UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE:	)	Adversary No. 11-2790 (MG) SIPA
MF GLOBAL INC.,	)	
Debtor.	)	

MEMORANDUM OF THE SECURITIES INVESTOR PROTECTION CORPORATION REGARDING APPLICABLE LIQUIDATION PROCEDURES

JOSEPHINE WANG
General Counsel

CHRISTOPHER H. LAROSA
Associate General Counsel

LAUREN ATTARD
Staff Attorney

SECURITIES INVESTOR PROTECTION CORPORATION
805 Fifteenth Street, N.W., Suite 800
Washington, D.C. 20005-2207
Telephone: (202) 371-8300

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PUBLICATIONS AND TREATISES:

Pursuant to the Court's order of November 17, 2011, the Securities Investor Protection Corporation ("SIPC") submits this memorandum regarding the procedures applicable in the instant liquidation proceeding of MF Global, Inc. ("Debtor") under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78aaa et seq.

ORIGINS OF SIPA AND SIPC'S ROLE

This liquidation is governed, first and foremost, by SIPA. Congress enacted SIPA in 1970 "to protect individual investors from financial hardship; to insulate the economy from the disruption which can follow the failure of major financial institutions; and to achieve a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss." See S. Rep. No. 91-1218, at 3, 4 (1970) ("Senate Report"); H.R. Rep. No. 91-1613, at 2 (1970) ("House Report").[1] Through SIPA, Congress sought to accomplish these objectives in two ways. First, it enhanced the power of the Securities and Exchange Commission ("SEC") to establish financial responsibility rules for broker-dealers and to impose upon the securities industry's self-regulatory organizations requirements for the financial examination of their members. See SIPA § 78iii(f). Second, it created SIPC,[2] made membership in SIPC mandatory for most broker-dealers, and empowered SIPC to commence proceedings for the liquidation of member broker-dealers whose financial

[1]SIPA was extensively revised in 1978. See Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249 (1978); Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 308, 92 Stat. 2549, 2674-76 (1978). The most recent amendments to SIPA were enacted in 2010 under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2]SIPC is a private, non-profit, membership corporation. See SIPA § 78ccc(a)(1). Its Board of Directors consists of seven persons, five appointed by the President of the United States with the advice and consent of the Senate, and one each appointed by the Federal Reserve Board and the Secretary of the Treasury, respectively.

condition posed the risk of loss to their customers. See SIPA §§ 78ccc(a) & eee(b). See also House Report at 11-13.

SIPC plays a central role in a statutory process designed to afford carefully delineated protection to securities customers against the financial risks posed by broker-dealer failure. That process begins with the SEC and/or the self-regulatory organizations.[3] If the SEC or any self-regulatory organization believes that a member broker-dealer is in, or is approaching, financial difficulty, it must immediately notify SIPC. SIPA § 78eee(a)(1). If, upon such notice, SIPC determines that the referred broker-dealer has failed to meet its obligations to customers, or is in danger of failing to do so, and that one or more specified statutory conditions exists, it may apply to the appropriate federal district court for a "protective decree," adjudicating that the customers of such member are in need of the protection provided by SIPA. SIPA §§ 78eee(a)(3) and 78*lll*(13). If the district court finds that at least one of the relevant statutory conditions exists, it must issue a protective decree, and must then appoint as trustee for the subject broker-dealer, and as attorney for the trustee, such persons as SIPC, in its sole discretion, shall specify. SIPA § 78eee(b)(1) and (3); SIPC v. Barbour, 421 U.S. 412 (1975). The proceeding thus commenced is a liquidation in which the trustee generally has the same powers and title with respect to the debtor broker-dealer and the debtor's property as a trustee in bankruptcy, including the right to avoid preferences. See SIPA §§ 78fff, 78fff-1(a).

SIPA does not attempt to make all customers whole, and SIPC is not an insurer of customer accounts. Rather, SIPA establishes a plan of limited protection in which SIPC's role is carefully delineated. SIPC administers a “quasi-public” fund established by SIPC via

[3]The self-regulatory organizations include the national securities exchanges and the Financial Industry Regulatory Authority, Inc. (“FINRA”). 15 U.S.C. § 78c(a)(26).

assessments upon its member broker-dealers.[4] SIPA § 78ddd; SEC v. Packer, Wilbur & Co., 498 F.2d 978, 980 (2d Cir. 1974). SIPA contemplates that customer claims will be satisfied to the maximum extent possible from the assets (including customer property) on hand with the broker-dealer in liquidation. SIPC funds merely supplement those assets within the limits and in the manner provided in SIPA and are available solely as advances to the trustee for the satisfaction of protected customer claims and for other specified purposes. To the extent of these advances, SIPC has rights of subrogation and recoupment as specified in SIPA. See SIPA § 78fff-3(a) and 78fff-2(c)(1).

ROLE OF SUBCHAPTER IV

Despite the absence of SIPC protection for commodities customers, SIPA expressly contemplates the liquidation of a SIPC member operating as both a securities broker-dealer and futures commission merchant ("FCM"). Thus, where the debtor is both a securities broker-dealer and a "commodity broker" - a term defined in Section 101(6) of the Bankruptcy Code (11 U.S.C.) that encompasses any FCM - Section 78fff-1(b) of SIPA imposes upon a SIPA trustee the same duties as applicable to a trustee under the Commodity Broker Liquidation provisions of Chapter 7, Subchapter IV, 11 U.S.C. §§ 761-767, to the extent that those duties are consistent with SIPA or "as otherwise ordered by the court."

Although the Subchapter IV provisions generally apply in a SIPA liquidation, SIPC protection does not extend to assets held in commodities accounts. On the contrary, under SIPA, SIPC protection is available only with respect to securities customers of the failed SIPC member.

[4]SIPA authorizes SIPC to borrow up to $2.5 billion dollars through the SEC from the United States Treasury should SIPC's funds be inadequate to carry out its purposes. See SIPA §§ 78ddd(f), (g), & (h).

The statute thus limits the definition of "customer" – which delineates the category of claimants eligible for SIPC advances, inter alia – to "any person…who has a claim on account of securities received, acquired or held by the debtor in the ordinary course of its business as a *broker or dealer* from or for the *securities* accounts of such person…" SIPA § 78*lll*(2)(A) (emphasis added). Thus, for SIPA purposes, "customers" eligible for SIPC protection include only those with assets held by the debtor for them as a securities broker-dealer in "securities," not commodities accounts.

ALLOCATION AND DISTRIBUTION OF PROPERTY

Consistent with the foregoing, in a SIPA liquidation in which the debtor is both a SIPC-member securities broker-dealer and an FCM, the property subject to administration by the Trustee falls into three general categories: (1) cash or securities qualifying as "customer property" under SIPA, and subject to allocation and distribution to the Debtor's securities customers as provided in SIPA ("Fund of Customer Property");[5] (2) property qualifying as "customer property" under Bankruptcy Code Section 761(10) and the associated regulations issued by the Commodity Futures Trading Commission ("CFTC"), and subject to allocation and distribution to the Debtor's futures customers ("Commodities Funds"); and (3) property allocable to the Debtor's general estate. The rules applicable to the allocation and distribution of property in these three categories differ.

[5]"Customer names securities" may also be in the custody of the broker-dealer. These are securities registered or in the process of being registered in the names of customers and negotiable only by the customers. SIPA §78*lll*(3). Customer name securities are not part of the fund of customer property and to the extent they are in the possession or under the control of the brokerage firm, they are returned outright to the customer by the trustee irrespective of their value, provided that the customer is not indebted to the broker. See SIPA §§78fff-2(c)(2) and 78*lll*(4).

A. Fund of Customer Property

As noted, the Fund of Customer Property consists of all cash and securities that qualify as "customer property" within the meaning of SIPA. The statute generally defines "customer property" as the cash and securities "at any time received acquired, or held by or for" the Debtor "from or for the securities accounts of a customer." See SIPA § 78*lll*(4). In turn, SIPA generally defines the term "customer" to include a claimant with a claim against the Debtor on account of such property, including cash on deposit with the Debtor for the purposes of purchasing securities. See SIPA § 78*lll*(2).

The "customer" provisions of SIPA lie at the heart of the statute, and are the principal expression of Congress's intent to create a unique liquidation scheme applicable to securities broker-dealers. In a SIPA liquidation, "customers" have priority in the distribution of "customer property," a fund of assets generally consisting of the cash and securities "received, acquired or held" by the debtor for its "customers" in the ordinary course of its business, along with the proceeds of any such property transferred by the debtor. See SIPA §§ 78fff-2(b) and (c)(1), 78*lll*(4). "Customers" generally share ratably in this fund to the extent of their "net equity" and do so on a priority basis, to the exclusion of general creditors. See SIPA § 78fff-2(b) and (c)(1). Any "excess" customer property not so allocated and distributed becomes part of the general estate of the debtor.[6] SIPA § 78fff-2(c)(1).

[6] SIPA's provisions regarding the allocation and distribution of customer property are designed to fit hand in glove with the pre-liquidation property segregation requirements imposed by SEC Rule 15c3-3, 17 C.F.R. § 240.15c3-3, the "customer property rule." Rule 15c3-3 requires that a broker-dealer promptly obtain possession, and thereafter maintain physical possession or "control" of all "fully-paid" and "excess margin" securities held by the firm for customers. See 17 C.F.R. §§ 240.15c3-3(b)-(d). For this purpose, securities are deemed to be in the firm's "control" when held in the firm's name at a clearing corporation or other approved "control location" and allocated to the firm's customers on its books and records – a form of

SIPA expressly contemplates, and encourages, the use of account transfers as a mechanism "to facilitate the prompt satisfaction of customer claims and the orderly liquidation of the debtor…" SIPA § 78fff-2(f). In this regard, Section 78fff-2(f) of SIPA provides specifically that, with the consent of SIPC, the Trustee may sell or transfer "all or any part of the account of a customer of the debtor" to another SIPC-member broker-dealer, without the consent of such customer. See id. The same section authorizes SIPC to use its funds to indemnify the Purchaser "against shortages of cash or securities in the customer accounts sold or transferred," provided that SIPC determines that the probable cost of such indemnification can reasonably be

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"bookkeeping segregation." See 17 C.F.R. § 240.15c3-3(c)(1) and (3). See also Michael E. Don & Josephine Wang, Stockbroker Liquidations Under the Securities Investor Protection Act and Their Impact on Securities Transfers, 12 Cardozo L. Rev. 508, 529-31 (1990) ("Don & Wang"). Most important, the firm cannot use such securities in any aspect of its business, and thus cannot sell them without customer authorization, lend them to others, use them to deliver against short sales, or use them as collateral for a loan. See Steven D. Lofchie, Lofchie's Guide to Broker-Dealer Regulation 481 (3d ed. 2005) ("Lofchie").

Rule 15c3-3 treats customer cash slightly differently. Under the rule, and pursuant to a formula specified in Rule 15c3-3a, a broker-dealer must make a weekly calculation of an amount designed to reflect its net cash obligations to customers. See 17 C.F.R. §§ 240.15c3-3(e)(1), 240.15c3-3a. See also Michael P. Jamroz, The Customer Protection Rule, 57 Bus. Law. 1069, 1095-96 (2002) ("Jamroz"). The firm must then maintain in a "special reserve bank account for the exclusive benefit of customers" a deposit equal to the amount yielded by the Rule 15c3-3a calculation. See 17 C.F.R. § 240.15c3-3(e)(1). The firm at all times must keep this reserve account "separate from any other bank account of the broker or dealer" and must maintain a deposit in the account in the amount required by Rules 15c3-3 and 15c3-3a. See id.

The purpose of the reserve account requirement "is to ensure that funds a broker-dealer holds as a result of its customer business are used only to finance customer liabilities, and not to finance the broker's proprietary positions." Lofchie at 489. See also Jamroz at 1095-97. Thus, while Rule 15c3-3 recognizes that cash is fungible, and therefore does not require a broker-dealer to segregate the specific cash deposited by its customers, it does require the broker-dealer to segregate cash in an amount equal to its current, net cash obligations to all customers. As in the case of securities, the rule thus requires the physical segregation of customer property on an aggregate basis. Should the firm have to liquidate, this cash is then available for delivery to individual customers in accordance with the firm's cash obligations to them, as established, through the firm's books and records. Cf., Jamroz at 1095-97.

expected not to exceed the cost to SIPC of providing the advances for account protection authorized by SIPA, but limited by the statute to $500,000, with a maximum of $250,000 for cash. See id.; SIPA §§ 78fff-3(a) and (b).

To the extent that customer property cannot be returned to customers through the bulk transfer of accounts and associated customer assets, it must be returned pursuant to a claims process. Pursuant to SIPA, the Court recently entered an order approving a parallel claims procedure for securities and commodities claimants, respectively. The process established through that order is discussed briefly in the following section.

If the fund of "customer property" is insufficient to satisfy the "net equity" claims of "customers" in full, SIPA mandates that SIPC provide additional relief by making limited advances to the SIPA trustee for this purpose from the SIPC Fund.[7] SIPA § 78ddd. See also SEC v. Packer, Wilbur & Co., 498 F.2d 978, 983, 985 (2d Cir. 1974). In this regard, SIPC may advance to the SIPA trustee not more than $500,000 per customer, of which no more than $250,000 may be used to satisfy that portion of a claim which is for cash rather than for securities. See SIPA § 78fff-3(a). Thus, each "customer" with a valid claim is assured of satisfaction within the limits indicated, relief not available to general creditors. Id.; In re A.R. Baron & Co., 226 B.R. 790, 795 (Bankr. S.D.N.Y. 1998). To the extent that a customer's ratable share of customer property, coupled with any available SIPC advance, is insufficient to satisfy the customer's "net equity" claim, the customer is entitled to share in the general estate of the debtor as an unsecured creditor. See SIPA § 78fff-2(c)(1). SIPC is subrogated to the claims of

[7] SIPA excludes certain classes of customers from eligibility for SIPC advances, including, inter alia, specified persons with an ownership interest or management role in the Debtor, along with banks and other securities broker-dealers, except if acting on behalf of customers themselves eligible for protection. See SIPA § 78fff-3(a)(5).

customers to the extent of its advances to the trustee for the purpose of satisfying customer claims. See SIPA § 78fff-3(a).

In satisfying customer claims for securities, the trustee is obligated to deliver securities to the maximum extent practicable. See SIPA §§ 78fff-1(b)(1), 78fff-2(b)(2). The trustee may satisfy any claim for securities filed more than sixty days, but not more than six months, following the publication of notice of the commencement of the liquidation, however, in cash or securities, or such combination of the two, "as the trustee determines is most economical to the estate." SIPA § 78fff-2(a)(3).

B. Commodities Funds

For purposes of the Commodity Broker Liquidation provisions of Subchapter IV, "customer property" includes cash, securities, or other property, or the proceeds thereof, "received, acquired, or held by or for the account of the debtor from or for the account of a customer." "Customer" is limited to an entity with whom the debtor futures commission merchant deals, and for whom the debtor holds property, as a financial intermediary in one or more of five enumerated categories associated with commodities and futures transactions.[8] See 11 U.S.C. §§ 761(9) and (10); 17 C.F.R. § 190.08(a). Unlike SIPA, the regulations that implement the Commodity Broker Liquidation provisions ("Part 190 Regulations") do not provide for the distribution of "customer property" to a single class of commodities customers. On the contrary, the Part 190 Regulations require the trustee to allocate "the property of the debtor's estate" – specifically the "customer property" allocable to the debtor's commodities

[8] These categories, all defined in Subchapter IV and the associated regulations, include a "futures commission merchant," "foreign futures commission merchant," "leverage transaction merchant," "clearing organization," and "commodity options dealer." See 11 U.S.C. § 761(9); 17 C.F.R. § 190.01

customers – among two customer classes and six account classes, each of which may be a separate estate for distributional purposes. See 17 C.F.R. §§ 190.01(a), 190.08.

Customer classes consist of public and non-public customers, while the account classes are: (1) futures accounts; (2) foreign futures accounts (defined as accounts which may contain commodities contracts entered on foreign exchanges (see 11 U.S.C. § 761(11)); (3) leverage accounts (also known as margin accounts (see 11 U.S.C. § 761(13)); (4) commodity option accounts; (5) "delivery" accounts, as defined in 17 C.F.R. § 190.05(a)(2); and (6) as applicable here, "cleared OTC derivatives accounts" (i.e., accounts in which over-the counter derivatives transactions may be cleared). As an example of the application of these principles, the legislative history to the Commodity Broker Liquidation provisions explains that "[a] debtor that is a leverage transaction merchant and a commodity options dealer would have separate estates for the leverage transaction customers and for the options customer, and a general estate for other creditors." H.R. Rep. No. 95-595, at 390 (1977). See also Alan N. Resnick, Henry J. Sommer, 6 Collier on Bankruptcy ¶ 761.18[1] ("Collier").

Like SIPA, the Part 190 Regulations expressly endorse the use of account transfers as a means of returning customer property to commodities customers. In this connection, the regulations provide that, commencing immediately after the entry of the order for relief, the trustee must use his best efforts to effect a transfer of all the debtor's customer accounts, with limited exceptions. See 17 C.F.R. § 190.02(e); 6 Collier ¶ 764.03[2]. Although the regulations contemplate that, under most circumstances, these transfers will occur "no later than the close of business on the fourth business day after the order for relief," they also reserve to the CFTC the power to permit account transfers that do not comply with this requirement, or the others

ordinarily applicable to such transfers, "in appropriate cases and to protect the public interest." See 17 C.F.R. §§ 190.02(e), 190.06(h)(2). This Court has invoked these provisions on several occasions to approve account transfers proposed by the Trustee. Of course, SIPA also authorizes the court to modify the application of these regulations as necessary. See SIPA § 78fff-1(b).

The Commodity Broker Liquidation provisions and Part 190 Regulations also contain an analog to "customer name securities" under SIPA – known in the statute and regulations as "specifically identifiable property" – and impose special rules governing the disposition of such property. See, supra, n.1. Although the statute does not define "specifically identifiable property," the Part 190 Regulations contain a detailed definition of the term. Under this definition, "specifically identifiable property" is limited to specified property uniquely associated with a particular customer, including, e.g.: (1) securities that are registered in the name of the customer, are not short term obligations, and are not transferable by delivery; (2) warehouse receipts, bills of lading, or other documents of title held for the account of the customer, that are not in bearer form or otherwise transferable by delivery; and (3) certain open commodity contracts held for the account of the customer that qualify as "bona fide hedging positions." See 17 C.F.R. § 190.01(kk).

The Part 190 Regulations require that, within two days after the entry of the order for relief, the trustee publish in a daily newspaper or a newspaper of general circulation for two consecutive days a notice to customers advising them, inter alia, that all specifically identifiable property will be liquidated commencing on the fifth business day after the second publication if the relevant customer has not instructed the trustee in writing on or before the fourth business

day (fifth business for open commodity contracts) to return the property pursuant to Section 190.08(d)(1) or, in the case of open commodity contracts, to transfer such contracts in accordance with the applicable regulations. See 17 C.F.R. § 190.02(b). See also 11 U.S.C. § 765(a).

The rules governing the transfer of specifically identifiable property essentially establish a "buy back" procedure, under which the customer tenders the value of the property to the trustee in cash and, in exchange, receives return of the property. See 17 C.F.R. § 190.08(d). Thus, for example, the return of specifically identifiable property margining an open commodity contract is conditioned upon the deposit by the customer with the trustee of cash in an amount equal to the greater of the full fair market value of the property on the return date or the balance due on the return date of any loan by the debtor to the customer for which the property serves as security. See id. at § 190.08(d)(1). As discussed below, this transaction has no effect on the customer's "net equity" because, in general, the customer has merely exchanged cash for property of equal value.

C. General Estate

In general, SIPA governs the disposition of property allocable to the general estate of the Debtor. Under Section 78fff(e) of SIPA, the general estate is used to pay for all expenses associated with estate administration, and estate property is otherwise subject to distribution in accordance with the priorities established in Bankruptcy Code Section 726. See SIPA § 78fff(e). If the estate is insufficient to pay for such expenses, SIPC advances funds necessary to pay for expenses allocable to the administration of the general estate and the Fund of Customer Property. See SIPA § 78fff-3(b). Moreover, under some circumstances, property allocable to the general

estate may be reallocated to the Customer Property or Commodities Funds. See, e.g., SIPA § 78*lll*(4)(E) (defining "customer property" to include "[a]ny other property of the debtor which, upon compliance with applicable laws, rules, and regulations, would have been set aside or held for the benefit of customers…"); Ferris, Baker Watts, Inc. v. Stephenson (In re MJK Clearing, Inc.), 286 B.R. 109, 129-33 (Bankr. D. Minn. 2002), aff'd, 2003 WL 1824937 (D. Minn. April 7, 2003), aff'd, 371 F.3d 397 (8th Cir. 2004) (reallocating general estate property to fund of customer property pursuant to SIPA Section 78*lll*(4)(E) to the extent necessary to make up shortfall in customer property); 17 C.F.R. § 190.08(a)(1)(ii)(J) (providing for the reallocation of general estate property to "customer property" subject to allocation and distribution to commodities customer to the extent necessary to make up a shortfall therein). But see In re Griffin Trading Co., 245 B.R. 291, 308-19 (Bankr. N.D. Ill. 2000), vacated as mooted sub nom., Inskeep v. MeesPierson N.V. (In re Griffin Trading Co.), 270 B.R. 882 (N.D. Ill. 2001) (holding that Section 190.08(a)(1)(ii)(J) of the Part 190 Regulations "exceeds the CFTC's statutory authority to regulate and must be stricken"); 6 Collier ¶ 761.11 (same).

CLAIMS PROCESS AND STANDARDS

A. Claims Process

The Court recently entered an order implementing the claims provisions of SIPA. The order directed the Trustee to publish and mail to customers and other creditors of the Debtor notice of the commencement of the instant liquidation, and to include in the mailing separate claim forms and instructions for commodities and securities customers in substantially the form approved by the Court. The Trustee completed publication and mailing on December 2, 2011 in accordance with the terms of the Court's order.

Consistent with SIPA, the Court in its procedures order also provided that all claims must be filed with the Trustee, and established filing deadlines. Under the Court's order, commodities claimants must file claims such that those claims are received by the Trustee on or before January 31, 2011, unless that date is extended by the Court for good cause shown. Claims received by the Trustee after that date, but on or before June 2, 2011, may be afforded general creditor status, but not "customer" status under the Commodity Broker Liquidation provisions. With limited exceptions provided in SIPA, no claim received after June 2, 2011 can be allowed in any status. See SIPA § 78fff-2(a)(3).

Securities claims also must be received by the Trustee by January 31, 2011 in order for claimants to receive maximum protection under SIPA. A claim received by the Trustee after that date, but on or before June 2, 2011, may be eligible for "customer" relief under SIPA, but, under SIPA "need not be paid or satisfied in whole or in part out of customer property, and, to the extent such claim is satisfied from moneys advanced by SIPC, it shall be satisfied in cash or securities (or both) as the trustee determines is most economical to the estate." See SIPA § 78fff-2(a)(3).

Once a claim is received, the Trustee determines the claim and issues to the claimant a claim determination. To the extent that the claimant disagrees with the Trustee's determination, the claimant must then file with the Court and serve upon counsel for the Trustee a written objection to the determination. If the claimant fails to file an objection within thirty days of the mailing of the Trustee's determination, or fails to attend a scheduled hearing, the Trustee's determination is final. Within 120 days after the filing of an objection, the Trustee must use his best efforts to set a status conference regarding the contested claim. Upon the filing of a motion

by the Trustee to uphold his determination or, if the Trustee fails to timely move for a status conference or to uphold his determination, upon the claimant's motion, the claimant will be afforded the opportunity to have his or her objection to the Trustee's determination heard by the Court as a contested matter under Rule 9014 of the Federal Rules of Bankruptcy Procedure.

The above claims process applies only to "customer" claims. General creditor claims are evaluated by the Trustee only if there is a general estate available for distribution. See 11 U.S.C. §704(a)(5) (trustee examines proofs of claim "if a purpose would be served.")

B. "Customer" Status – Securities Investors

In order to qualify for the special relief available under SIPA, a securities investor must qualify as a "customer" within the meaning of the statute. Under SIPA, the extent of the relief available to a "customer" is limited to his "net equity." See SIPA § 78fff-2(c)(1) (customers "share ratably in such customer property on the basis and to the extent of their respective net equities"); SIPA § 78fff-3(a) (authorizing SIPC to make advances "for prompt payment and satisfaction of net equity claims of customers of the debtor"). A customer's "net equity" generally consists of the cash and the value of the securities owed by the broker to the customer on the "filing date" - generally the date on which SIPC files an application for a protective decree placing a SIPC-member broker-dealer in liquidation under SIPA - less any indebtedness of the customer to the broker. *See* SIPA § 78*lll*(11). Accordingly, where the amount of a claimant's aggregate debts to a debtor broker-dealer exceed the aggregate "filing date" value of the cash and securities owed to the claimant by the debtor, the claimant has no "net equity" and is ineligible for relief as a "customer" under SIPA.

In affording preferred status to "customers," Congress intended to protect securities investors against losses stemming from the failure of an insolvent or otherwise failed securities brokerage to properly perform its custodial function. See SIPC v. Exec. Secs. Corp., 556 F.2d 98, 99 (2d Cir. 1977); SIPC v. Morgan Kennedy, 533 F.2d 1314, 1317 (2d Cir.), cert. den. sub nom., Trustees of the Reading Body Works, Inc. v. SIPC, 426 U. S. 936 (1976); SEC v. F.O. Baroff Co., 497 F.2d 280, 282-83 (2d Cir. 1974). Accordingly, "customer" status under SIPA is not a shorthand designation for anyone who deals with a broker-dealer, but rather is limited to those who entrust cash or property to a broker-dealer for the purpose of engaging in securities investing and trading. See, e.g., Morgan Kennedy, 533 F.2d at 1316. Accordingly, "customer" relief is not available to claimants asserting claims based upon fraud, fraudulent inducement, misrepresentation, non-disclosure, or other similar acts or omissions by the debtor or its principals. See In re Stratton Oakmont, Inc., 239 B.R. 698, 701 (S.D.N.Y. 1999) ("SIPA does not protect against all cases of alleged dishonesty or fraud"), aff'd, 210 F.3d 420 (2d Cir. 2000); SEC v. S.J. Salmon & Co., 375 F. Supp. 867, 870-71 (S.D.N.Y. 1974); In re Adler Coleman Clearing Corp., 198 B.R. 70, 75 (Bankr. S.D.N.Y. 1996); In re Bell & Beckwith, 124 B.R. 35 (Bankr. N.D. Ohio 1990); In re Government Securities Corp., 90 B.R. 539, 540 (Bankr. S.D. Fla. 1988); In re MV Securities, Inc., 48 B.R. 156, 160 (Bankr. S.D.N.Y. 1985).

To qualify as a "customer," the obligations of the debtor broker-dealer to a claimant, as a "customer," must be ascertainable from the debtor's books and records, or the claimant must establish the nature and extent of those obligations "to the satisfaction of the trustee." See SIPA § 78fff-2(b); In re Brentwood Sec., Inc., 925 F.2d 325, 328 (9th Cir. 1991); SIPC v. I.E.S. Mgmt. Group, Inc., 612 F. Supp. 1172, 1177 (D.N.J. 1985), aff'd without opinion, 791 F.2d 921 (3d Cir.

1986); SIPC v. Stratton Oakmont, 229 B.R. 273, 278 (Bankr. S.D.N.Y.), aff'd sub nom., Arford v. Miller, 239 B.R. 698 (S.D.N.Y. 1999), aff'd, 210 F.3d 420 (2d Cir. 2000); In re Adler Coleman Clearing Corp., 204 B.R. 111, 115 (Bankr. S.D.N.Y. 1997). A claimant bears the burden of showing that he is a customer separately with respect to every cash balance, security, and/or transaction as to which the claimant asserts "customer" status. Baroff, 497 F.2d at 282 n. 2; Stratton Oakmont, 229 B.R. at 277; Adler, Coleman, 204 B.R. at 115. This narrowness is necessary to ensure that the relief available to genuine "customers" is as complete as possible, within the limits imposed by SIPA. See, e.g., SEC v. Albert & Maguire Sec. Co., 560 F.2d 569 (3d Cir. 1977). In this regard, because "customer property" is distributed to "customers" on a pro rata basis, every claimant accorded "customer" status dilutes the recovery available to other "customers." See id.; In re Adler Coleman Clearing Corp., 277 B.R. 520, 558 (Bankr. S.D.N.Y. 2002).

C. "Customer" Status - Commodities Investors

As under SIPA, "customer" status under the Commodity Broker Liquidation provisions is a prerequisite to the right to share in the "customer property" subject to allocation and distribution to commodities customers. See 11 U.S.C. §§ 761(9), 766(h). Although those provisions contain a single definition of the term "customer," the prerequisites to "customer" differ depending upon whether the debtor was acting with respect to the claimant seeking such status as an FCM, a foreign FCM, a leverage transaction merchant, a clearing organization, or as a commodity options dealer. See 11 U.S.C. § 761(9). Despite these differences, the prerequisites applicable to all of these statuses except that of clearing organization share certain commonalities. See id.; 6 Collier ¶ 761.10[1]. For example, each group of prerequisites consists

of two subparts, satisfaction of either of which will confer customer status. See 11 U.S.C. § 761(9)(A), (B), (C), and (E); 6 Collier ¶ 761.10[1]. To satisfy the first subpart, the claimant must have had an account at the debtor and a claim against the debtor on account of a commodity contract "made, received, acquired, or held" by the debtor in the ordinary course of its business in the capacity with respect to which customer status is sought (e.g., as an FCM) from or for the claimant's account. See 11 U.S.C. § 761(9)(A)(i), (B)(i), (C)(i), and (E)(i); 6 Collier ¶ 761.10[1]. To satisfy the second part, the claimant must hold a claim against the debtor arising out of: (1) the making, liquidation, or change in value of a commodity contract of the kind described in the first subpart; (2) a deposit of cash, securities, or other property with the debtor for the purpose of making or margining such a contract; or (3) the making or taking of delivery on such a contract. See 11 U.S.C. § 761(9)(A(ii), (B)(ii), (C)(ii), and (E)(ii); 6 Collier ¶ 761.10[1].

Like SIPA, the Commodity Broker Liquidation provisions and the Part 190 Regulations measure a customer's eligibility for relief in terms of the customer's "net equity." The amount of a customer's "allowed net equity" represents the customer's ratable share of customer property, that is, the amount of "customer property" allocable to the debtor's commodities customers that is distributable to a particular customer. See 11 U.S.C. § 766(h); 17 C.F.R. §§ 190.06(e)(2), 190.08(d). A customer's "allowed net equity" is "its pro rata share of customer property, taking into account its claims in each account class against the debtor and the aggregate value of customer property in each account class." 6 Collier ¶ 761.18[2][a].

The computation of a customer's "allowed net equity" consists of three steps. First, the customer's "net equity" is calculated with respect to each account class described in the

preceding section in accordance with a formula specified in the Part 190 Regulations. See 17 C.F.R. § 190.07(b). That formula is used to compute, for each account class, "the total claim of a customer against the estate of the debtor based on the commodity contracts held by the debtor for or on behalf of such customer less any indebtedness of the customer to the debtor." Id. Second, with respect to each account class, the customer's "net equity" is then used to compute the customer's "funded balance" – the customer's ratable share of the customer property allocable to that account class. 17 C.F.R. § 190.07(c). A customer's funded balances are calculated as of the "primary liquidation date," that is, the "first business day immediately following the day on which all commodity contracts have been liquidated or transferred which are not being held open for later transfer in accordance with § 190.03." 17 C.F.R. § 190.01(ff).

Third, and finally, the customer's funded balances are aggregated, and that aggregate figure is then adjusted to reflect unrealized gains or losses on open commodity contracts and certain other items specified in the Part 190 Regulations. See 17 C.F.R. § 190.07(a) and (d).

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Respectfully submitted,

JOSEPHINE WANG
General Counsel

/s/Christopher H. Larosa
CHRISTOPHER H. LAROSA
Associate General Counsel

LAUREN ATTARD
Staff Attorney

SECURITIES INVESTOR PROTECTION CORPORATION
805 15th Street, N.W., Suite 800
Washington, D.C. 20005
Telephone: (202) 371-8300
Facsimile: (202) 371-6728
E-Mail: jwang@sipc.org
clarosa@sipc.org
lattard@sipc.org