12-410(L)

12-437 (CON), 12-483 (CON), 12-529 (CON)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Bricklayers and Allied Craftsman Local 2 Annuity Fund (additional Appellants on next page)

Appellants,

James L. Kruse, Henry T. DeNero, Nancy S. DeNero, Charles F. Rolecek, C. Thomas Brown, Margaret H. Brown, Sally S. Beaudette, Marshall G. Rowe, Lee F. Wood, Harvey A. Taylor, Markian D. Stecyk, Donald H. Hangen, Martha L. Wood, Robert H. Scott, Molly McNaughton, Jan Feldman, James P. Dulany, Neva Rosamilia, Nicholas Rosamilia,

Claimants - Appellants,

Securities Investor Protection Corporation, Irving H. Picard,

Appellees,

Securities and Exchange Commission,

Intervenor.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION

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Bricklayers and Allied Craftsworkers Local 2, Health Benefit Fund, Bricklayers & Allied Craftworkers, Local No. 2, AFL-CIO, Building Trade Employers Insurance Fund, Central New York Laborers Annuity Fund, Central New York Laborers Health and Welfare Fund, Central New York Laborers Pension Fund, Central New York Laborers Training Fund, Construction Employers Association of CNY, Inc., Construction and General Laborers' Local No. 633, AFL-CIO, Engineers Joint Welfare Fund, Engineers Joint Training Fund, International Brotherhood of Electrical Workers Local Union No. 43 and Electrical Contractors Pension Fund, International Brotherhood of Electrical Workers Local No. 43 and Electrical Contractors Welfare Fund, I.B.E.W. Local 241 Welfare Benefits Fund, I.B.E.W. Local 910 Welfare Fund, Laborers' Local 103 Annuity Fund, Laborers' Local 103 Welfare Fund, New York State Lineman's Safety Training Fund, Oswego Laborers' Local No. 214 Pension Fund, Plumbers, Pipefitters and Apprentices Local No. 112 Health Fund, Roofers' Local 195 Annuity Fund, Roofers' Local 195 Health & Accident Fund, Syracuse Builders Exchange, Inc. /CEA Pension Plan, Service Employees Benefit Fund, Service Employees Benefit Fund of Upstate New York, S.E.I.U. Local 200 United, AFL-CIO, Syrabex, Inc., Syracuse Builders Exchange, Inc., U.A. Local 73, Plumbers & Fitters, AFL-CIO, Local 73 Retirement Fund, Upstate Union Health and Welfare Fund, Upstate New York Bakery Drivers and Industry Pension Fund,

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COUNTER-STATEMENT OF THE ISSUE PRESENTED

The Securities Investor Protection Act of 1970 ("SIPA") protects as a "customer" a person who has a claim for securities or cash that is being held for that person's account with a failed broker-dealer. Such persons enjoy a favored status as compared with other creditors and are each eligible to receive an individual payment (up to a statutory maximum) from a fund maintained by the Securities Investor Protection Corporation ("SIPC"). The claimants here undisputedly did not have accounts with failed broker-dealer Bernard L. Madoff Investment Securities, LLC ("BLMIS"). Rather, claimants purchased interests in other entities known as "feeder funds" that did have accounts with BLMIS and invested at least a portion of their assets with BLMIS. The issue presented is whether these feeder fund investors who did not have accounts at BLMIS are "customers" of BLMIS entitled to the special protections of SIPA.

STATEMENT OF THE CASE AND OF THE FACTS

The claims at issue in these appeals were filed by investors in sixteen investment funds that had securities accounts with BLMIS. *See Aozora Bank Ltd. v. SIPC*, 2012 WL 28468, at *1 & n.1 (S.D.N.Y. Jan. 4, 2012). The funds were legal entities – limited partnerships and limited liability companies organized under the laws of New York and Delaware, and companies organized under the laws of the Cayman Islands and British Virgin Islands. *See id.* at *1. Investors purchased ownership interests in the fund entities – shares and limited partnership interests. *See id.* at *4 n.3, *7, *10. *See also* Exh. 61 (offering of common shares) attached to Declaration of David J. Sheehan, dated June 11, 2010 ("Sheehan Dec.") (JA 1215-1294).

The funds had securities accounts with BLMIS, and the funds' assets in those accounts were purportedly invested by BLMIS using Madoff's "split strike conversion strategy." Typically, the prospectuses and private placement memoranda received by persons who purchased interests in the funds state that management of the funds' business is the responsibility of the general partners or managing members, who delegate responsibility for investing part or all of the funds' assets to an investment advisor, which either is expressly identified as BLMIS, is described in a way that refers to BLMIS, or is not identified. *See e.g.*,

Sheehan Dec. Exh. 64, Kingate Global Fund Amended and Restated Information Memorandum, at 4 (JA 1314) ("All decisions with respect to the general management of the Fund are made by the Manager, who has complete authority and discretion in the management and control of the business of the Fund, including the authority to delegate all investment management activities to the selected Investment Advisor."); *id*. at ii (JA 1299) ("The Fund's assets are managed by a New York based NASD registered broker-dealer . . . [that] utilizes a 'split strike conversion' options strategy . . . .").

On June 11, 2010, the SIPC trustee appointed to carry out the liquidation of BLMIS, Irving H. Picard, made a motion in the Bankruptcy Court for the Southern District of New York overseeing the liquidation seeking an order affirming his denial of the claims of investors in the funds. Trustee's Motion to Affirm Trustee's Determinations Denying Claims of Claimants Without BLMIS Accounts in Their Names, Namely, Investors in Feeder Funds, dated June 11, 2010 ("Trustee's Motion") (ECF No. 2416). The Securities and Exchange Commission filed a Memorandum of Law supporting the Trustee's denial of claims. On June 28, 2011, the Bankruptcy Court granted the Trustee's Motion, to the extent set forth in the court's memorandum of decision (*i.e.*, with respect to the sixteen feeder funds named in the Trustee's Motion). Memorandum Decision and Order Granting, to the

Extent Set Forth Herein, Trustee's Motion to Affirm Trustee's Determinations Denying Claims of Claimants Without BLMIS Accounts in Their Names, Namely, Investors in Feeder Funds, *SIPC v. Bernard L. Madoff Inv. Sec. LLC*, 454 B.R. 285 (Bankr. S.D.N.Y. 2011) ("*BLMIS*"). Certain claimants appealed to the U.S. District Court for the Southern District of New York. The Commission filed a Memorandum of Law in the district court supporting the Bankruptcy Court's decision. The district court affirmed, holding that "these investors do not qualify as 'customers' under the plain language of [SIPA]." *Aozora Bank*, 2012 WL 28468, at *1. These appeals followed. The Commission submits this brief in order to address an important question regarding the interpretation of SIPA.[1/]

[1/] This brief addresses whether the claimants who invested in the sixteen feeder funds named in the Trustee's motion are "customers" under SIPA. The Trustee's Motion did not seek affirmance of his denial of claims involving other feeder funds, or of claims involving other types of entities where the claimants did not have accounts with BLMIS. *See* Trustee's Motion at 6, ¶ 12; Sheehan Dec. at ¶ 3 (JA 445); Sheehan Dec. Exh. 1 (JA 457) (listing sixteen funds to which motion applied). The Bankruptcy Court's and the District Court's decisions likewise did not address such other claimants. *BLMIS*, 454 B.R. at 291 n.7; *Aozora Bank*, 2012 WL 28468, at *1. Whether other claimants are "customers" within the meaning of SIPA will depend upon an analysis of the particular factual circumstances of their claims and how SIPA applies under those circumstances.

The Commission is submitting this brief as intervenor in accordance with a determination of the Office of the Clerk of this Court. Under SIPA Section 5(c), the Commission may "file notice of its appearance in any proceeding under the Act and may thereafter participate as a party." 15 U.S.C. 78eee(c). The Commission filed its notices of appearance in these appeals on April 14, 2012.

SUMMARY OF THE ARGUMENT

The Securities and Exchange Commission urges affirmance of the District Court's decision rejecting "customer" status under SIPA for claimants who did not themselves have accounts with BLMIS but who instead had invested in entities, called "feeder funds," that did have accounts with BLMIS. The claimants make various arguments on appeal based upon their interpretation of the "customer" definition in SIPA Section 16(2), 15 U.S.C. 78*lll*(2), and the case law. The Commission, based upon its expertise in this area and its analysis of the statute, legislative history, and cases as applied to the facts pertaining to the claimants' investments in the sixteen feeder funds, concludes that Congress did not intend the claimants to have "customer" status under SIPA. Although the feeder funds that had the accounts with BLMIS are "customers" entitled to SIPA protection, the investors in those funds are not.

SIPA protects a person who has a claim for securities or cash that is being held for that person's account with the debtor broker-dealer. The claimants here, who undisputedly did not have accounts with BLMIS, seek to be treated in the liquidation of BLMIS like other investors who did have accounts with BLMIS. The account requirement, however, reflects Congress's purpose in SIPA of protecting assets that are held by brokerage firms for their customers. The account

requirement is also supported by the plain meaning of the language chosen by Congress to define a "customer."

The account requirement is further supported by consideration of SIPA's statutory structure. Congress included numerous provisions in SIPA that refer to a customer's securities account that would be difficult to square with a "customer" definition that allowed such accounts to be somewhere other than with the debtor, or did not require an account at all. Moreover, SIPA contains an express exception – which claimants do not contend applies to them – for those who have an indirect relationship with the debtor though a bank or another broker-dealer. Congress's inclusion of that exception evinces an intent that unexpressed, additional exceptions not be created.

In addition, the legislative history of SIPA reveals that early versions of the Act contained provisions that would have protected (in addition to account holders) third-party beneficiaries like the claimants here. The fact that the those broader proposals did not become law suggests a congressional intent that such third-party beneficiaries not be covered.

Finally, the principal cases from other jurisdictions on which claimants rely are readily distinguishable, whereas a decision of this Court held, after thorough analysis, that claimants under analogous circumstances were not "customers."

ARGUMENT

I. The Securities Investor Protection Act and the "Customer" Definition

The purpose of SIPA is to assure that customers of failed brokerage firms receive the securities and cash that should be held for them by those firms. H. R. Rep. No. 91-1613, at 1 (1970) ("The primary purpose of the reported bill is to provide protection for investors if the broker-dealer *with whom they are doing business* encounters financial troubles. In these circumstances public customers sometimes encounter difficulty in obtaining their cash balances or securities from the broker-dealers.") (emphasis added); H. R. Rep. No. 95-746, at 21 (1977) ("A customer generally expects to receive what he believes is in his account at the time the stockbroker ceases business.").

Consistent with this purpose, the Act establishes procedures for liquidating failed broker-dealers. A SIPA liquidation is intended "to distribute customer property and (in advance thereof or concurrently therewith) otherwise satisfy net equity claims of customers." SIPA Section 6(a)(1)(B), 15 U.S.C. § 78fff(a)(1)(B). A fund of "customer property" is established for priority distribution among customers, to the exclusion of general creditors.[2/] SIPA Section 8(c)(1), 15 U.S.C.

[2/] "[C]ustomer property" is defined as "cash and securities . . . at any time received, acquired, or held by or for the account of a debtor from or for the

§ 78fff-2(c)(1). Customers share ratably in the fund of customer property to the extent of an individual customer's "net equity." SIPA Sections 8(c)(1)(B), 9(a), 15 U.S.C. §§ 78fff-2(c)(1)(B), 78fff-3(a). The Act defines "net equity" as "the dollar amount of the account or accounts of a customer, to be determined by . . . calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer . . . ." SIPA Section 16(11), 15 U.S.C. § 78*lll*(11).

In the event the fund of customer property is insufficient to satisfy every customer's net equity claim, SIPC is required to advance money from the SIPC fund to the SIPA trustee to satisfy each customer's net equity claim up to $500,000 "*for each customer*" for claims for securities and $100,000 (since increased to $250,000) for claims for cash. SIPA Section 9(a), 15 U.S.C. § 78fff-3(a) (emphasis added); *see* SIPA Section 9(a)(1), (d), 15 U.S.C. § 78fff-3(a)(1), (d). Because only a "customer's" net equity claim is protected, only one who meets SIPA's "customer" definition may receive a payment based on an advancement from the SIPC fund.

(footnote cont.)
securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted." SIPA Section 16(4), 15 U.S.C. § 78lll(4).

The key provision, SIPA Section 16(2), defines a "customer" as a person who has a claim based upon securities or cash held by the debtor broker-dealer for that person's securities account at the firm. The statute provides, in pertinent part:

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

l5 U.S.C. 78*lll*(2). The "customer" definition essentially encompasses three types of customers: (1) a person with a claim based on securities held for that person's account with the debtor; (2) a person with a claim based on securities that were being held for that person's account with the debtor but are no longer held because they have been sold or converted; and (3) a person who has deposited cash with the debtor to purchase securities.

The necessary qualities of the first two types of customers are expressly tied to a person's "securities accounts." The text describing the first type of customer states that a "customer" is a "person" with a claim for "*securities*" that are

"received, acquired, or held" by the broker-dealer "*from or for the securities accounts of such person*." The text describing the second type of customer – one who has a claim for "sales or conversions" of securities – refers to "such securities." The phrase "such securities" refers to the "securities" described in the immediately preceding text that were received, acquired, or held "from or for the securities accounts" of the person. The text describing the third type of customer – one who has deposited cash – does not expressly refer to a "securities account." But the deposit of cash with a broker-dealer for the purpose of purchasing securities creates an obligation that must be entered on the firm's books and records as cash held by the broker-dealer for the account of the person who deposited the cash.

Some claimants maintain that BLMIS held securities for their "securities accounts," notwithstanding the fact that they did not have accounts with BLMIS, because, they argue, the customer definition does not require their securities accounts to be *with* BLMIS. *See* Bricklayers & Allied Craftsworkers Local 2 *et al.* Brief at 9-11. However, the unambiguous, plain meaning of the customer definition's reference to a securities account for which the broker-dealer holds securities is to an account with *that* broker-dealer, and not an account at some other, unspecified location. It is unreasonable to read the definition as contemplating a broker-dealer holding securities in the ordinary course of its business for

safekeeping for a person who does not have an account with the broker-dealer. The district court correctly reasoned that the claimant's reading of SIPA "ignores its plain meaning" and that "the most natural reading of [the customer definition] limits the 'securities accounts' of investors to those established at the debtor . . . ." *Aozora Bank*, 2012 WL 28468, at *7. The incorrectness of claimants' interpretation is further apparent from the fact that they have not identified any alternative location of their securities accounts. They did not have securities accounts with the feeder funds, and instead had ownership interests in the various limited liability companies, limited partnerships, and offshore companies.

Congress's intention to limit the "accounts" referred to in the customer definition only to accounts with the debtor is corroborated by the statutory structure of SIPA. SIPA Section 9(a)(2), which relates to dollar limits on advances from SIPC's funds, provides that "a customer who holds accounts *with the debtor* in separate capacities shall be deemed to be a different customer in each capacity." 15 U.S.C. 78fff-3(a)(2) (emphasis added). SIPA Section 8(f) addresses the power of the trustee to transfer the "account of a customer of the debtor." 15 U.S.C. 78fff-2(f). It is unlikely that Congress would have contemplated that a SIPC trustee for a debtor broker-dealer (over which the trustee has authority) could transfer securities accounts that are *not with* that debtor but are somewhere else.

Moreover, SIPA Section 8(a)(1) specifies that notice of the commencement of a SIPA liquidation proceeding be "mailed to each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months." 15 U.S.C. 78fff-2(a)(1). The reach-back aspect of this provision appears to be deliberately overbroad, with the purpose of increasing its effectiveness in notifying all persons for whom the debtor should have been holding cash or securities at the time of its financial difficulties. If a person without an account with the debtor could meet the "customer" definition, however, then this provision's reliance on open accounts appearing from the books and records of the debtor to identify the debtor's customers would be peculiarly ineffective.

Additionally, customers in SIPA proceedings file claims for their "net equity," which is defined in Section 16(11) as "the dollar amount of the account or accounts of a customer," based in part on the "sum which would have been owed by the debtor to such customer if *the debtor* had liquidated" all of the securities positions of such customer on the filing date. 15 U.S.C. 78*lll*(11) (emphasis added). Apart from the cases of banks and broker-dealers addressed specifically by Congress under SIPA Section 9(a)(5) (discussed *infra*), it would have been odd for Congress to have referred to a broker-dealer's liquidating all of a customer's

securities positions if the account in which those positions were held was not with that broker-dealer.

Lastly, Congress made an express exception to the account requirement in SIPA Section 9(a)(5), which the claimants do not argue applies here. 15 U.S.C. 78fff-3(a)(5). That Section addresses payments from SIPC with respect to accounts held by banks and other broker-dealers. Banks and other broker-dealers are entitled to receive payments only to the extent that their claims arise from transactions for their customers, and those customers are each deemed to be a separate "customer" of the debtor for purposes of SIPA:

> [N]o advance shall be made by SIPC to the trustee to pay or otherwise satisfy any net equity claim of any customer who is a broker or dealer or bank, other than to the extent that it shall be established to the satisfaction of the trustee . . . that the net equity claim of such broker or dealer or bank against the debtor arose out of transactions for customers of such broker or dealer or bank . . . in which event each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor.

Section 9(a)(5), 15 U.S.C. 78fff-3(a)(5). If a person without an account with the debtor could qualify as a "customer" of the debtor, as claimants urge, then the special protections afforded to customers of banks and broker-dealers that are customers of the debtor would be superfluous.

In sum, the statutory purpose, plain meaning of the statutory language, and the statutory structure of SIPA all show that, except as allowed by SIPA Section 9(a)(5), Congress intended that SIPA protection be extended only to persons who have accounts with the broker-dealer undergoing liquidation. [3/]

II. Legislative History of the "Customer" Definition

The construction of SIPA's "customer" definition as requiring a claimant to have an account with the debtor broker-dealer is supported the legislative history of SIPA. During its deliberations on the legislation that became SIPA, Congress had before it several proposals that would have provided coverage not only to a person who has an account with a broker-dealer, but also to third parties who have interests in that account. These proposals were not included in the legislation as enacted.

The initial bill proposed by Senator Muskie, the principal sponsor of the legislation in the Senate, defined "insured customer account" as "the net amount due any customer from his account maintained with an insured broker or insured dealer . . . less any part thereof which is in excess of $50,000." S. 2348, 91st Cong.

[3/] Even if the statute were thought to be ambiguous on the issue, the interpretation urged here is more reasonable than that urged by the claimants for all of the reasons discussed in this brief. At a minimum, the Commission's interpretation (shared by SIPC here) is a reasonable one and therefore warrants deference. *See In re New Times Sec. Servs.*, 371 F.3d 68, 81 n.16, 88 (2nd Cir. 2004) (deferring to the shared interpretations of SIPA by the Commission and SIPC).

§ 2(7) (1969). Before the hearings on the legislation, Senator Muskie introduced an amendment that expanded the definition to add coverage for accounts with beneficial interests. The revised definition stated:

> The term "insured customer account" means (a) the net amount due any customer from his account maintained with an insured broker or insured dealer, less any part thereof which is in excess of $50,000 . . . ; or (b) the net amount due any institution or *entity which represents the beneficial interest of five or more natural persons*, less any part thereof which is in excess of $250,000 . . . .

S. 2348, Amendment in the Nature of a Substitute, 91st Cong. § 2(5) (1970) (emphasis added).

During hearings on the proposed legislation, the Commission and a securities industry task force both made legislative proposals that were introduced as bills in Congress. The Commission's proposal included a section that would have provided even greater coverage than Senator Muskie's amendment for accounts with the debtor broker-dealer in which third parties have interests:

> [I]n the case of a person acting as agent who transacts business for third parties through an account or accounts with a broker, dealer, or member of a national securities exchange, for purposes of the $50,000 limitation, *the term customer shall not be limited by the number of such accounts but shall include each such third party* insofar as the claims of such third parties are ascertainable from the books and records of either the debtor or the person

> acting as agent made available to the trustee or are otherwise determined to the satisfaction of the trustee.

S. 3989, 91st Cong. § (35)(j)(8) (1970) (emphasis added); H.R. 18081, 91st Cong. § 35(j)(8) (1970) (same). The legislation proposed by the securities industry task force had no such provision, providing for only a single payment not to exceed $50,000 for each customer with an account. H.R. 18109, 91st Cong. § 36(g) (1970).

The Commission and the securities industry task force were able to reach agreement on a single bill, which then formed the basis for the legislation that ultimately was enacted. *Hearings before the Subcomm. on Securities of the S. Comm. on Banking and Currency*, 91st Cong. 257, 296 (1970). The combined proposal did not include the Commission's provision addressing third-party interests in accounts with the debtor. Instead, it included a new, narrower provision applicable to customers of banks and broker-dealers that have accounts with the debtor, which provided that "each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor." H.R. 18458, 91st Cong., § 35(m)(13)(c)(1970). This provision is identical to the language in current SIPA Section 9(a)(5).

The combined proposal also for the first time included a definition of "customer," which was adopted, with some modifications, in the legislation as

enacted. The parts of the definition at issue in this case are not significantly changed from the definition in the 1970 enactment.[4/]

III. The Deposit of Cash for the Purpose of Purchasing Securities

A. Relevant Case Law

There are two court of appeals decisions that analyze SIPA's "customer" definition in the context of a Ponzi scheme: *Focht v. Heebner (In re Old Naples Sec., Inc.)*, 223 F.3d 1296 (11th Cir. 2000), and *Ahammed v. SIPC (In re Primeline*

[4/] The 1970 definition provided:

> "customers" of a debtor means persons (including persons with whom the debtor deals as principal or agent) who have claims on account of securities received, acquired, or held by the debtor from or for the account of such persons (I) for safekeeping, or (II) with a view to sale, or (III) to cover consummated sales, or (IV) pursuant to purchases, or (V) as collateral security, or (VI) by way of loans of securities by such persons to the debtor, and shall include persons who have claims against the debtor arising out of sales or conversions of such securities, and shall include any person who has deposited cash with the debtor for the purpose of purchasing securities . . . .

SIPA of 1970, § 6(c)(2)(A), 84 Stat. 1636. In addition to making stylistic changes, the 1978 amendments to SIPA changed the phrase "from or for the accounts of such persons" to "from or for the securities accounts of such persons," and the clause "(VI) by way of loans of securities by such persons to the debtor" was omitted. The legislative history of the 1978 amendments explains that the purpose of these changes was to make clear that persons who lend securities to a broker-dealer and receive consideration for their loans are not "customers." *See* H.R. Rep. No. 95-746, 95th Cong., at 33-34, 54 (1977).

Sec. Corp.), 295 F.3d 1100 (10th Cir. 2002). Both cases address when persons can be deemed to have deposited cash with a broker-dealer and qualify as "customers" under SIPA Section 16(2) although their deposit was not made directly with the broker-dealer.

In *Old Naples*, the investors, who were clients of a branch office of Old Naples Securities, Inc., were told by the branch manager to wire their investment funds to Old Naples Financial Services, the investment advisory affiliate of the brokerage firm, and not to the firm itself. The SIPC trustee of the brokerage firm and SIPC argued that because the customer definition requires a person to have "deposited cash with the debtor," the investors were not "customers." The Eleventh Circuit disagreed, stating:

> Whether a claimant "deposited cash with the debtor," however, does not (as [the trustee] and the SIPC suggest) depend simply on to whom the claimant handed her cash or made her check payable, or even where the funds were initially deposited. Instead, the question is whether there was "actual receipt, acquisition or possession of the property of a claimant by the brokerage firm under liquidation."

223 F.3d at 1302 (citations omitted). The court explained that an investor who "intended to have the brokerage purchase securities on her behalf and reasonably followed the broker's instructions regarding payment" can be a "customer" under

SIPA. *Id.* at 1303. Because the *Old Naples* claimants were dealing with an agent of the brokerage firm and reasonably believed that in following his instructions they were sending their money to the brokerage firm, and because the brokerage firm in fact acquired control over their money, the court concluded that they had "deposited cash with the debtor." *Id.* at 1303-04.

Primeline involved investors who had been instructed by a registered representative of Primeline Securities Corporation (the brokerage firm) to make checks out to one of his own companies. 295 F.3d at 1104. The investors had met with the representative at Primeline's offices and were given business cards showing his position as a Primeline registered representative. *Id.* at 1107. Under these circumstances, the Tenth Circuit concluded that the bankruptcy court's finding that the "[c]laimants reasonably thought [the representative] was acting as an agent of Primeline when he directed them to make out their checks to one of his third-party companies" was not clearly erroneous. *Id.* Based on the analysis of *Old Naples*, the court ruled that the bankruptcy court did not err in ruling that the claimants had "deposited cash 'with the debtor'" and thus were "customers" under SIPA. *Id.* at 1108.

In addition to these cases addressing the provision of the "customer" definition applicable to cash deposited for the purpose of purchasing securities, this

Court has held that the employee-beneficiaries of a profit-sharing plan whose assets were maintained in a trust account at a brokerage firm were not "customers" under SIPA. *SIPC v. Morgan, Kennedy & Co., Inc.*, 533 F.2d 1314 (2nd Cir. 1976). The beneficiaries, the court found, "made no purchases, transacted no business, and had no dealings whatsoever with the broker-dealer in question respecting the trust account." *Id*. at 1318. The account "was in the name of the Trustees who had the exclusive power to entrust the assets to the debtor, to invest and reinvest, and to purchase and trade securities in the account as they saw fit." *Id.* Under these circumstances, "the single trust account, represented by the Trustees collectively, possessed the required attributes for customer status under SIPA," while the employee-beneficiaries "possessed none of those attributes." *Id.*

B. Application to the Facts

The district court correctly concluded that the claimants did not deposit cash with BLMIS for the purpose of purchasing securities, but gave it to the feeder fund entities to pay for their purchases of limited partnership interests and shares in those entities. *See Aozora Bank*, 2012 WL 28468, at *7. Investors in the feeder funds received detailed memoranda explaining the nature of the investments. *See id.* at *2. *See also* Sheehan Dec. Exhs. 53, 61, 64, 76 (JA 1062-1156, 1215-1294, 1295-1375, 1376-1457). Once the investors in the feeder funds gave their money to the funds in

exchange for their ownership interests in the funds, that money became the property of the funds. *See* N.Y. Ltd. Liab. Co. Law § 601 ("A member has no interest in specific property of the limited liability company."); 6 Del. Code § 17-701 ("A partner has no interest in specific limited partnership property."); *In re Marriott Hotel Prop. II Ltd. P'ship Unitholders Litig.,* 2000 WL 128875, at *15 (Del . Ch. Jan. 24, 2000) (Section 17-701 of Title 6 of the Delaware Code "has been interpreted to preclude the attempt to equate ownership interests in a partnership with ownership of partnership property."). Accordingly, it was not claimants' cash but rather fund assets that were deposited with BLMIS. The investors had interests that entitled them to distributions from the funds based upon any earnings on the assets held in the funds' accounts.

The claimants here are not like the investors found to be "customers" by the courts in *Old Naples* and *Primeline*. Those courts based their findings that certain investors should be deemed to have deposited money with a brokerage firm, even though the money was deposited elsewhere, on factual circumstances that are not present here. In both cases the investors were dealing with agents of the brokerage firm. *See Old Naples*, 223 F.3d at 1303 (investors were dealing with person who "acted as the agent of Old Naples Securities"); *Primeline*, 295 F.3d at 1107 (investors were dealing with person whom claimants "reasonably thought . . . was

acting as an agent of Primeline"). Here, there was no agency relationship because the feeder funds were not controlled by BLMIS. "Control" of the agent by the principal is necessary to establish an agency relationship. *See* Restatement (Third) of Agency § 1.01 ("Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."). The prospectuses and private placement memoranda for the funds make clear that control remained with the various general partners or managing members of the funds, who then delegated responsibility for investing part or all of the funds' assets to BLMIS. *See, e.g.*, Sheehan Dec. Exs. 53 (p. 8), 61 (p. 14), 64 (p. 13), 76 (p. 2) (JA 1077, 1243, 1323, 1397). *See also Aozora Bank*, 2012 WL 28468, at *7 ("Each of the Feeder Funds pooled the money it received and exercised exclusive control over those assets.").

Moreover, in both *Old Naples* and *Primeline*, the investors believed that in following the instructions of the brokerage firms' agents, they would be depositing their money with the firm itself. *Old Naples*, 223 F.3d at 1303 (one investor "believed that he was sending money to the brokerage" and the other investor was "assured" that "Old Naples Securities and Old Naples Financial Services were one and the same"); *Primeline*, 295 F.3d at 1105 ("Claimants testified they believed

they were investing with, through, or in Primeline"). In contrast, the claimants here received detailed documents explaining that their investments were in the feeder funds. Moreover, claimants do not argue that there is – and we are not aware of – a sufficient factual and legal basis to conclude that the legal separateness of BLMIS and the funds should be disregarded. Thus, purchasing an interest in one of the sixteen feeder funds was not comparable to depositing money with the BLMIS itself.

Additionally, many of the factual circumstances that led the Second Circuit to conclude that trust beneficiaries in *Morgan, Kennedy* were not entitled to "customer" status are also present with respect to the holders of interests in the feeder funds. It was the funds' money that was entrusted with BLMIS; the investors were not named as holders of the accounts; they had no control over investment decisions of the funds; and they had no power over the assets held in the accounts. *See Morgan, Kennedy*, 533 F.2d at 1318.

CONCLUSION

Only the sixteen feeder funds that had accounts with BLMIS are "customers" under SIPA, not the owners of interests in those funds who did not have accounts with BLMIS. The decision of the district court should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Michael L. Post, hereby certify that on August 23, 2012, I caused to be served by CM/ECF the foregoing Brief of the Securities and Exchange Commission on counsel for all the parties to the consolidated appeals.

/s/ Michael L. Post