substantive *de novo* review upon objection of the affected SIPC "Member." *See supra* Section I. And even though SIPC's complaint may result in a show-cause order, the allegedly failing broker-dealer is given a full and fair opportunity—with *de novo* review—to present its case regarding SIPC's "Member" and "Customer" determination. *See SEC v. Alan F. Hughes, Inc.*, 461 F.2d 974 (2d Cir. 1972).

Indeed, the SEC dramatically mischaracterizes the *Alan F. Hughes* case to suggest that SIPC determinations are judicially unreviewable. The SEC argues that *Hughes* "establishe[s] that SIPC's initial determination about the need for customer protection under SIPA Section 5(a)(3), causing it to commence a liquidation proceeding, is judicially unreviewable." (SEC Mem. at 17.) But *Hughes* actually holds precisely the opposite:

> Under the 1970 Act [*i.e.*, SIPA], we hold that due process is satisfied as long as the district court, after providing the broker-dealer with an opportunity to be heard, ***makes its own determination*** that the broker-dealer has failed or is in danger of failing to meet its obligations to its customers. Further, we conclude that, consonant with the requirements of due process, ***such 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***.

Hughes, 461 F.2d at 979 (emphasis added).[6]

The *Hughes* court squarely confronted—and rejected—the SEC's current argument (SEC Mem. at 21) that SIPA § 78eee(b)(1)'s language ("shall forthwith issue a protective decree") precludes judicial review of SIPC's determination that its "member . . . has failed or is in danger of failing to meet its obligations to customers." Specifically, the SEC argued that "§ 5(b)(1) of the 1970 Act precludes a district court from making its own finding as to whether a broker-dealer is in danger of failing to meet its obligations to its customers," because "[u]nder § 5(b)(1)(A), the district court to which SIPC applies 'shall grant the application and issue a decree adjudicating that customers of the member named in the application are in need of protection under this [Act]'

[6] The language in *Hughes* cited by the SEC stands for the straightforward proposition that, prior to its formal application to the district court for a protective decree, SIPC need not afford "Members" an opportunity to contest its internal decision making. *See Hughes*, 461 F.2d at 979 ("Due process does not require that an opportunity for a hearing be afforded at the time [SIPC] makes its initial determination that one of its members has failed or is in danger of failing to meet its obligations to its customers.").

if it finds that one or more of the conditions set forth in § 5(b)(1)(A) exists." *Hughes*, 461 F.2d at 980. The court recognized that "a literal reading of this section may be said to require a district court to grant SIPC's application if one of the five enumerated conditions is present, even though the broker-dealer is not in danger of failing to meet its obligations to its customers." *Id.* But it then concluded that "***[s]uch a literal reading of course would raise a most serious question as to the statute's constitutionality. So read, it would provide for no hearing and no judicial determination of the broker-dealer's ability to meet its obligations***." *Id*, 461 F.2d at 980-81 (emphasis added).

Thus, even if the SEC's application to compel SIPC to act is the equivalent of SIPC's "application" to a district court under SIPA § 78eee, the Court must engage in a full, independent, and *de novo* review of both the legal issues and the predicate factual questions in this case—that there are in fact covered "Customers" of a SIPC "Member" brokerage firm. That process of conducting *de novo* review begins like civil cases normally do—with a Complaint and a Case Management Conference.

II. This Case Requires The Development Of A Full And Fair Record Before Considering Both The Law And The Facts.

A. The Federal Rules of Civil Procedure Apply.

Nor can the SEC try to beg off these questions, by claiming that the "regular rules of civil procedure do not apply." (Dec. 12, 2011 SEC *Ex Parte* Mot. at 2.) The Federal Rules of Civil Procedure "govern the procedure in all civil actions and proceedings in the United States district courts." Fed. R. Civ. P. 1. And under the Federal Rules, barring express statutory language to the contrary, civil proceedings begin with a Complaint—not an "Application" coupled with an *ex parte* motion for an order to show cause. Fed. R. Civ. P. 3 ("A civil action is commenced by filing a complaint with the court."). An order from this Court making it clear that the Federal

Rules apply is necessary now, at the outset, so that both parties understand the procedural framework that will be used to resolve this dispute. Indeed, that is precisely why SIPC requested a Case Management Conference: so that this Court can provide guidance as to how this case will proceed going forward.

There can be no serious question that this is a civil "proceeding" within the scope of the Federal Rules. *See* Fed. R. Civ. P. 2 ("There is one form of action—the civil action."); *see also* 4 Charles Alan Wright, et al., *Fed. Prac. & Proc. Civ.* § 1042 (3d ed.) ("[T]here is a single procedural framework for all federal civil proceedings, regardless of the substantive claim at issue. . . . [T]he civil action prescribed by the federal rules is the proper medium for exercising any civil power the district courts may possess."). Barring a "clear expression of congressional intent to exempt actions . . . from the operation of the Federal Rules of Civil Procedure" and absent "a direct expression by Congress of its intent to depart from the usual course of trying 'all suits of a civil nature,'" the Federal Rules apply. *See, e.g.*, *Califano v. Yamasaki*, 442 U.S. 682, 699-700 (1979) (Rule 23 applies to class actions brought under § 205 of the Social Security Act because act did not expressly provide to the contrary) (citing Fed. R. Civ. P. 1); *see also Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1438 (2010) ("And like the rest of the Federal Rules of Civil Procedure, Rule 23 automatically applies 'in all civil actions and proceedings in the United States district courts.'") (quoting Fed. R. Civ. P. 1 and citing *Califano*, 442 U.S. at 699-700); *Woodford v. Garceau*, 538 U.S. 202, 208 (2003) (because petitions for writs of habeas corpus are civil in nature, "[t]he Federal Rules of Civil Procedure apply in the context of habeas suits").

The SEC seems to believe that because it styled its initial pleading as an "Application," not a "Complaint," the "regular rules of civil procedure do not apply." (Dec. 12, 2011 SEC *Ex*

Parte Mot. at 2.) That is not the law: courts have rejected similar superficial efforts to use an "Application" in order to bypass the Federal Rules. *See, e.g.*, *Application of Howard*, 325 F.2d 917, 918 (3d Cir. 1963) (rejecting argument that an "application" does not trigger the Federal Rules because the Federal Rules "restrict original civil proceedings in a district court to a single form of action") (citations omitted). The Supreme Court has also rejected efforts to shortcut the Federal Rules by filing a "petition" rather than a "complaint." In *New Hampshire Fire Insurance Co. v. Scanlon*, 362 U.S. 404 (1960), a case the SEC cites—remarkably—for the proposition that this case should be conducted without a complaint (*see* SEC Opp'n at 12-13), the Court held that "there is neither justification nor authority for carving out an exception to the uniform and regular civil procedure laid down by the Federal Rules." 362 U.S. at 407-08. The upshot here is that courts "look beyond the caption of a pleading to its substance to determine the nature of the submission." *Willhite v. Mainsource Bank*, Civ. No. 04-1396, 2005 WL 1539267, at *1 (D.D.C. June 30, 2005) (applying Federal Rules to a "petition" filed to commence a civil case). And absent express statutory language providing that the Federal Rules do ***not*** apply to certain kinds of civil proceedings, courts uniformly hold that they ***do*** apply, *see Califano*, 442 U.S. at 699-700—no matter how the civil proceeding is styled. In fact, even if this were a summary proceeding (and it is not, as previously discussed), the Federal Rules would still apply. *See United States v. Garrett*, 571 F.2d 1323, 1330 (5th Cir. 1978) ("[T]he discovery procedures in the Federal Rules of Civil Procedure apply in summary proceedings to enforce IRS summonses.").

Nor can the SEC justify *ex parte* relief because it provided SIPC with a few days notice that it would sue and sent courtesy copies of its briefs after filing them with the Court. (SEC Opp'n at 3-4.) If anything, the fact that the SEC knows how to reach SIPC counsels ***against*** *ex* *parte* proceedings, not in their favor. *See Council on American-Islamic Relations v. Gaubatz*, 667 F. Supp. 2d 67, 75 (D.D.C. 2009). And the SEC's effort to distinguish *United States v. Libby*, 429 F. Supp. 2d 18 (D.D.C. 2006), and *Berntsen v. CIA*, 511 F. Supp. 2d 108 (D.D.C. 2007), on the basis that those cases come from the national security context and involved the Classified Information Procedures Act (*see* SEC Opp'n at 5 n.4) prove the point—*ex parte* proceedings are permitted only in extraordinary circumstances (like the national security context or where a statute expressly permits *ex parte* procedures). *See Libby*, 429 F. Supp. 2d at 21; *Berntsen*, 511 F. Supp. 2d at 110.

Finally, the SEC incorrectly claims that it may commence this suit with an Application and an *ex parte* motion because that is what SIPC supposedly does in emergency circumstances when it files an action for a protective order against a failing broker-dealer. (*See* SEC Opp'n at 11-12.) As support, the SEC points to the docket in *SIPC v. Continental Capital Investment Services, Inc.* (N.D. Ohio) (Martens Decl. Ex. 4, Attach. K). But even assuming that SIPC's initiation of a liquidation were comparable to the SEC's initiation of an action against SIPC under § 78ggg(b) (which it is not, as discussed above in Section I.C.), SIPC's commencement of proceedings in *Continental Capital* stands in stark contrast to what the SEC has done here.

Unlike the SEC—which filed an "Application" on this Court's miscellaneous docket—SIPC initiated a formal civil action in *Continental Capital* by submitting a civil cover sheet and filing a "Complaint and Application." The other dockets attached to the Martens Declaration likewise confirm that SIPC typically initiates its proceedings with a Complaint. *See, e.g.*, *SIPC v. Paul L. Forchheimer & Co., Inc.*, Civ. A. No. 06-14355 (S.D.N.Y.) (Martens Decl. Ex. 4, Attach. G). Nor are the two scenarios comparable in any event, because this is not a case in which the SEC can claim emergency circumstances (especially when the SEC has known of SIPC's position in the Stanford matter since 2009).

At bottom, while the SEC claims that its motion is simply a "procedural" device (SEC Opp'n at 4), it cites no "procedure"—and certainly cites no Federal Rule—that would authorize this kind of extraordinary approach. Given that nothing in SIPA suggests that the Federal Rules do not apply in actions brought under § 78ggg(b), and given the uniform case law holding that the Federal Rules ***do*** apply absent express statutory language to the contrary, this Court should reject the SEC's effort to commence this action with an upside-down, burden-flipping show-cause procedure. This case should begin under the Federal Rules—with a Complaint as Rules 2 and 3 expect. And where, as here, there are disputed issues of material fact regarding whether there ***in fact*** exist both a SIPC "Member" and covered "Customers," the Rules provide a well-defined process for determining those ***facts***. *See, e.g.*, Fed. R. Civ. P. 26. Indeed, discovery is critical to addressing and debunking the SEC's unsubstantiated assertions.

B. This Extraordinary and Unprecedented Action Requires Full Development of the Factual Record.

Summary treatment of this case would be particularly inappropriate because of its unprecedented nature, the crippling effect the requested relief would have on SIPC's ability to fulfill its statutory role, and, most importantly, because discovery will confirm that the SEC is not entitled to the remedy it seeks. The SEC asserts that "there can be no dispute" that the "factual predicates for initiation of a liquidation proceeding [are] present." (SEC Opp'n at 2.) But this is an intensely factual allegation, and there ***is*** in fact a genuine dispute as to whether such "factual predicates" have been satisfied—in addition to other facts that the SEC tries to ignore. For example, the SEC has not alleged facts to demonstrate that Stanford Group Company in the U.S. had "custody" of Stanford International Bank's Antiguan CDs when SGC failed. Even if the SEC adds these allegations to a Complaint, the only way to test them is through discovery, like in any civil case. SIPC should be entitled to serve written discovery so that the SEC can answer questions such as:

- Identifying individuals the SEC alleges to be "Customers" eligible for SIPA protection;
- Identifying how alleged "Customers" purchased their Stanford International Bank Antiguan CDs;
- Identifying where those Stanford International Bank Antiguan CDs are located today;
- Identifying what facts the SEC allegedly has to show that Stanford Group Company in the U.S. has custody of any of these CDs; and
- Identifying what alleged "Customers" have done to seek relief from the Antiguan Receiver.

Although the SEC attempts to frame the dispute as a routine administrative case that this Court can resolve on a summary basis, this is incorrect. Unlike run-of-the-mill agency cases with ready-made administrative records that the Court can examine in testing a party's factual allegations, here there is ***no record at all***. Courts regularly permit discovery in actions brought to compel agency action when the factual record requires development. *See, e.g., United States v. Garrett*, 571 F.2d 1323, 1330 (5th Cir. 1978) ("[T]he discovery procedures in the Federal Rules of Civil Procedure apply in summary proceedings to enforce IRS summonses."); *A.O. Smith Corp. v. FTC*, 530 F.2d 515, 527 (3d Cir. 1976) ("[T]he availability of discovery in a summary enforcement proceeding is not categorically foreclosed to either party."). Indeed, the D.C. Circuit and this Court have required discovery where, as here, the question presented is not an abstract legal dispute, but rather asks whether an entity like SIPC has applied the law in a permissible manner in light of an agency's position that rests on factual predicates that no tribunal has ever had an opportunity to test. *See Gen. Elec. Co. v. EPA*, 360 F.3d 188, 192 (D.C.

Cir. 2004) (reversing in part and directing the district court to permit discovery in as-applied constitutional challenge); *Elk Run Coal Co., Inc. v. U.S. Dep't of Labor*, No. 10-cv-1056, 2011 WL 3627163, at *18 (D.D.C. Aug. 18, 2011) ("After discovery and a further factual fleshing out of the issue, the Court will be better able to determine whether [the Mine Safety and Health Administration] has deprived them of a legitimate protected property interest."); *Hous. Auth. of the Cnty. of King v. Pierce*, 711 F. Supp. 19, 21 (D.D.C. 1989) (granting motion to reconsider motion to dismiss because plaintiff had not had opportunity to test factual underpinnings of the U.S. Department of Housing and Urban Development's position).

As SIPC explained in its opening submission, it is no answer for the SEC to claim that the presence or absence of "Customers" of a "Member" can be deferred to the liquidation proceeding itself. After all, SIPC has a statutory duty to bring liquidations ***only*** when the facts and the law permit: it has no authority to exceed the statutory limits that Congress has set. Moreover, while the statute does not permit a private right of action to challenge SIPC's decision that a liquidation proceeding should not be started, the initiation of a proceeding opens the door for the submission of claims, which SIPC would then have to contest with a trustee and/or in court. 15 U.S.C. § 78fff-2(a)(2). Requiring SIPC to spend years litigating claims that *exceed* the bounds of the statute—for persons who, in the end, are not entitled to protection under the facts of this case—would waste time and resources (not only from SIPC, but also from the courts). Far from warranting a rush to judgment, the SEC's unprecedented lawsuit first requires thorough discovery followed by careful review.

CONCLUSION

For the foregoing reasons, the SEC's *ex parte* motion for an order to show cause should be stricken or denied, and the Court should conduct a Rule 16 Case Management Conference to determine the appropriate next step in this unprecedented case.

Dated: December 27, 2011

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 27 th day of December, 2011, I served the Securities Investor Protection Corporation's Reply Brief In Support of Its (1) Motion to Strike Securities and Exchange Commission's Ex Parte Motion for Order to Show Cause, and (2) Motion for Case Management Conference via courier and email to the following:

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