UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Securities and Exchange Commission,	)	
	)	
Applicant,	)	
	)	
v.	)	Misc. No: 1:11-mc-00678-RLW
	)	
Securities Investor Protection Corporation,	)	
	)	
Respondent.	)	
	)	
	)	

SECURITIES AND EXCHANGE COMMISSION'S REPLY BRIEF IN SUPPORT OF ITS MOTION FOR AN ORDER TO SHOW CAUSE WHY THE SECURITIES INVESTOR PROTECTION CORPORATION SHOULD NOT BE ORDERED TO FILE AN APPLICATION WITH RESPECT TO STANFORD GROUP COMPANY

Matthew T. Martens
Chief Litigation Counsel
David S. Mendel (D.C. Bar #470796)
Assistant Chief Litigation Counsel
U.S. Securities and Exchange Commission – Enforcement Division
100 F Street, NE
Washington, DC 20549
(202) 551-4481 (Martens)
(202) 551-4418 (Mendel)
(202) 772-9362 (fax)
martensm@sec.gov
mendeld@sec.gov

Of Counsel:
Michael A. Conley
Deputy General Counsel
Michael L. Post
Senior Litigation Counsel
Office of the General Counsel

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Applicant U.S. Securities and Exchange Commission ("SEC" or "Commission") respectfully submits this reply brief[1] in support of its motion for an order to show cause why the Securities Investor Protection Corporation ("SIPC") should not be ordered to file an application for a protective decree with the federal district court for the Northern District of Texas ("Texas Court") pursuant to Section 5(a)(3) of the Securities Investor Protection Act of 1970, as amended, 15 U.S.C. § 78aaa, *et seq.* ("SIPA"), with respect to Stanford Group Company ("SGC") and to otherwise discharge its obligations under SIPA.

[1] Although SIPC captioned its filing on December 27, 2011, as a "Reply Brief in Support of Its Motion To Strike SEC's *Ex Parte* Motion for Order to Show Cause, and (2) Motion for Case Management Conference" (Docket Item No. 12, hereafter "SIPC Brief"), SIPC also stated that the filing served as an Opposition to the SEC's Motion for an Order To Show Cause. *See* SIPC Brief at 4 n.3, 24. On January 3, 2012, SIPC submitted an Erratum re-captioning its December 27, 2011, submission as, in part, an Opposition to SEC's *Ex* Parte Motion for Order To Show Cause (Docket Item No. 14). Accordingly, the SEC hereby replies to SIPC's Opposition. In providing this Reply, the SEC incorporates fully by reference its Memorandum of Points and Authorities in Opposition to SIPC's (1) Motion To Strike SEC's *Ex Parte* Motion for Order To Show Cause and (2) Motion for Rule 16 Case Management Conference (filed Dec. 19, 2011; Docket Item No. 10) ("SEC Opposition to Motion To Strike").

INTRODUCTION

In this proceeding, the Commission seeks to compel SIPC to file an application in the Texas Court to initiate a liquidation proceeding. Previously, SIPC has initiated liquidations through a summary proceeding in which it obtains an order to show cause based on an application containing a bare assertion that a "customer" is in need of protection. SIPA does not provide for judicial review of SIPC's customer need determination. The application is based, to use SIPC's term, on its "say-so." There is, of course, good reason for such a summary approach. As SIPC also recognizes, the need to file an application to initiate a liquidation often occurs in exigent circumstances when SIPC would be unable to obtain admissible evidence sufficient to litigate the customer need determination.

In this instance, the SEC, as SIPC's plenary supervisor with regard to the need of customers for the protections of SIPA, has examined the evidence surrounding the SGC matter and "determined, based on the totality of the facts and circumstances of this case, that SIPC member [SGC] has failed to meet its obligations to customers."[2] The Commission's determination was accompanied by the record it relied upon to make that determination. SIPC has had six months to review the Commission's factual findings, legal analysis, and formal determination. When SIPC nonetheless failed to take steps to initiate a liquidation proceeding with regard to SGC, the Commission utilized the same procedures that SIPC has utilized, namely seeking an order to show cause based on an application (albeit one that incorporated the Commission's determination). And as when SIPC files an application to initiate a liquidation proceeding, the Commission has argued that its customer need determination is not subject to judicial review in this proceeding.

[2] Analysis of Securities Investor Protection Act Coverage for Stanford Group Company at 1 ("Commission Analysis"), attached to letter from Elizabeth M. Murphy to Orlan M. Johnson, dated June 15, 2011, Declaration of Matthew T. Martens ("Martens Decl.") ¶ 3(a) & Exh. 2.

SIPC, however, challenges the Commission's use of summary procedures and an order to show cause to initiate this matter. In so doing, SIPC continues to confuse the relief sought by the Application of the Securities and Exchange Commission (Docket Item No. 1) ("Commission Application" or "Application") with the relief sought by the SEC's Motion for an Order To Show Cause (Docket Item No. 2) ("SEC Motion for Order To Show Cause"). The Commission Application poses the question whether the Commission's customer need determination is subject to judicial review. But that is not the issue with regard to the SEC Motion for Order To Show Cause. The issues presented by the Motion for Order To Show Cause are (1) whether this proceeding is a summary one, and (2) whether SIPC should be required to respond to the Commission Application by identifying its factual and legal objections to that Application. Although SIPC contends that the statute does not authorize a summary proceeding, this contention ignores both the language of SIPA Section 11(b) and SIPC's own practice. And SIPC cites no reason why, if the Order To Show Cause issued, it would be unable to respond to the Application by identifying the factual issues its contests or the legal premises with which it disagrees.

Instead, SIPC poses a number of rhetorical questions and implies a number of nefarious-sounding reasons for the Commission's approach to this proceeding. The actual reasons underlying the Commission's approach should be clear. Put simply, SIPA must be interpreted so as to preserve the Commission's ability to move quickly to compel the prompt initiation of a liquidation proceeding. The customer need issue is more appropriately left for litigation in the liquidation proceeding itself where the customers will be notified; they can present claims based on their facts and circumstances; and the court overseeing the liquidation can provide judicial review before SIPC is required to pay any customer claims. Accordingly, the Commission

respectfully submits that the Order To Show Cause should issue directing SIPC to respond to the Commission Application.

ARGUMENT

I. SIPA Authorizes the Commission to Initiate A Summary Proceeding Against SIPC

SIPC continues to challenge the notion that this proceeding should be a summary one initiated by an order to show cause. SIPC Brief at 5-17. SIPC's argument in this regard is inconsistent both with the language and structure of SIPA as well as SIPC's own practice under the Act. And nothing about the use of a summary proceeding or an order to show cause unfairly shifts the burden of production or proof to SIPC.

A. A Summary Proceeding Is Necessary To Meet the SIPA's Goal of Promptly Protecting Customers

As noted previously, SIPA provides that a district court in which SIPC files an application for a protective decree hold a hearing within three business days (unless the court sets a different date taking "urgency" into consideration).[3] SIPC itself explained the necessity for this three-day turnaround in its Reply Brief: there may be an "exigent need for a rapid response" where "a SIPC-'Member' brokerage may literally go under," and there is "risk that 'Customer' assets could literally disappear." SIPC Brief at 15. The longer the delay before a SIPC trustee is appointed and a liquidation proceeding commenced, the greater the risk that customer property may be dissipated.

Just as SIPA provides for a "rapid response" to a SIPC "application," so too must the statute be construed to provide an expeditious response to an application by the Commission for an order by this Court directing SIPC to take such "rapid" action in a particular case. If it were otherwise, the statute's express goal of prompt customer protection could by wholly undermined

[3] SEC Opposition to Motion To Strike at 7.

by SIPC's refusal to take steps to commence a liquidation proceeding as directed by its plenary supervisor, the Commission. An application under SIPA Section 11(b) is the Commission's only means to compel SIPC to invoke SIPA's protections for a broker-dealer's customers where, as here, the Commission determines that customers need protection but SIPC but refuses to abide by the Commission's determination. It would make no sense to require the Commission to effectuate a trigger of the "rapid" three-day period under SIPA Section 5(b) by first conducting a full-blown civil litigation against SIPC. Construing Section 11(b) as similarly allowing for a rapid summary proceeding against SIPC is the only way sensibly to construe the statute as a whole.

SIPC provides no answer to how the Commission effectively could exercise its enforcement authority under Section 11(b) if, as SIPC erroneously contends, that provision does not authorize the Commission to obtain expeditious relief against SIPC through a summary proceeding. Although SIPC lodges various arguments that a proceeding initiated by an SEC application under Section 11(b) is different – or in some cases less urgent – than a SIPC application under Section 5(a) – these arguments are misguided and fail to show that Section 11(b) authorizes only a regular civil action.

First, SIPC's contention that its application for a protective decree is different because it merely seeks to "begin the judicial process of liquidation proceedings against a SIPC 'Member'" (SIPC Brief at 14) ignores what may be, and is here, the identical ultimate objective of a Commission application: the start of the judicial process of liquidation proceedings.[4]

[4] Although the Commission possibly could seek other relief through an application under Section 11(b), this does not warrant a conclusion that a summary proceeding is unavailable where the Commission seeks commencement of a liquidation proceeding, as SIPC seems to suggest. *See* SIPC Brief at 15 n.5. Moreover, without knowing the nature of such a hypothetical dispute, it is impossible to delineate the Commission's required factual showing or the scope of this Court's review. Presumably the Court, with the assistance of the parties, would be able to fashion procedures appropriate to the circumstances of the summary proceeding initiated by such an application.

Second, the asserted lack of "exigency" in the present Stanford matter and passage of time since SGC was placed into receivership are, contrary to SIPC's assertions (SIPC Brief at 15-16), irrelevant to how Section 11(b) generally should be interpreted for this and future cases. There may be a future instance in which immediate action by SIPC ***is*** required to afford SIPA protections to a broker-dealer's customers and, because of a refusal by SIPC to act, the Commission must urgently seek enforcement under Section 11(b). The Commission's authority to "apply" for an order under this provision should be construed to allow for this possibility by enabling a summary proceeding against SIPC.[5]

Third, the Commission's initiation of a summary proceeding through an application under SIPA Section 11(b) is consistent with SIPC's regular practice of initiating a summary proceeding through an application for a protective decree under SIPA Section 5(a). SIPC does not seriously argue that that the proceedings it initiates to obtain protective decrees are anything but summary in nature, even when done through the filing of a pleading partially captioned as a "complaint." *See* SIPC Brief at 16-17, 21.[6] Indeed, SIPC essentially concedes that proceedings in which it obtains the broker-dealer's consent are summary. *See* SIPC Brief at 16 (contending that a SIPC complaint affords "substantive *de novo* review ***upon objection of the affected SIPC 'Member'"*** (emphasis in boldface italics added)). Nor can SIPC characterize proceedings in

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[5] Before its June 15, 2011, letter directing SIPC to take steps to commence a liquidation proceeding as to SGC, the Commission did not take a position as to whether such a proceeding was warranted. During this time, the Commission had an ongoing investigation that included SGC's activities and continued through early 2011 to receive relevant information from victims of the Stanford fraud.

[6] SIPC's practice is to seek a protective decree by filing either a simple "Application" (in a suit already initiated by the SEC) or a "Complaint and Application" (where SIPC must initiate the action). *See* SEC Opposition to Motion To Strike at 7 & n.6.

which it does not obtain consent as full-blown civil actions; SIPC may seek to expedite these cases through an order to show cause, just as the Commission has done here.[7]

SIPC's argument is not that it does not use summary proceedings to seek protective decrees under SIPA Section 5; rather, it posits that somehow these proceedings provide more process to the respondent than the Commission has provided here to SIPC. This argument is specious. SIPC states that where it obtains an order to show cause, "the allegedly failing broker-dealer is given a full and fair opportunity – with *de novo* review – to present its case" as to why a liquidation proceeding should not be commenced. SIPC Brief at 16-17. Thus, SIPC confirms that a summary proceeding that achieves prompt judicial resolution of disputed issues about the potential availability of SIPA coverage – all presumably within the urgent timeframe mandated by SIPA Section 5(b), 15 U.S.C. § 78eee(b) – is ***not*** inconsistent with allowing the respondent in such a proceeding a meaningful opportunity to be heard on the disputed issues.[8] In this proceeding, the Commission's requested Order To Show Cause would provide SIPC with ample opportunity to respond to the merits of the Commission's Application while still abiding by the expeditious summary process required by SIPA.

Fourth, SIPC argues that a summary proceeding is unavailable under Section 11(b) because it would be incompatible with a judicial resolution of the "Customer status" question as to SGC. SIPC Brief at 7, 18, 22. But the Commission Application as framed does not seek such resolution. Rather, the Commission's initial determination that a broker-dealer (such as SGC)

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[7] *See* SEC Opposition to Motion To Strike at 11-12 & n.9 (citing five cases since 1999 in which SIPC sought an order to show cause).

[8] That said, none of the Section 5 applications that SIPC filed in the last 14 years – with or without the broker-dealer's consent – and that Commission staff identified and reviewed in preparing the Commission Application appear to have resulted in the district court's denial of a protective decree sought by SIPC. *See* SEC Memorandum of Points and Authorities in Support of Application (filed Dec. 12, 2011) at 21-23 & nn.15-19 ("SEC Memorandum in Support of Application"); Declaration of Matthew Martens (filed Dec. 12, 2011) 5 & Exh. 4, Attachments A-O.

has failed or is in danger of failing to meet its obligations to customers – like SIPC's determination of the same issue, absent Commission objection – is not judicially reviewable.[9]

In any event, SIPC's argument is inconsistent with its own practice. SIPC itself has not always sought judicial resolution of the "customer" question. In particular, in seeking a protective decree as to broker-dealer C.J. Wright, SIPC did not submit ***any*** facts on which the reviewing court could determine "customer status." Moreover, SIPC stated in its application and supporting papers only that there "may be customers" in need of SIPA's protections:

- "SIPC has determined that Defendant has failed to meet its obligations ***to persons who may be 'customers'*** within the meaning of Section 5(a)(3) of SIPA , 15 U.S.C.A. §78eee(a)(3) (1981), and that there exists one of the conditions specified in section 5(b)(1) of SIPA, 15 U.S.C.A. §78eee(b)(1) (1981), in that, Defendant is insolvent and unable to meet its obligations as they mature."[10]

- "By reason of the facts hereinabove alleged, ***there may be customers*** of the Defendant broker-dealer in need of the protection provided by SIPA . . . ."[11]

- The Court should "enter a protective decree adjudicating that ***there may be customers*** of the Defendant broker-dealer in need of the protection under SIPA."[12]

- SIPC has filed "for a protective decree that persons ***who may be customers*** of C.J. Wright & Company Incorporated (the 'Debtor') ***may need the protection*** provided under the [SIPA] . . ."[13]

- "SIPC has made the determination required by section 78eee(a)(3), upon information supplied by the Commission and the National Association of Securities Dealers, that the Debtor has failed to meet its obligations to persons

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[9] *See* SEC Memorandum in Support of Application at 4, 11-35.

[10] *SIPC v. C.J. Wright & Co., Inc. (In re C.J. Wright & Co.)*, Case No. 5:91cv92-OC, Complaint and Application (filed Apr. 24, 1991) ¶ 4 ("SIPC *C.J. Wright* Application") (emphasis added), attached to Second Declaration of Matthew Martens ("Second Martens Decl.") as Exhibit 1.

[11] SIPC *C.J. Wright* Application ¶ 5 (emphasis added).

[12] SIPC *C.J. Wright* Application, Prayer for Relief (emphasis added).

[13] *SIPC v. C.J. Wright & Co., Inc. (In re C.J. Wright & Co.)*, Case No. 5:91cv92-OC, Memorandum of Law in Support of the Complaint and Application of SIPC (filed Apr. 24, 1991) at 1 ("SIPC *C.J. Wright* Memorandum") (emphasis added).

> ***who may be customers*** and that one or more of the conditions specified in section 78eee(b)(1) exists."[14]

Thus, SIPC by its own practice has shown that SIPC itself need not resolve definitively the "customer status" question before taking steps to commence a liquidation proceeding, and, further, that the district court hearing SIPC's application need not resolve definitively this question either before issuing a protective decree. Thus, SIPC cannot legitimately argue that the Commission's use of a summary proceeding against SIPC is precluded by either (1) the asserted requirement for this Court to determine the customer question, or (2) SIPC's professed need for discovery on the customer question.[15]

Fifth, although SIPC purports to rely on *SEC v. Alan F. Hughes, Inc.*, 461 F.2d 974 (2d Cir. 1972), for its argument that this Court must conduct a "*de novo*" review of "the predicate factual questions in this case," SIPC Brief at 18, the *Hughes* case at most holds that the court addressing SIPC's application to initiate a liquidation proceeding must provide review ***if*** the broker-dealer objects. The court in *Hughes* found that due process does ***not*** require an opportunity for a hearing "at the time SIPC makes its initial determination" of customer need, before SIPC files an application with the district court. *See Hughes*, 461 F.2d at 979. In any event, SIPC's claim that this Court must review the Commission's customer need determination is an issue to be resolved in addressing the merits of the Commission Application, not the SEC Motion for Order To Show Cause. And SIPC has failed to explain why a summary proceeding is

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[14] SIPC *C.J. Wright* Memorandum at 5 (emphasis added).

[15] Even were SIPC correct – which it is not – that this Court should review the Commission's customer need determination before ordering SIPC to initiate a liquidation proceeding, SIPC has not explained why that review could not also be conducted here in a summary manner. Despite having six months to review the Commission's analysis, SIPC has not in any of its filings indicated that it disagrees with the factual findings on which the Commission based its customer need determination. Nor could it likely do so, as those facts are consistent with those established in the ongoing Stanford litigation in the Texas Court. *See, e.g., Janvey v. Alguire*, 647 F.3d 585, 597 (5th Cir. 2011) (affirming district court finding that "the Stanford enterprise operated as a Ponzi scheme"); *id.* at 598 (holding that the "position that SGC [the brokerage] should be separated from SIB [the Antiguan bank] is of no moment" given SGC's receipt of funds from the sale of SIB CDs).

inadequate to evaluate the legal question of the proper scope of this Court's review of the Commission's customer need determination.

B. The Language and Structure of SIPA Permit a Summary Proceeding

The language and structure of the Act, like its purposes, also confirm that this proceeding is appropriately a summary one initiated by an order to show cause. SIPA expressly permits the SEC to make an "appl[ication]" to this Court, a term long understood to refer to summary proceedings under the federal securities laws.

1. *McCarthy* Supports Treating the SEC Application as a Summary Proceeding

By providing that the Commission "may apply" for a district court order requiring SIPC to discharge its statutory obligations, SIPA Section 11(b) "expressly authorize[s]" the Commission to bring this summary proceeding against SIPC. *SEC v. McCarthy*, 322 F.3d 650, 655 (9th Cir. 2003) (citing *New Hampshire Fire Ins. Co. v. Scanlon*, 362 U.S. 404, 407-08 (1960)); *see also SEC v. Sprecher*, 594 F.2d 317, 320 (2d Cir. 1979); SEC Opposition to Motion To Strike at 6-7. Congress's decision to use the word "apply" rather than the phrase "bring an action" in Section 11 was significant, because elsewhere in the securities laws Congress specifically uses the words "action" or "bring an action" "when it intends to require the Commission to file a formal civil action to initiate proceedings." *McCarthy*, 322 F.3d at 657; *see, e.g.*, 15 U.S.C. § 78u(d)(1) ("bring an action"). The use of "apply" in Section 11 warrants the "well-established canon of statutory interpretation that the use of different words or terms within a statute demonstrates that Congress intended to convey a different meaning for those words." *McCarthy*, 322 F.2d at 656.

SIPC cannot evade the persuasive reasoning of *McCarthy* no matter how "careful" a reading of this case it asserts. SIPC Brief at 9. SIPC's observation that Rule 1 of the Federal

Rules of Civil Procedure states that "the Federal Rules apply to both 'actions' and 'proceedings'" (SIPC Brief at 9) is a non-starter. Although Rule 1 was amended in 2007 (after the *McCarthy* decision) to include reference to the word "proceedings," the Advisory Committee Notes make clear that "[t]his change does not affect such questions as whether the Civil Rules apply to summary proceedings created by statute." FRCP Rule 1, Advisory Committee Note (citing *McCarthy* and *Scanlon*); *see also* SEC Opposition to Motion To Strike at 6 n.5.

Similarly unavailing is SIPC's attempt to distinguish *McCarthy* on the ground that the court in that case concluded that Section 21(e)(1) of the Securities Exchange Act of 1934 authorized summary proceedings "only after a close review of the 'plain meaning' and structure of the Exchange Act itself." SIPC Brief at 10. The reasoning that underlies that court's "close review" applies equally to SIPA Section 11, because SIPA generally functions as an amendment to the Exchange Act. *See* SIPA Section 2, 15 U.S.C. § 78bbb; SEC Opposition to Motion To Strike at 6-7. There is no significant difference in "structure" between Exchange Act Section 21(e)(1), which authorizes particular forms of judicial relief "[u]pon application of the Commission," 15 U.S.C. § 78u(e)(1), and SIPA Section 11(b), which provides that the Commission "may apply" for another form of judicial relief, 15 U.S.C. § 78ggg(b).

Contrary to SIPC's description of *McCarthy*, the court in that case did ***not*** hold that Exchange Act Section 21(e)(1) authorizes summary proceedings "only because" the parties already had litigated an underlying dispute that gave rise to the proceeding at issue. SIPC Brief at 10. While the court recognized that summary proceedings were "particularly appropriate" in such a circumstance, the court by no means indicated that summary proceedings should be limited to these circumstances. Quite the opposite, the court explained: "Summary proceedings are utilized in other legal contexts as well. So long as express statutory authorization exists,

courts have deemed summary proceedings permissible in a number of different contexts." *McCarthy*, 322 F.3d at 658.[16]

Here, as in *McCarthy*, the Commission seeks a summary proceeding that will allow the respondent an "opportunity to be fully heard." SIPC Brief at 10. Despite approving the use of a summary proceeding in *McCarthy*, the court of appeals remanded the matter to the district court for consideration of respondent's arguments in opposition to the Commission's application in the first instance. *McCarthy*, 322 F.3d at 659-60. The court of appeals did this – without Commission opposition – because the district court erroneously had granted the Commission's application without affording the respondent an opportunity to respond. *See id.* at 659. The district court's error would not have occurred had the court "issued an order to show cause as to why the Application should not be granted, or set a hearing on the matter." *Id.* Similarly here, the Commission asks this Court to issue an order to show cause precisely for the reason of allowing SIPC an "opportunity to respond" to the Commission Application for an order directing SIPC to take steps to commence a liquidation proceeding.[17] *Id.*

Finally, *SEC v. J.W. Barclay & Co., Inc.*, 442 F.3d 834 (3d Cir. 2006), far from "den[ying] significance to *McCarthy*'s distinction between 'applications' and 'actions' in the context of the Exchange Act," SIPC Brief at 10, reaffirms this distinction and further undermines SIPC's challenge to the applicability of that analysis to this case. In *J.W. Barclay*, the court was

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[16] The court in *McCarthy* observed that courts had affirmed summary proceedings for the Commission's enforcement of investigative subpoenas, *id.* at 658 (citing *Sprecher*, 594 F.2d at 320), and for the enforcement of IRS jeopardy levies, *McCarthy*, 322 F.3d at 658 (citing *United States v. First Nat'l. City Bank*, 568 F.2d 853 (2d Cir. 1977)), among other purposes. Notably, neither of these scenarios involves prior litigation of the "merits" of a particular dispute. By using a summary proceeding to enforce a jeopardy levy, for example, the IRS in *First National City Bank* sought to reach the assets of a suspected delinquent taxpayer without regard to the timeframe by which the taxpayer's liability was litigated, and, as affirmed by the court of appeals, even without intervention by the taxpayer in the summary proceeding. *See id.*, 568 F.2d at 854-55, 857-59.

[17] *See* SEC Motion for Order To Show Cause at 2; SEC Memorandum in Support of Motion for Order To Show Cause at 5; SEC Opposition to SIPC Motion To Strike at 4-5, 10.

presented with the issue of whether an individual was liable as a "control person" under Section 20(a) of the Exchange Act on the asserted ground that he had induced an "act or acts constituting the violation or cause of action" under another provision of the Exchange Act. *J.W. Barclay*, 442 F.3d at 844 & n.15. The court concluded that the failure of the company for which the individual served as president to pay a penalty was an act constituting a cause of action under Exchange Act Section 21(e). *See id.* at 844. The court also found that this holding was not inconsistent with the *McCarthy* court's approval of summary proceedings under that same provision. *Id.* at 844 n.16. The word "action" had a "general definition" that could encompass "special proceedings" initiated by the Commission that were "not conducted as full civil actions government by the Federal Rules of Civil Procedure." *Id.* Thus, the court found, the distinction drawn by the *McCarthy* court between "applications" and "actions" "for the purpose of determining whether SEC applications brought under § 21(e)" were summary proceedings was inapplicable "to the issue of whether the failure to comply with an SEC order constitutes a 'cause of action' under § 21(e)." *Id.*

2. The Analogy to a Subpoena Enforcement Proceeding is Apt

The Commission's use of summary proceedings under its statutory authority to file an "application" for enforcement of subpoenas further supports the Commission's construction of SIPA Section 11(b) as allowing for a summary proceeding here. *See* SEC Opposition to Motion To Strike at 8-9. SIPC challenges the Commission's analogy to the subpoena enforcement context on the asserted ground that a subpoena is intended only to initiate discovery, and "not to prove a pending charge or complaint." SIPC Brief at 11. This argument ignores the basic fact that a subpoena enforcement proceeding resolves the propriety of the subpoena itself. And the propriety of the subpoena does not get litigated before the summary subpoena enforcement proceeding takes place. Thus, the subpoena enforcement proceeding demonstrates that summary

proceedings can be used finally to resolve issues that have not previously been litigated. The analogy is apt.

3. Other Statutory Provisions for "Applications" Do Not Undercut SIPA's Authorization of Summary Proceedings

SIPC cites cases in which parties have not used summary proceedings even though relevant statutory language allows them to "apply" for relief. SIPC Brief at 9. However, these cases do not affect the availability of summary proceedings under SIPA Section 11(b). Specifically, SIPC cites 12 U.S.C. § 1818(c)(2), which provides that after a Federal banking agency issues a temporary cease-and-desist order, the affected party may apply for an injunction providing relief from the order. SIPC Brief at 9. It is unsurprising – and wholly irrelevant to this Court's construction of SIPA Section 11(b) – that private parties seeking to obtain injunctive relief against a federal agency have apparently done so by filing a civil action, rather than a summary proceeding. *See Lenz v. FDIC*, 251 F. Supp. 2d 121 (D.D.C. 2003), cited in SIPC Brief at 9.[18]

4. Statements that the SEC Has an "Action" Under Section 11(b) Do Not Disallow Summary Proceedings Under that Provision

SIPC continues to excerpt references from a variety of sources – case law, including the Supreme Court's decision in *SIPC v. Barbour*, 421 U.S. 412 (1975), and various Commission statements, *see* SIPC Brief at 12-14 – to the effect that the Commission can bring an "action" or "suit" under SIPA Section 11(b). SIPC's hypersensitivity to terminology used ***outside the statute itself*** is unavailing. In each of the contexts cited by SIPC, no one (including the Supreme Court and the SEC) was addressing the type of proceeding that the Commission could bring

[18] SIPC's citation to *United States v. Roberts & Oake*, 65 F.2d 630 (7th Cir. 1933), SIPC Brief at 9, is also unavailing. The short analysis provided by the court of appeals in that decision, issued nearly 30 years before the Supreme Court's decision in *Scanlon* and 70 years before *McCarthy*, addressing the Department of Agriculture's attempt to seek a court injunction for the enforcement of a bond requirement, hardly informs the proper construction of the Commission's authority to seek relief against SIPC under SIPA Section 11(b).

under Section 11(b). Thus, these references to "actions" and "suits" were of a general nature, and easily could be taken to encompass summary proceedings of the sort the Commission now has initiated. *See J.W. Barclay*, 442 F.3d at 844 n.16 (concluding summary proceedings brought under the Exchange Act "fit [the] general definition of an 'action' – even if they are not conducted as full civil actions governed by the Federal Rules of Civil Procedure – because they are judicial proceedings which terminate in a judgment or decree"); *see also* SEC Opposition to Motion To Strike at 9. For purposes of determining the Commission's authority under Section 11(b), the dispositive language is in the provision itself, and that provision states that the Commission "may apply" for an order directing SIPC to discharge its obligations, thus indicating that the Commission may initiate a summary proceeding.

5. SIPC's Invocation of the Federal Rules Does Not Convert This Proceeding Into a Standard Civil Action

SIPC's generic contention that "the Federal Rules of Civil Procedure Apply" (SIPC Brief at pages 18-22) merely restates its erroneous argument that Section 11(b) requires the Commission to file a standard civil action against SIPC, the language and structure of SIPA and the weight of the case law notwithstanding. By citing cases that do not involve summary proceedings (or even attempts by parties to use them), SIPC adds nothing to its argument. *See* SIPC Brief at 19 (citing *Califano v. Yamasaki*, 442 U.S. 682 (1979) and *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431 (2010)). These cases address the applicability of certain Federal Rules, such as the class action provisions of Rule 23, to proceedings that are indisputably civil actions. They have nothing to do with whether a proceeding is summary in the first instance.

SIPC's reliance on *Application of Howard*, 325 F.2d 917 (3d Cir. 1963) (SIPC Brief at 19-20) is also misplaced, as that decision merely restated the proposition, confirmed in *Scanlon*,

that summary proceedings generally must be authorized by rule or statute, *see id.* at 919 ("the applicant instituted a summary proceeding for which the rules make no provision"). Here, unlike in *Howard*, the relevant statute expressly authorizes use of summary proceedings.

SIPC proffers the alternative argument that, "even if this were a summary proceeding . . . the Federal Rules would still apply." SIPC Brief at 20. But this cannot mean that ***all*** of the rules would apply, as that would defeat the very point of a summary proceeding. The Commission, of course, does not dispute that certain provisions of the Federal Rules – for example, rules regarding the form and service of motions and other papers – might provide helpful guidance to the Court and the parties in structuring a summary proceeding under Rule 11(b). But SIPC's demands for a Rule 16 Conference accompanied by burdensome discovery and fact-finding would serve no useful purpose in light of SIPA's requirements and should be rejected, as discussed in prior Commission filings and below.

C. The Commission Motion Does Not Unfairly Seek To "Flip the Burden"

SIPC contends that the SEC Motion for Order To Show Cause seeks to "stack the deck" by shifting the burden to SIPC to prove it has not discharged its obligations. SIPC Brief at 5-8. This argument is without merit. As an initial matter, the show-cause procedure is a familiar judicial procedure that lacks any inherent unfairness. The Commission has made a customer need determination and a *prima facie* showing to this Court. If the Commission's construction of SIPA is correct and the only two factual predicates that are material under that construction are met, then its Application should be granted. Both of the factual predicates under the Commission's approach – that the Commission made a customer need determination as to SGC and that SGC is insolvent (and the subject of a receivership) – are not and cannot be disputed. The Commission has met its initial burden by making out a *prima facie* case, and the only

justification for any further proceedings in this matter would be if SIPC can show that the Commission's construction of SIPA is somehow incorrect. Thus, the show-cause procedure does not unfairly "flip the burden" any more than when a movant for summary judgment makes out a *prima facie* case and the non-movant is required to respond with a sufficient basis to avoid summary judgment.[19]

SIPC next contends that the SEC must bear the burden of establishing "customer" status in this Court, citing cases holding that claimants in a SIPA liquidation proceeding bear the burden of showing that they are protected "customers" under SIPA. SIPC Brief at 7. Those cases are inapposite here, where the Commission has applied under Section 11(b) for an order requiring SIPC to act. The purpose of *this* proceeding is to compel SIPC to take steps to initiate a liquidation proceeding in which the claimants can seek to establish their "customer" status under SIPA. SIPC has not cited any cases holding that the Commission – which is not a claimant but instead SIPC's plenary supervisor seeking judicial enforcement of its formal directive that SIPC begin a liquidation proceeding – must make the showing the claimants would be required to make on their own behalf in the liquidation proceeding. Indeed, the rule in SIPC's cited cases supports the Commission's explanation that litigation of the "customer" question is

[19] Even if, as SIPC contends, the Commission's customer need determination is reviewable in this proceeding, the Order To Show Cause should nonetheless issue. The Commission has formally determined that a customer is in need of protection and has supported that conclusion with factual findings supported by a record. *See* Commission Analysis, Martens Decl. Exh. 2. The Commission's findings and evidentiary support cited therein are sufficient to satisfy any burden the Commission may have to make a *prima facie* showing on the customer need question in order to obtain an order to show cause. Indeed, courts in the ongoing receivership proceeding in the Texas Court have made findings consistent with those of the Commission here. *See Janvey*, 647 F.3d 597-98. In response to an order to show cause, SIPC would then identify those Commission factual findings with which SIPC takes issue, if any, and offer any legal arguments regarding the sufficiency of those allegations to establish a customer in need of protection. But the fact that SIPC may contest the Commission's factual findings or legal conclusions is no reason to deny the Commission's request for an order to show cause directing SIPC to offer its factual objections or legal arguments. Nothing about this process "flips the burden" on SIPC. And even under SIPC's view that the customer need issue is reviewable in this proceeding, there is simply no reason to embark on discovery if SIPC does not take issue with the factual findings underlying the Commission's analysis.

unnecessary in this court because that question will be adequately litigated during the liquidation proceeding in the Texas Court.

Finally, SIPC asserts that, if the Commission's approach were correct, Congress could simply have empowered the Commission to require SIPC to begin a liquidation and there is no purpose in involving the courts. SIPC Brief at 7. The purpose is, of course, the availability of the contempt power for enforcement of an order against SIPC, once obtained from the court. SIPC is a private organization and the Commission needs (as Congress recognized) to enlist the judicial power to require SIPC to act. To support its contention, SIPC cites certain SIPA provisions that authorize the Commission to directly "require" SIPC to take certain actions. SIPC Brief. at 7-8. But in those instances, as here, if SIPC failed to take such required action, the Commission would be compelled to file an application with this Court under Section 11(b) seeking an order, enforceable by the contempt power, directing SIPC to take the required action. Thus, the purpose in involving the courts is readily apparent.

D. The Commission Application Does Not Depend On *Chevron* Deference

SIPC's claim that the Commission's construction of SIPA is not entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), also misses the mark. SIPC Brief at 5. This argument reflects a fundamental misunderstanding of the *Chevron* doctrine and confuses two distinct issues – discretion granted to the Commission by the statute and deference to the Commission in interpreting the statute. Here, the Commission has shown that, based on the text, structure, legislative history, and purposes of SIPA, Congress intended the Commission to have discretion to make an initial customer need determination. If this Court agrees, that is the end of the matter under step one of *Chevron*. Even if congressional intent were unclear and the statute silent or ambiguous, the issue of *Chevron* deference still

would be irrelevant because the Commission has persuasively shown that it has provided the best reading of the statute. Finally, SIPC ignores the court's statement in *In re New Times Securities Services, Inc.*, 371 F.3d 68 (2d Cir. 2004), that "[u]ltimately, we agree with the SEC that '[w]hatever SIPC's expertise in overseeing SIPA liquidations, Congress did not intend for the Commission's interpretations of SIPA to be overruled by deference to the entity that was made subject to the Commission's oversight.'" *Id.* at 80; *see also id.* ("deference to SIPC, under the circumstances presented here, would impermissibly undermine [the] statutory hierarchy"); *id.* at 76-77 ("[W]e find that Congress deliberately limited the authority of SIPC relative to the SEC."). SIPC also ignores the actual outcome in *New Times*, where the court deferred to the Commission's interpretation over SIPC's interpretation based on *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). *See New Times*, 371 F.3d at 87.[20]

II. Discovery is Unnecessary At This Juncture

The Commission has demonstrated that discovery is unnecessary to resolve the Commission Application, if the Court agrees with the Commission's interpretation of its authority under Section 11(b). *See, e.g.*, SEC Opposition to SIPC Motion to Strike at 13-15. The SIPC Brief fails to counter the Commission's showing.

As the Commission has explained, under its construction of SIPA, the only factual predicates here are (a) that the SEC has exercised its discretion and determined that customers are in need of protection under SIPA, and (b) that one of the other statutory predicates for

[20] In any event, the Commission's construction of SIPA may well be entitled to *Chevron* deference. Congress expressly directed that the Exchange Act apply to SIPA as if SIPA were an amendment to and included in that Act, 15 U.S.C. § 78bbb, and Congress entrusted SIPA to the Commission's expert administration. The Commission clearly has the power to develop rules addressing the issues in this case, including the meaning of "customer" and the grounds on which SIPC must begin a proceeding. The circumstances of *In re New Times Sec. Servs.*, 371 F.3d 68, 80-82 (2d Cir. 2004), in which the Commission did not ask for deference to its construction of SIPA that came for the first time in an *amicus* brief on appeal in the context of a liquidation proceeding, and the court did not give such deference, *id.* at 80-82, are readily distinguishable. Here the Commission's interpretation is embodied in a formal determination, made prior to any litigation, and in the context of the Commission's explicit authority to enforce SIPC's obligations under SIPA.

initiation of a liquidation (such as the insolvency of the broker-dealer or its being subject to receivership) is present. *See* Memorandum in Support of Commission Application at 4, 18-23; SEC Opposition to SIPC Motion To Strike at 14. SIPC asserts that "there ***is*** in fact a genuine dispute as to whether such 'factual predicates' have been satisfied," and then lists several factual issues. SIPC Brief at 22-23. None of the listed issues, however, has any bearing whatsoever on the factual predicates to which the Commission referred. Those factual predicates remain undisputed, and cannot be disputed. Moreover, SIPC has failed to show how any other factual issues could bear on the evaluation of the correctness of the Commission's statutory construction. The SEC Motion for Order To Show Cause and Commission Application present a purely legal, threshold issue for the Court's resolution, until which any discovery or other procedures are unnecessary, and would be a waste of the court's and parties' resources.

SIPC contends that even if this were a summary proceeding the Federal Rules governing discovery would still apply. SIPC Brief at 20. The Commission, however, has not argued that every summary proceeding in the courts must proceed without discovery. The Commission has shown that discovery should not be had in this particular proceeding based on, *inter alia*, the purpose of the statute to achieve promptness; the statutory preclusion of judicial review of a determination of customer need made by SIPC when it begins a liquidation; and the text of Section 11(b) authorizing the Commission to "apply" for an order. The Commission also has explained that there is no information to be discovered that would tend to contradict the Application's only two factual predicates.

SIPC next argues that "[c]ourts regularly permit discovery in actions brought to compel agency action *when the factual record requires development*." SIPC Brief at 23 (emphasis added). SIPC's proposition is inapplicable by its own terms because, here, the factual record

requires no development. Additionally, SIPC misreads *United States v. Garrett*, 571 F.2d 1323 (5th Cir. 1978), and that case is readily distinguishable. SIPC quotes a generic statement by the court that the Federal Rules apply in summary proceedings to enforce IRS summonses. SIPC Brief at 20. But the court's holding was that taxpayers may claim the benefit of the discovery rules where the IRS's purpose in issuing a summons legitimately has been put in issue (*e.g.*, through a claim of harassment) and the taxpayer has alleged circumstances under which that purpose would bear on the legality of the summons. *See* 571 F.2d at 1326. Here, as noted, SIPC has failed to identify any factual issues that would bear on the merits of the Commission Application under a proper construction of SIPA. Finally, the Fifth Circuit has recognized that *Garrett* has been eroded by subsequent Supreme Court precedent, *see United States v. Harris*, 628 F.2d 875, 882-83 (5th Cir. 1980), and congressional enactment, *In re EEOC*, 709 F.2d 392, 398-99 (5th Cir. 1983) ("[T]he relatively liberal preenforcement standards [in IRS cases] have proven so unsatisfactory . . . that Congress has changed the law.").[21]

SIPC's reliance on *A.O. Smith Corp. v. FTC*, 530 F.2d 515 (3d Cir. 1976), is similarly misplaced. The Commission acknowledges that discovery is not categorically foreclosed in all summary proceedings. Nevertheless, as the court in *A.O. Smith* correctly declared, "the compass of available discovery is circumscribed by the requirement that discovery be 'relevant to the subject matter involved in the pending action.'" *Id.* at 527. Significantly, even where any discovery should be available, the court recognized that the need for a prompt determination in a summary proceeding suggests that "bounds to discovery be set," and that where "what is to be

[21] Notably, the "discovery" at issue in the IRS cases is only the "chance to question Service officials at a subpoena enforcement hearing." *EEOC*, 709 F.2d at 397-98. "Depositions, interrogatories, and the rest of the panoply of expensive and time-consuming pre-trial discovery devices may *not* be resorted to as a matter of course …." *Id*. at 398 (emphasis in original). Indeed, *Garrett* itself admonished that any discovery in an IRS summons enforcement proceeding is "more restricted" than in a usual civil case because (1) the "issues relevant to enforcement are few and the available sources of evidence are extremely limited," and (2) wider discovery would place the agency under a severe handicap due to the potential for delays which would jeopardize the effectiveness of the entire investigation. *Id.* at 1326-27.

reviewed is administrative agency action entitled to some judicial deference . . . full, unbridled discovery may be inappropriate." *Id.*

Finally, SIPC argues that "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." SIPC Brief at 23. Again, SIPC's proposition is inapplicable by its own terms. As framed by the Commission Application, this matter is solely an abstract legal dispute. In any event, SIPC's cited authorities do not even remotely stand for SIPC's convoluted proposition.

By way of example, SIPC describes *G.E. v. EPA*, 360 F.3d 188, 192 (D.C. Cir. 2004), as "reversing in part and directing the district court to permit discovery in [an] as-applied constitutional challenge." SIPC Brief at 23-24. A review of the opinion discloses that the court reversed the dismissal of the complaint for lack of subject matter jurisdiction and simply remanded to the district court to "address the merits of [the plaintiff's] *facial* due process claim." 360 F.3d at 281 (emphasis added). The word "discovery" does not even appear once in the court opinion. Moreover, in *Elk Run Coal Co. Inc. v. U.S. Dep't of Labor*, 2011 WL 3627163 (D.D.C. Aug. 18, 2011), (cited in SIPC Brief at 24), it was undisputed that plaintiff's facial due process challenge was ripe for review on a motion to dismiss and "no discovery is necessary," *id.* at *12.[22]

SIPC's claimed need for discovery on the customer status question is at odds with its own practice. For example, in *C.J. Wright*, SIPC sought an adjudication that there "may be

[22] Even as to plaintiff's as-applied due process challenge against the government in *Elk Run* – which is wholly unlike the issues before the Court here – the court did not "require" discovery but rather, upon denying the government's motion to dismiss this claim, made the unremarkable observation, in dicta and in the context of a plenary civil action, that it would be better able to evaluate the plaintiff's contention that it had a legitimate property interest after further proceedings. *Elk Run*, 2011 WL 3627163, at *18.

customers" in need of SIPA's protections. *See supra* Argument Section I.A. If SIPC can begin a liquidation proceeding on this basis, this wholly undermines SIPC's contention here that extensive discovery is needed so that the Court can resolve the customer status question before issuing the Commission's requested order directing SIPC to take steps to commence a liquidation proceeding. In any event, for all of the reasons discussed in Commission's prior filings, the Commission Application does not present in this Court the issue of whether the Commission's determination was correct.

CONCLUSION

For the foregoing reasons, and for the reasons stated in the SEC Motion for Order To Show Cause, the SEC Memorandum of Points and Authorities in Support of Motion for Order To Show Cause, and the SEC Opposition to Motion To Strike, the Commission respectfully submits that the requested Order To Show Cause should be issued.

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Respectfully submitted,

/s/ David S. Mendel

Matthew T. Martens
Chief Litigation Counsel
David S. Mendel (D.C. Bar #470796)
Assistant Chief Litigation Counsel
U.S. Securities and Exchange Commission – Enforcement Division
100 F Street, NE
Washington, DC 20549
(202) 551-4481 (Martens)
(202) 551-4418 (Mendel)
(202) 772-9362 (fax)
martensm@sec.gov
mendeld@sec.gov

Of Counsel:
Michael A. Conley
Deputy General Counsel
Michael L. Post
Senior Litigation Counsel
Office of the General Counsel

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of January, 2012, I caused service of the foregoing SECURITIES AND EXCHANGE COMMISSION'S REPLY BRIEF IN SUPPORT OF ITS *EX PARTE* MOTION FOR AN ORDER TO SHOW CAUSE WHY THE SECURITIES INVESTOR PROTECTION CORPORATION SHOULD NOT BE ORDERED TO FILE AN APPLICATION WITH RESPECT TO STANFORD GROUP COMPANY by ECF on the following:

Eugene F. Assaf, P.C. (Eugene.assaf@kirkland.com)
Edwin John U (Eu@kirkland.com)
John O'Quinn (John.oquinn@kirkland.com)
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
Telephone: (202) 879-5000

/s/ David S. Mendel

Matthew T. Martens
Chief Litigation Counsel
David S. Mendel (D.C. Bar #470796)
Assistant Chief Litigation Counsel
U.S. Securities and Exchange Commission – Enforcement Division
100 F Street, NE
Washington, DC 20549
(202) 551-4481 (Martens)
(202) 551-4418 (Mendel)
(202) 772-9362 (fax)
martensm@sec.gov
mendeld@sec.gov