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## TAKING STOCK OF THE COURT'S JURISDICTION IN A SIPA LIQUIDATION

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*The efficacy of any piece of remedial legislation depends, of course, upon the extent to which it is enforced. However, the enforcement of a statute is, in turn, dependent upon the nature of the jurisdiction conferred upon the enforcement agency. Where the jurisdictional grant is couched in vague language, imperfectly meshed with existing jurisdictional statutes, or easily hampered, the purposes of the statute may frequently be frustrated. The authors of this article examine the jurisdictional provisions of the Securities Investor Protection Act of 1970, emphasizing the effect of the categorization of summary and plenary jurisdiction upon the statute's operation. The authors conclude that the jurisdictional reach under the 1970 Act should be expanded and made more precise, in order to effectuate fully the legislative intent.*

### INTRODUCTION

The Securities Investor Protection Act of 1970 [hereinafter referred to alternatively as the "1970 Act" or "SIPA"]<sup>1</sup> was a response to numerous failures of broker-dealer firms in the late 1960's. The statute was designed to restore public confidence in the financial stability of the securities industry by protecting

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<sup>1</sup> Act of December 30, 1970, Pub. L. No. 91-598, § 1(a) *et seq.*, 84 Stat. 1636, 15 U.S.C. § 78aaa *et seq.* (1970).

individual investors from loss through the availability of a special insurance fund; by alleviating the domino effect of the failure of one firm upon other securities firms; and by providing for a specialized and expedited procedure for the liquidation of financially distressed firms. The aims of SIPA were clear and laudatory. Unfortunately, however, the statute was drafted so hastily and poorly that its objectives, particularly that of expedition, have not been attained.

One of the major obstacles to an easy interpretation of the 1970 Act is its haphazard incorporation by reference of the provisions of other federal statutes. This article will discuss one of the results of such disjointed structuring, *i.e.*, the unnecessarily abstruse nature of SIPA court jurisdiction.

The 1970 Act created the Securities Investor Protection Corporation [hereinafter referred to as "SIPC"], a non-profit membership corporation comprised of broker-dealers, which organization plays a significant role in the administration of the statute. SIPC initiates liquidations under the 1970 Act by making application to a federal district court for a decree adjudicating the customers of a SIPC member to be in need of the protections of the 1970 Act.<sup>2</sup> SIPC then selects a trustee and a counsel for the trustee.<sup>3</sup> Thereafter, SIPC supplies any necessary funds for the payment of customer claims insured under the 1970 Act,<sup>4</sup> the completion of certain open contractual commitments,<sup>5</sup> and the costs of administration.<sup>6</sup>

In addition to establishing a fund for the payment of customer claims, the 1970 Act was to provide a streamlined bankruptcy procedure for liquidating SIPC members, which would avoid the delays and inequities of a broker-dealer bankruptcy pursuant to section 60(e) of the Bankruptcy Act.<sup>7</sup> However, instead of specifying the procedures which the trustee and the courts were to follow in a SIPA liquidation, Congress provided in section 6(c)(1) that,

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<sup>2</sup> Securities Investor Protection Act of 1970 [hereinafter cited as SIPA] § 5(a)(2), 15 U.S.C. § 78eee(a)(2) (1970).

<sup>3</sup> SIPA § 5(b)(3), 15 U.S.C. § 78eee(b)(3) (1970).

<sup>4</sup> SIPA § 6(f)(1), 15 U.S.C. § 78fff(f)(1) (1970).

<sup>5</sup> SIPA §§ 6(d), (f)(2), 15 U.S.C. §§ 78fff(d), (f)(2) (1970).

<sup>6</sup> SIPA §§ 6(b)(1)(A), (f)(2), 15 U.S.C. §§ 78fff(b)(1)(A), (f)(2) (1970).

<sup>7</sup> H.R. REP. No. 1613, 91st Cong., 2nd Sess. 9 (1970) [hereinafter cited as H.R. REP. No. 1613]; *Report of the Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., ch. III, pt. 1, 410 *et seq.* (1963), referring to Bankruptcy Act § 60(e), 11 U.S.C. § 96(e) (1970); Note, *The Securities Investor Protection Act of 1970: An Early Assessment*, 73 COLUM. L. REV. 802, 829-31 (1973).

[e]xcept as inconsistent with the provisions of this [Act] . . . and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of chapter X and such of the provisions (other than section [60(e)]) of chapters I to VII, inclusive, of the Bankruptcy Act as section [102] of [chapter X] would make applicable if an order of the court had been entered directing that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive . . . .<sup>8</sup>

This somewhat confusing delineation of the jurisdiction and powers of a court is made all the more perplexing by section 2 of the 1970 Act, which also incorporates by reference the Securities Exchange Act of 1934 [hereinafter referred to as the "Exchange Act"] as follows:

Except as otherwise provided in this [Act] . . . , the provisions of the [Exchange Act] . . . apply as if this [Act] . . . constituted an amendment to, and was included as a section of, such Act.<sup>9</sup>

Finally, section 5(b)(2) of the 1970 Act provides that,

[u]pon the filing of an application pursuant to subsection (a)(2) of this section, the court to which application is made shall have *exclusive* jurisdiction of the debtor involved and its property wherever located with the powers, to the extent consistent with the purposes of this [Act] . . . , of a court of bankruptcy and of a court in a proceeding under chapter X of the Bankruptcy Act.<sup>10</sup>

In numerous situations, a SIPA trustee cannot be sure where or how to prosecute a claim, or whether the claim arises under the 1970 Act, or simply involves the estate of a SIPA debtor. Such uncertainty, interfering with the prompt liquidation of the debtor, should be needless. The new Bankruptcy Rules have provided for procedural similarities among actions under the summary jurisdiction of a bankruptcy court, under the plenary jurisdiction of a bankruptcy court, and under the non-bankruptcy jurisdiction of a federal district court.

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<sup>8</sup> SIPA § 6(c)(1), 15 U.S.C. § 78fff(c)(1) (1970).

<sup>9</sup> SIPA § 2, 15 U.S.C. § 78bbb (1970).

<sup>10</sup> SIPA § 5(b)(2), 15 U.S.C. § 78eee(b)(2) (1970) (emphasis added).

## I. TYPES AND SOURCES OF JURISDICTION

### A. Sources of Jurisdiction

Because of the manner in which SIPA is drafted, there exist at least four possible sources of statutory authority for jurisdiction of the SIPA court. The first jurisdictional provision which might apply in a SIPA proceeding is section 27 of the Exchange Act, which provides in pertinent part:

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.<sup>11</sup>

Section 27 has been interpreted to allow private causes of action to be heard in the federal district courts, even where a civil remedy for the claims asserted was not expressly provided for in the Exchange Act.<sup>12</sup>

The argument that section 27 applies to a SIPC proceeding rests on at least two bases. First, section 5(a)(2) of the 1970 Act specifically authorizes SIPC to apply "to any court of competent jurisdiction" specified in section 27 or 21(e) of the Exchange Act,<sup>13</sup> for a decree adjudicating that customers of a broker-dealer member of SIPC are in need of protection. Secondly, section 2 of the 1970 Act (quoted above) categorizes SIPA as an amendment to the Exchange Act and the Securities and Exchange Commission [hereinafter referred to as the "SEC"] is granted rule-making authority under SIPA.<sup>14</sup> Therefore, except as otherwise provided under SIPA, United States district courts should have the same jurisdiction in a SIPA liquidation which they enjoy under section 27 of the Exchange Act.

SIPA does have a jurisdictional provision of its own, section 5(b)(2),<sup>15</sup> which is the second possible source of jurisdiction for a SIPA court. Since this section speaks of "exclusive jurisdiction of the debtor involved and its property,"<sup>16</sup> it is not clear whether

<sup>11</sup> Securities Exchange Act of 1934 [hereinafter cited as the Exchange Act] § 27, 15 U.S.C. § 78aa (1970).

<sup>12</sup> See, e.g., *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 358-62 (2d Cir. 1973).

<sup>13</sup> SIPA § 5(a)(2), 15 U.S.C. § 78eee (a)(2) (1970).

<sup>14</sup> SIPA § 7(a), 15 U.S.C. § 78ggg(a) (1970), *amending Exchange Act* § 15(c)(3), 15 U.S.C. § 78o(c)(3) (1964); SIPA §§ 3(e)(3), 9(f), 15 U.S.C. §§ 78ccc(e)(3), 78iii(f) (1970).

<sup>15</sup> SIPA § 5(b)(2), 15 U.S.C. § 78eee(b)(2) (1970).

<sup>16</sup> SIPA § 5(b)(2), 15 U.S.C. § 78eee(b)(2) (1970).

Congress intended jurisdiction of a SIPA court to be broader or narrower than that of a district court hearing the case arising under the Exchange Act. If the phrase "jurisdiction of the debtor involved and its property wherever located" were given the broadest possible interpretation, a SIPA court could exercise jurisdiction over property which is, or by possession or claim to ownership might become, property of the debtor. As a general rule, for a case to present a federal question as an original matter, a right arising under the federal statute invoked for federal jurisdiction must be an essential element of the case.<sup>17</sup> However, in a liquidation under SIPA, unlike the customary Exchange Act controversy, the court is administering the rights of various claimants to a *res*, to wit, the debtor's estate as supplanted by the SIPC insurance fund.

Section 5(b)(2) of the 1970 Act does refer, however, to the jurisdiction of a court of bankruptcy and of a court in a proceeding under chapter X of the Bankruptcy Act. Those jurisdictional powers are incorporated by reference into SIPA proceedings to the extent consistent with the purposes of the statute. Therefore, the third possible source of jurisdiction is section 111 of the Bankruptcy Act, which applies to chapter X reorganizations. The jurisdictional grant found in section 111 reads as follows:

Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.<sup>18</sup>

Despite the parallel language of section 111 of the Bankruptcy Act and section 5(b)(2) of SIPA, an argument may be made that the full reach of the jurisdiction of a chapter X reorganization court does not prevail in a SIPA liquidation. Rather, it may be argued that the jurisdictional provisions of chapters I through VII of the Bankruptcy Act apply. These provisions may constitute another jurisdictional source because of the possible effect of section 6(c)(1) of the 1970 Act, which makes applicable to the liquidation "such of the provisions . . . of chapters I to VII, inclusive, of the Bankruptcy Act as section 102 of Chapter X would make applicable if an order of the court had been entered" pursuant thereto. One of the sections of the Bankruptcy Act referred to in section 102,<sup>19</sup> which presumably would apply to a SIPC liquidation according to this analysis, is section 23.<sup>20</sup> As will

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<sup>17</sup> *Gully v. First Nat'l Bank*, 299 U.S. 109 (1936).

<sup>18</sup> Bankruptcy Act § 111, 11 U.S.C. § 511 (1970).

<sup>19</sup> Bankruptcy Act § 102, 11 U.S.C. § 502 (1970).

<sup>20</sup> Bankruptcy Act § 23, 11 U.S.C. § 46 (1970).

be more fully explained below, section 23(b) of the Bankruptcy Act limits the bankruptcy court's plenary jurisdiction, and, accordingly, a chapter X reorganization court is generally believed to have more ample jurisdiction than a bankruptcy court administering a liquidation proceeding pursuant to chapters I to VII.<sup>21</sup>

Section 2(a)(7) of the Bankruptcy Act, applicable both to reorganization and liquidation proceedings, provides, in part, that courts of bankruptcy are "invested . . . with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this [Act] . . . to . . . cause the estates of bankrupts to be collected . . . and determine controversies . . . thereto . . . ."<sup>22</sup> A major distinction which may be drawn between jurisdiction originating under section 27 of the Exchange Act on the one hand, and jurisdiction arising from section 5(b)(2) of the 1970 Act or provisions of the Bankruptcy Act on the other, is that the former covers all Exchange Act duties and liabilities, the latter, "property of the debtor." The difference is basically that between *in personam* and *in rem* approaches to jurisdiction. A question as to the type of federal jurisdiction being used consequently arises where the Exchange Act duty or liability is determinative of the ownership or disposition of property of the debtor. In such instances, one might construe section 27 of the Exchange Act to be inapplicable, in view of the "except as otherwise provided" restriction upon Exchange Act incorporation as set forth in section 2 of SIPA. On the other hand, there might be construed to be an alternative or concurrent jurisdiction under section 27 and the property-of-the-debtor jurisdictional provisions of section 5 of SIPA. One common situation in which an Exchange Act proscription affects the debtor's property in a broker-dealer liquidation is the unlawful conversion of hypothecation of securities contrary to rule 15c2-1 under the Exchange Act.<sup>23</sup>

The fact that there are four possible sources of jurisdictional authority for a SIPA court should not mislead the participants in a SIPA proceeding to the erroneous conclusion that there is sufficient authority for the court to adjudicate whatever controversy is immediately at hand. In fact, depending upon which provision is determined to be the source of jurisdiction for the court, the constitutional nature of the judicial authority, the location of the

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<sup>21</sup> See text accompanying notes 42-45 *infra*.

<sup>22</sup> Bankruptcy Act § 2(a)(7), 11 U.S.C. § 11(a)(7) (1970).

<sup>23</sup> 17 C.F.R. § 240.15c2-1 (1973).

forum, and the rules of procedure applicable may be quite different. It is the purpose of this article to analyze which of the jurisdictional provisions are most appropriate to accomplishing the congressional purposes behind SIPA, and to set into relief those areas in which clarification of the source and nature of the court's jurisdiction would eliminate interesting but pointless litigation.

### B. *Delegation to a Bankruptcy Judge*

Although the SIPA liquidation proceeding is commenced and generally conducted before a federal district court judge, it has been the practice of some district court judges, particularly in the Southern District of New York, to refer the case in whole or in part to a bankruptcy judge. Neither the statutory language nor the legislative history directly authorizes or prohibits such a reference. Two threshold questions therefore arise: whether or not delegation of the SIPA proceeding to a bankruptcy judge is authorized, and what effects, if any, such delegation has upon the proceeding.

Bankruptcy Judge Herzog takes the position that reference by the district court judge to the bankruptcy judge, as a general proposition, is a lawful exercise of the judicial power granted to the district judge in a SIPA adjudication.<sup>24</sup> He arrives at this conclusion by a rather straightforward analysis of section 6(c)(1)<sup>25</sup> of SIPA, which incorporates applicable Bankruptcy Act provisions into SIPA. Since he sees no inconsistency between the provisions or purposes of SIPA and those of the Bankruptcy Act, he believes that reference is authorized by either section 22<sup>26</sup> of ordinary bankruptcy or section 117 of chapter X.<sup>27</sup> He does, however, favor section 22 as the source for the delegation of authority, on the theory that the SIPA proceeding is more akin to a liquidation than to a reorganization. Nevertheless, whether section 22 or section 117 applies, the outcome is the same: the district judge can retain the entire matter, refer the entire matter to a bankruptcy judge, *qua* bankruptcy judge, or refer the entire matter or any part thereof to the bankruptcy judge as special master to hear and report.

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<sup>24</sup> 3 COLLIER ON BANKRUPTCY [hereinafter cited as COLLIER] ¶ 60.86[3.2] at 1257 (14th ed. 1972).

<sup>25</sup> SIPA § 6(c)(1), 15 U.S.C. § 78ff(c)(1) (1970).

<sup>26</sup> Bankruptcy Act § 22, 11 U.S.C. § 45 (1970), *as modified by* BANKRUPTCY R. 102 (1973).

<sup>27</sup> Bankruptcy Act § 117, 11 U.S.C. § 517 (1970).



Judge Herzog buttresses his case for the incorporation of Bankruptcy Act delegation by noting that section 6<sup>28</sup> of SIPA speaks of the "court." For those accustomed to the language of bankruptcy, the "court" is defined in section 1(9) of the Bankruptcy Act<sup>29</sup> to include either the district judge or the bankruptcy judge, thus possibly evincing an indirect approval by Congress of SIPA proceedings being conducted before a bankruptcy judge.

We would reach a different conclusion as to the meaning of the word "court" under the 1970 Act. Under section 5 of SIPA,<sup>30</sup> the word "court" appears repeatedly in such a context as to indicate clearly that only a district judge could have been intended as the subject of the term.<sup>31</sup> It seems highly implausible that Congress could have intended the initial adjudication of customer need for the 1970 Act's protection to take place before a bankruptcy judge. Similarly, although it is the "court" which appoints the trustee in those cases where liquidation is necessary, we believe that it was there intended that the court be that of the district judge. In fact, the incorporation argument of section 6(c)(1) can apply only if a liquidation proceeding has actually commenced, since there can be no "liquidation proceeding" within the meaning of section 6 of SIPA until the judge of the district court has determined that one is necessary.

It should also be noted that section 38 of the Bankruptcy Act<sup>32</sup> invests the bankruptcy judge with jurisdiction over only specified matters. For example, the bankruptcy judge has jurisdiction over all "petitions" which are referred to him. Section 1(24) of the Bankruptcy Act<sup>33</sup> defines a petition as a document filed in the bankruptcy court initiating a proceeding "under this title," to wit, the Bankruptcy Act, title 11 of the United States Code. However, the application for a liquidation proceeding under SIPA originates from title 15, and not from title 11. The other jurisdictional grants of section 38 conferred upon the bankruptcy judge (*e.g.*, to grant, deny, or revoke discharges) relate to specific bankruptcy matters, and also might not apply to a title 15 proceeding.

The point of these rebuttals to Judge Herzog is not to assert the proposition that there is no authority for delegating to bank-

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<sup>28</sup> SIPA § 6, 15 U.S.C. § 78ff (1970).

<sup>29</sup> Bankruptcy Act § 1(9), 11 U.S.C. § 1(9) (1970).

<sup>30</sup> SIPA § 5, 15 U.S.C. § 78eee(1970).

<sup>31</sup> See SIPA §§ 5(a)(2), (b), 15 U.S.C. §§ 78eee(a)(2), (b) (1970).

<sup>32</sup> Bankruptcy Act § 38, 11 U.S.C. § 66 (1970).

<sup>33</sup> Bankruptcy Act § 1(24), 11 U.S.C. § 1(24) (1970).

ruptcy referees the administration and adjudication of SIPA liquidations. The purpose of our arguments is, rather, merely to point out that the authority for so referring a case requires further clarification. A bankruptcy judge may well be the judicial officer best equipped and suited to preside over a variety of the aspects of SIPA liquidations. However, those problems which are unique to a SIPA proceeding, or which involve interpretations of the Exchange Act, perhaps should be retained or more actively supervised by the district judge. SIPA would, otherwise, be vulnerable to the argument that delegation to a referee of a particular matter is inconsistent with the provisions and purposes of SIPA. In addition, it would seem a more appropriate distribution of judicial power to reserve for adjudication in the district court 1970 Act and Exchange Act matters which rarely arise in day-to-day bankruptcy proceedings, while delegating to the referee those matters which might generally be called "matters of administration."

### C. *The Distinction Between Summary and Plenary Jurisdiction*

As a consequence of the operation of sections 5(b)(2) and 6(c)(1) of the 1970 Act, whenever the jurisdiction of the SIPA court over the debtor's property is challenged, it becomes necessary to determine (1) the extent of jurisdiction of ordinary bankruptcy and chapter X courts, (2) which jurisdictional grant, if the above indeed be different, is applicable, and (3) whether or not such jurisdiction is "consistent with the purposes of [the 1970] Act." Accordingly, the fact that a court of bankruptcy or a chapter X court would be unable to subject particular property of the debtor to its jurisdiction should not preclude a SIPA court from exercising its broad jurisdiction where the limitations placed upon the jurisdiction of a court proceeding under the Bankruptcy Act would frustrate the purposes of SIPA.

#### 1. Jurisdiction "under" the Bankruptcy Act

It is beyond the scope of this article to analyze in depth the many complex considerations which determine the scope of federal jurisdiction under the Bankruptcy Act.<sup>31</sup> However, some

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<sup>31</sup> See 2 COLLIER ¶ 23.01, *supra* note 24, at 433 *et seq.* (for an extensive treatment of bankruptcy jurisdiction); 5A REMINGTON ON BANKRUPTCY § 2350 at 62 *et seq.* (5th ed. 1953, Supp. 1973); Seidman, *Summary or Plenary Jurisdiction*, 77 COM. L.J. 73 (1972); Note, *Katchen v. Landy and Summary Jurisdiction in Bankruptcy*, 52 VA. L. REV. 1530 (1966); Note, *Scope of the Summary Jurisdiction of the Bankruptcy Court*, 40 COLUM. L. REV. 489 (1940).

understanding of the distinction between summary and plenary bankruptcy jurisdiction is necessary to appreciate more fully the jurisdictional problems under SIPA.

Whenever a federal district court adjudicates directly under the Bankruptcy Act a matter pertaining to the estate of the debtor, it is said to exercise summary jurisdiction over the property which is the subject of adjudication. In such a controversy, the district court is sitting as a court of bankruptcy, and the source of the court's jurisdiction is the Bankruptcy Act.

In contrast to summary jurisdiction, whenever a state court or a district court entertains an independent suit upon a matter which is not part of the administration of the estate, but nevertheless pertains to the debtor's estate, the court is said to exercise plenary jurisdiction. In such a controversy, the federal district court does not sit as a bankruptcy court; nor does a bankruptcy judge have jurisdiction over a plenary suit.

In an unending line of cases, judges, attorneys and parties have done battle over whether a suit should proceed in summary or plenary fashion. Summary jurisdiction exists over matters concerning administration of the debtor's estate, over all property within the actual or constructive possession of the court, over all property to which timely objection to the exercise of jurisdiction has not been made, and over various disputes expressly made subject to such jurisdiction by statute.

In an ordinary bankruptcy proceeding, section 2(a)(7) of the Bankruptcy Act<sup>35</sup> confers both summary and plenary jurisdiction upon the federal district courts. When the property which is the subject matter of the dispute is in the physical possession of the court or its agents, summary jurisdiction is clearly appropriate to determine any disputes concerning that property.<sup>36</sup> Similarly, when the property is in the possession of a third party, summary jurisdiction may nonetheless be exercised if the party in possession expressly or impliedly consents thereto, or waives any objections due to failure to file a timely objection under section 2(a)(7) and Bankruptcy Rule 915(a).<sup>37</sup>

However, when a third party is in possession of property which is claimed to be the property of the bankrupt, and if the

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<sup>35</sup> Bankruptcy Act § 2(a)(7), 11 U.S.C. § 11(a)(7) (1970).

<sup>36</sup> 2 COLLIER, *supra* note 24, ¶ 23.05[2] at 471.

<sup>37</sup> See *Katchen v. Landy*, 382 U.S. 323 (1966); *Cline v. Kaplan*, 323 U.S. 97 (1944); *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940); *Harrison v. Chamberlin*, 271 U.S. 191 (1926); *May v. Henderson*, 268 U.S. 111 (1925); *Taubel-Scott-Kitzmiller Co. v. Fox*, 264 U.S. 426 (1924).

party in possession does not consent or waive his objections to summary jurisdiction, the claim must be adjudicated in a plenary suit should the party assert a "substantial, adverse claim" to the property.<sup>38</sup> Section 23(b) of the Bankruptcy Act curtails the jurisdiction of the district courts in plenary suits by placing the trustee in the pre-filing shoes of the bankrupt for jurisdictional purposes, thus requiring an independent non-bankruptcy ground for federal jurisdiction. Otherwise, the trustee must resort to his common law or statutory remedies in a state court, since pendent jurisdiction cannot attach.

A significant exception to the jurisdictional limitations of section 23(b) exists, however, in that a trustee in either an ordinary or liquidation proceeding can institute plenary suits in the federal district courts to enforce the rights provided by sections 60, 67, or 70 of the Bankruptcy Act.<sup>39</sup> In general, these are the rights given to trustees to set aside preferences and fraudulent conveyances. Sections 60(b), 67(e) and 70(e)(3) of the Bankruptcy Act<sup>40</sup> give state courts and federal district courts concurrent jurisdiction over such actions. Despite some confusion in the statutory language used, the better view is that a federal district court hearing such a plenary action is sitting as a court of first instance rather than as a court of bankruptcy.<sup>41</sup>

Determination of whether or not a claim is substantial and adverse, and, therefore, whether or not the limitations of section 23(b) apply, is no easy matter. The bankruptcy court is not ousted of jurisdiction simply upon the assertion of an adverse claim, since it has jurisdiction to determine whether the claim constitutes a mere pretense to avoid jurisdiction (*i.e.*, a "colorable" claim). But if the claim is sufficiently well-founded as to demonstrate a contested matter of right involving both fair doubt and reasonable room for controversy in fact or in law, plenary suit will be required.<sup>42</sup> Those claims which are of particular importance to a SIPA proceeding, and which may be sufficient to require plenary suit, will be discussed below.

In a chapter X proceeding, the district court's plenary jurisdiction is not limited by section 23, in light of the provisions of

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<sup>38</sup> See cases cited in note 37 *supra*.

<sup>39</sup> Bankruptcy Act §§ 60, 67, 70, 11 U.S.C. §§ 96, 107, 110 (1970).

<sup>40</sup> Bankruptcy Act §§ 60(b), 67(e), 70(e)(3), 11 U.S.C. §§ 96(b), 107(e), 110(e)(3) (1970).

<sup>41</sup> 2 COLLIER, *supra* note 24, ¶ 23.15 at 605.

<sup>42</sup> *Harrison v. Chamberlin*, 271 U.S. 191 (1926).

section 102.<sup>43</sup> The result is that the reorganization court has the full measure of summary and plenary jurisdiction established by section 2(a)(7).<sup>44</sup>

In addition, the summary jurisdiction of a reorganization court is more expansive than the summary jurisdiction of a liquidation court. Since reorganization contemplates adjustment of the various claims of creditors, it sometimes becomes necessary for the reorganization court to exercise a more flexible summary jurisdiction, notwithstanding the fact that a party in possession asserts a claim which would, in ordinary bankruptcy, be sufficiently substantial and adverse to avoid summary jurisdiction.<sup>45</sup> Should the reorganization effort fail, however, and an order be entered to proceed with liquidation instead, section 102 would reinstate the section 23 limitations upon plenary jurisdiction, as well as the stricter version of the substantial-adverse-claim test of the summary jurisdiction which applies in ordinary bankruptcy.

## 2. Summary Jurisdiction Under the SIPA

As stated previously, the court in a SIPA proceeding is given jurisdiction coextensive with a court of bankruptcy and a court proceeding under chapter X, unless the restrictions under the Bankruptcy Act are inconsistent with the purposes of SIPA. It therefore follows that the SIPA court must maintain all of the usual summary and plenary jurisdictional distinctions unless it can be shown that such distinctions would frustrate seriously the purposes of SIPA.

Whenever the trustee's investigation uncovers facts which would lead him to believe that securities, cash, or other property in the possession of third persons are properly assets of the debtor, he must determine whether a summary or plenary suit would be the more appropriate method to obtain the property. Substantive claims against the party in possession may arise under the federal securities laws or other federal statutes, the

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<sup>43</sup> Section 102 of the Bankruptcy Act, 11 U.S.C. § 502 (1970), provides in pertinent part: "The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter [X], apply in proceedings under this chapter . . . ."

<sup>44</sup> Bankruptcy Act § 2(a)(7), 11 U.S.C. § 11(a)(7) (1970).

<sup>45</sup> See *Lowden v. Northwestern Nat'l Bank & Trust Co.*, 298 U.S. 160 (1936); *In re Lehigh & Hudson River Ry. Co.*, 468 F.2d 430 (2d Cir. 1972); *Penn Central Transp. Co. v. Nat'l City Bank*, 315 F. Supp. 1281 (E.D. Pa. 1970), *aff'd*, 453 F.2d 520 (3d Cir.), *cert. denied*, 408 U.S. 923 (1972).

preference provisions of the Bankruptcy Act, the common law, the Uniform Commercial Code or other state statutory laws, or some combination thereof. If the SIPA court has summary jurisdiction, the trustee can conveniently litigate the issue of title in, and as an incident of, the SIPA proceeding itself. However, if a plenary suit is necessary, the appropriate forum might be the SIPA court, some other federal district court, or even a distant state court.

At least two bankruptcy judges<sup>46</sup> have determined that section 23 of the Bankruptcy Act applies in a SIPA proceeding. Their conclusion is derived from a rather straightforward literal reading of section 6(c)(1) of the 1970 Act. Under this view, the SIPA proceeding is treated as a liquidating reorganization under the rules of ordinary bankruptcy. It would follow, therefore, that section 23 of the Bankruptcy Act and the restrictive summary-plenary jurisdictional distinctions would apply.

The only flaw in this line of reasoning is that it ignores the proper consideration of whether or not a particular jurisdictional limitation imposed upon a court of bankruptcy is "consistent with the purposes" of SIPA. It would be a complete misreading of the statute to refuse to consider whether the effects of the restrictions on summary jurisdiction clash with the extent of jurisdiction required of a court in a SIPA proceeding to accomplish its congressional purposes.<sup>47</sup>

The legislative history of the 1970 Act generally indicates a congressional intent to prevent serious erosion of confidence in the securities markets as would be caused by broker-dealer failures, and a consequent domino-effect collapse. Congress set forth, rather specifically, the purposes of a liquidation proceeding under SIPA, as follows:

- (1) as promptly as possible . . .
  - (A) to return specifically identifiable property to the customers of the debtor entitled thereto;
  - (B) to distribute the single and separate fund, and (in advance thereof or concurrently therewith) pay to customers moneys advanced by SIPC . . . ;
- (2) to operate the business of the debtor in order to complete open contractual commitments of the debtor . . . ;

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<sup>46</sup> 3 COLLIER, *supra* note 24, ¶ 60.86[1] at 1252 (Bankruptcy Judge Herzog); SEC v. Morgan, Kennedy & Co. [1973-1974 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,568 at 95,966 (S.D.N.Y. May 20, 1974) (Bankruptcy Judge Babitt).

<sup>47</sup> See text accompanying notes 82-88 *infra*.

- (3) to enforce rights of subrogation as provided in this [Act]  
. . . ; and
- (4) to liquidate the business of the debtor.<sup>48</sup>

Rather clearly, a pervasive goal of SIPA is to accomplish a distribution of property and a resolution of claims in the minimum time necessary. Expedition is in the interest of the debtor's customers, since it would minimize the period during which they would be unable to trade and consequently, at the risk of the well-known volatility of securities market fluctuations.<sup>49</sup> Promptness is also necessary to complete certain open contractual commitments between the debtor and other broker-dealers, thus minimizing the disruption and possibility of domino-like collapse.<sup>50</sup>

Were the SIPA court required to determine the existence or absence of a substantial adverse claim sufficient to defeat summary jurisdiction, and were there a possibility that the trustee would be obliged to resort to another forum, expensive litigation and delay would necessarily result. Moreover, such delay would produce no material benefit to any of the parties or witnesses involved, especially since, with the adoption of the new Bankruptcy Rules, the differences between summary and plenary suits in the federal courts have been rendered minimal.<sup>51</sup> Furthermore, were the trustee to lack an independent non-bankruptcy ground for federal jurisdiction,<sup>52</sup> he could not take advantage of the doctrine of pendent jurisdiction in order to have the entire claim heard in a federal court. The trustee would then face the burdensome prospect of litigating numerous potential claims in forums all over the United States; he might, moreover, be obliged to forego certain claims, were the dollar amounts insufficient to justify the necessary expenses of travel.

The question may be posed as to why a SIPA trustee should

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<sup>48</sup> SIPA § 6(a), 15 U.S.C. § 78fff(a) (1970).

<sup>49</sup> H.R. REP. No. 1613 at 9-10.

<sup>50</sup> *Id.* at 9.

<sup>51</sup> See the Prefatory Note to Part VII (Adversary Proceedings) of the Bankruptcy Rules, which begins: "The Part VII Rules incorporate by reference or adapt in part most of the Federal Rules of Civil Procedure, and their numbering is correlated with that of the Federal Rules." 1 COLLIER, *supra* note 24, at 179 (Special Supp. 1973).

<sup>52</sup> ". . . United States District Courts will not have jurisdiction of plenary suits against adverse claimants in possession where the general requirements of diversity of citizenship and the minimum jurisdictional amount do not exist without their consent, except where the suit is one under the provisions of §§ 60, 67 or 70." 2 COLLIER, *supra* note 24, ¶ 23.15[4] at 614-15; *Williams v. Austrian*, 331 U.S. 642, 651-52 (1947); *Lowenstein v. Reikes*, 60 F.2d 933 (2d Cir. 1932), *cert. denied*, 287 U.S. 669 (1933).

not be subject to the same burdens in marshalling the assets of an estate as is any other liquidation trustee. One answer is that Congress has determined securities to be intricate merchandise affected with a national public interest;<sup>53</sup> that the economic stability of the securities industry is essential to the economic stability of the nation; and that the protection of broker-dealer customers is sufficiently important to warrant provision for an insurance fund by assessing members of the securities industry and giving SIPC a one-billion-dollar call on the United States Treasury.<sup>54</sup> Since SIPA liquidations are financed by public funds, it would be equitable for a SIPA trustee to recover assets for the debtor's estate as promptly and inexpensively as possible.

Although a narrow view of the jurisdiction of a SIPA court could have seriously adverse effects upon the entire congressional scheme for SIPA, there is no specifically relevant information in the legislative history as to whether or not summary jurisdiction was to be limited—either pursuant to bankruptcy case law or via section 23 of the Bankruptcy Act—in a SIPA proceeding. There is, therefore, no direct evidence as to whether Congress intended the SIPA court to be bound by those restrictions upon its summary jurisdiction which apply in an ordinary liquidation. All that might be fairly said is that Congress intended to give the SIPA court sufficiently broad jurisdiction to accomplish its purposes without specifying many details of its powers.

There can be no doubt that Congress has the power to provide for summary jurisdiction to an extent broader than presently available in ordinary bankruptcy or under chapter X:

Congress has, of course, power to confer upon the bankruptcy court jurisdiction to adjudicate the rights of trustees to property adversely claimed. In matters relating to bankruptcy its power is paramount. Hence, even if the property is not within the possession of the bankruptcy court, Congress can confer upon it, as upon any other lower federal court, jurisdiction of the controversy, by conferring jurisdiction over the person in whose possession the property is. Congress has, also (subject to the constitutional guaranties), power to determine to what extent jurisdiction conferred, whether through possession of the *res* or otherwise, shall be exercised by summary proceedings and to what extent by plenary suit.<sup>55</sup>

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<sup>53</sup> Exchange Act § 2, 15 U.S.C. § 78b (1970).

<sup>54</sup> SIPA § 4(h), 15 U.S.C. § 78ddd(h) (1970); Duffy, *Reforming SIPC*, REV. SEC. REG. VOL. 7, No. 2 at 985 (January 31, 1974).

<sup>55</sup> *Taubel-Scott-Kitzmilller Co. v. Fox*, 264 U.S. 426, 430-31 (1924).



Furthermore, the Supreme Court has concluded that a broad analysis of the impact of granting or denying summary jurisdiction upon the congressional scheme is a proper method by which to test the extent of such jurisdiction under the Bankruptcy Act:

With respect to the statutory question, it must be conceded that the Bankruptcy Act does not in express terms confer summary jurisdiction to order claimants to surrender preferences. But Congress has often left the exact scope of summary proceedings in bankruptcy undefined, and this Court has elsewhere recognized that in the absence of congressional definition this is a matter to be determined by decisions of this Court after due consideration of the structure and purposes of the Bankruptcy Act as a whole, as well as the particular provisions of the Act brought in question.

When Congress enacted general revisions of the bankruptcy laws in 1898 and 1938, it gave special attention to the subject of making the bankruptcy laws inexpensive in their administration. Moreover, this Court has long recognized that a chief purpose of the bankruptcy laws is to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period, and that provision for summary disposition, without regard to usual modes of trial attended by some necessary delay, is one of the means chosen by Congress to effectuate that purpose . . . .<sup>56</sup>

Although the case from which the above quotation was derived did not arise under a SIPA adjudication, the apparent purposes behind SIPA surely present an imperative for the application of broad, rather than narrow, summary jurisdiction.

Were the court in a SIPA liquidation to have only a limited version of summary jurisdiction, Congress would have seriously weakened the opportunities for a prompt and orderly liquidation of failing broker-dealers. A more reasonable interpretation of the statute, however, would be that Congress intended the SIPA court to have extremely broad summary jurisdictional powers and that any limitations to the contrary under the Bankruptcy Act should be inapplicable.

#### D. *Parties and Questions of Standing*

In a SIPA liquidation, SIPC and the debtor are the only parties to the proceeding. Nevertheless, the application by SIPC

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<sup>56</sup> *Katchen v. Landy*, 382 U.S. 323, 328-29 (1966) (citations, brackets and quotation marks omitted).

pursuant to section 5(a)(2)<sup>57</sup> of the 1970 Act may be, and frequently is, brought in conjunction with an SEC action to enjoin the debtor and its principals from further violations of the securities acts. Therefore, the SEC and persons associated with the debtor may appear as parties in the caption of the proceeding. Moreover, pursuant to section 5(c) of the 1970 Act,<sup>58</sup> the SEC may on its own motion file a notice of its appearance in any proceeding under the Act and thereafter participate as a party.

Section 7(b) of the 1970 Act<sup>59</sup> empowers the SEC to bring suit to require SIPC to discharge its obligations under SIPA. The language of this section neither compels the SEC to act, nor expressly prohibits parties other than the SEC from bringing similar suits against SIPC.<sup>60</sup>

In *Bohart-McCaslin Ventures, Inc. v. Midwestern Securities Corp.*,<sup>61</sup> the plaintiff sought to invoke the protection of SIPA by requiring SIPC to intervene and commit its funds to a broker-dealer liquidation. SIPC argued that the order sought by the plaintiff be denied on two grounds: first, the debtor had ceased all business activities prior to the effective date of SIPA, and SIPA was not intended to have retroactive effect; second, the plaintiffs had no standing, irrespective of whether or not customers of the debtor were protected by SIPA. The court agreed with SIPC on both points, interpreting section 7(b),<sup>62</sup> which empowers the SEC to sue, to allow *only* the SEC as a proper party to force SIPC action.<sup>63</sup> The court also noted that there was no express provision in the statute authorizing suits by parties other than the SEC.<sup>64</sup>

One commentator, citing the *Bohart* decision with approval, reasoned that SIPC's power to intervene must be discretionary,

<sup>57</sup> SIPA § 5(a)(2), 15 U.S.C. § 78eee(a)(2) (1970).

<sup>58</sup> SIPA § 5(c), 15 U.S.C. § 78eee(c) (1970).

<sup>59</sup> SIPA § 7(b), 15 U.S.C. § 78ggg(b) (1970).

<sup>60</sup> Section 7(b) of SIPA, 15 U.S.C. § 78ggg(b) (1970), reads as follows:  
(b) Enforcement of actions.—In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under this chapter and for such other relief as the court may deem appropriate to carry out the purposes of this chapter.

<sup>61</sup> 352 F. Supp. 937 (N.D. Tex. 1973).

<sup>62</sup> SIPA § 7(b), 15 U.S.C. § 78ggg(b) (1970).

<sup>63</sup> *Bohart-McCaslin Ventures, Inc. v. Midwestern Sec. Corp.*, 352 F. Supp. at 940.

<sup>64</sup> *Id.* at 940-41.

since its powers are limited to requests for liquidation. Because SIPC lacks the power to cause the debtor's reorganization or rehabilitation, delay is the only available remedial alternative to liquidation, should the broker-dealer be able to surmount its financial difficulties on its own or through a merger.<sup>65</sup> In this connection, it should be noted that SIPC has the power to force a broker-dealer, which is not actually bankrupt or insolvent, into liquidation.<sup>66</sup>

In a more recent case, *SEC v. Guaranty Bond and Securities Corp.*,<sup>67</sup> the Sixth Circuit considered the applicability of SIPA to a broker-dealer who had become insolvent prior to the effective date of the Act, but who had processed some 101 transactions after the effective date. The receiver brought suit to require SIPC to invoke the protection of the Act. SIPC raised the two-pronged argument that had been raised in *Bohart*, *i.e.*, non-retroactivity and lack of standing. The SEC agreed in theory with the receiver that SIPA should apply where the number of transactions after the effective date of SIPA was substantial, but agreed with SIPC that the receiver had no standing to raise the argument.

The lower court concluded that SIPA was inapplicable because the broker-dealer had become insolvent prior to the effective date, but accepted the receiver's argument that parties other than the SEC are proper plaintiffs to sue SIPC. The Sixth Circuit held that the receiver was correct on both counts: sufficient transactions were entered into after the effective date, and the receiver was a proper plaintiff. The circuit court found unconvincing the argument that, since there was no express provision for customers or representatives to bring suit to force SIPC to act, no such suit was possible. Moreover, the court noted in footnote,<sup>68</sup> section 3(b)(1) of SIPA<sup>69</sup> provides that SIPC has the corporate power to sue and to be sued, to complain and to defend, in its corporate name in any state or federal court, thus evincing some minimal, indirect congressional intent that SIPC could be sued in the normal manner. Most importantly, the court noted that

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<sup>65</sup> Guttman, *Broker-Dealer Bankruptcies*, 48 N.Y.U.L. Rev. 887, 930-31 (1973).

<sup>66</sup> Among the five grounds listed in section 5(b)(1)(A) of SIPA, 15 U.S.C. § 78eee(b)(1)(A) (1970), upon which a district court can base a decree requiring liquidation are failure to comply with the financial responsibility or hypothecation rules under the Exchange Act, or inability to make computations necessary to establish compliance with such regulations.

<sup>67</sup> 496 F.2d 145 (6th Cir. 1974), *petition for cert. filed sub nom. SIPC v. Barbour*, 43 U.S.L.W. 3021 (July 20, 1974).

<sup>68</sup> *Id.* at 150 n.5.

<sup>69</sup> SIPA § 3(b)(1), 15 U.S.C. § 78ccc(b)(1) (1970).

Congress could not have intended customers to be without a remedy in the event that SIPC and the SEC are inactive where the statute arguably affords the plaintiff its protection.<sup>70</sup>

The merits of the *Bohart* and *Guaranty Bond* decisions, namely, whether SIPC can be compelled to advance its funds in a suit by a party other than the SEC, are beyond the scope of this article, and we therefore do not express any opinion as to them. However, there is a preliminary question presented, which has not been discussed in the reported decisions, as to the jurisdictional basis for such private suits against SIPC. Where a SIPA liquidation is in fact pending, SIPC is a party to the proceeding, and therefore summary jurisdiction would lie so as to subject SIPC to an order requiring it to advance funds for a particular customer claim. Where no SIPA proceeding is yet pending, the jurisdictional basis could not originate from the summary powers of a liquidation court. The most obvious and, in our opinion, the correct source for *in personam* jurisdiction would then become the Exchange Act's exclusive jurisdiction over suits involving Exchange Act duties as previously discussed.<sup>71</sup>

Ordinarily, the filing of a claim by a creditor makes the creditor a formal party to a bankruptcy or reorganization proceeding.<sup>72</sup> Furthermore, the filing of such a claim is deemed a consent to the court's jurisdiction over related counterclaims by the trustee.<sup>73</sup> In a SIPC proceeding, claims are filed with the trustee rather than with the court.<sup>74</sup> Presumably, claimants nevertheless become parties to the proceeding, and cannot thereafter extricate themselves from the jurisdiction of the court if the trustee should assert a counterclaim against them.

Where the debtor has been conducting business as a sole proprietorship, the SIPC court has jurisdiction over all property

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<sup>70</sup> SEC v. Guaranty Bond & Sec. Corp., 496 F.2d at 150.

<sup>71</sup> See text accompanying notes 11-14 *supra*. Interestingly enough, the plaintiff in *Guaranty Bond* served SIPC pursuant to the Tennessee "long arm" statute, Tenn. Code Ann. § 20-235 *et seq.*, rather than the more liberal provisions of section 27 of the Exchange Act, 15 U.S.C. § 78aa (1970), and SIPC disputes such service on due process grounds. Petitioner's Brief for Certiorari at 24-26, *SIPC v. Barbour*, 43 U.S.L.W. 3021 (July 20, 1974) (arguing that SIPC neither does, nor transacts, business in Tennessee merely because the self-regulating exchanges act as SIPC's collecting agent for SIPC assessments).

<sup>72</sup> Creditors are among the "parties in interest" in a bankruptcy proceeding. However, creditors who do not file timely claims are not entitled to further notice of the proceedings. Bankruptcy R. 203(d) (1973).

<sup>73</sup> *Katchen v. Landy*, 382 U.S. 323 (1966).

<sup>74</sup> SIPA §§ 6(g),(j), 15 U.S.C. §§ 78fff(g),(j) (1970).

owned by the sole proprietor, including property which was regarded by him as personal and which was not contributed to the business of the broker-dealer.<sup>75</sup> Where the debtor is a partnership, section 5(d) of the Bankruptcy Act would give the court jurisdiction over all of the general partners of the broker-dealer and over all partnership and individual property.<sup>76</sup> Where the debtor is a corporation, section 7(b) of the Bankruptcy Act provides that one or more officers, members of its board of directors, or stockholders may be designated to perform the duties imposed upon the bankrupt; such a designated person would become a formal party to the SIPC proceeding. However, for a variety of reasons, the courts in SIPC liquidation proceedings have not always designated any individuals pursuant to section 7(b).<sup>77</sup>

One reason for the perplexities of the jurisdiction of a SIPC court is that SIPC, a quasi-governmental agency, is an active party in the liquidation proceeding, in many respects supplanting the role of a debtor's creditors.<sup>78</sup> Nevertheless, the court's jurisdic-

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<sup>75</sup> SEC v. Wick, 360 F. Supp. 312 (N.D. Ill. 1973).

<sup>76</sup> Bankruptcy Act § 5(d), 11 U.S.C. § 23(d) (1970).

<sup>77</sup> Bankruptcy Act section 7(b), 11 U.S.C. § 25(b) (1970), allows such designation; but under section 7(a)(10), 11 U.S.C. § 25 (a)(10) (1970), the effect of designation would be to give the designee derivative immunity and use immunity, *i.e.*, no testimony given by the designee, nor fruits derived therefrom, can be offered in evidence against him in any criminal proceeding, except such testimony as he may give in the hearings upon objections to his discharge. This might be unacceptable to SIPC or to the SEC in those cases in which the principals are themselves guilty of wrongdoing, unless adequate procedures are adopted to assure that prosecution of such principals is not prejudiced by the taint of compelled testimony.

<sup>78</sup> An illustration of SIPC's power is found in the process of selecting the debtor's trustee and counsel. In ordinary bankruptcy, the creditors elect a trustee pursuant to section 44(a) of the Bankruptcy Act, 11 U.S.C. § 72(a) (1970). The court will then appoint the creditor's nominee, but only if he meets the affirmative qualifications of competence, disinterestedness, and the posting of a bond. Bankruptcy Act §§ 45, 50(b), 11 U.S.C. §§ 73, 78(b); Bankruptcy R. 201(f), 209(d) (1973). Furthermore, should the creditor's selection fail to qualify as trustee, the court may appoint a replacement without an election. *In re Eloise Curtis, Inc.*, 388 F.2d 416 (2d Cir. 1967).

Although the role of the court is an active one in the appointment of a trustee in bankruptcy, its role under SIPA is much narrower. SIPC has replaced creditors *vis-à-vis* the selection of a trustee and counsel, and has been given more expansive powers. Section 5(b)(3) of SIPA, 15 U.S.C. § 78eee(b)(3) (1970), provides that the court "shall" appoint SIPC's nominee, but does not provide explicit standards, other than that of disinterestedness, to test the competence of the nominee. One judge rejected this congressional allocation of power as violative of the doctrine of separation of powers, but was overruled without opinion. SEC v. Oxford Securities, Ltd., 354 F. Supp. 301 (S.D.N.Y.), *rev'd*, 486 F.2d 1396 (2d Cir. 1973).

Part of the statutory scheme of the 1970 Act is that SIPC becomes the subrogee of customers to whom it advances funds, and thus may become the largest creditor of the

tion is based not upon its power over SIPC, nor upon any rights and obligations set forth in the 1970 Act, but, rather, upon express provision in the statute for jurisdiction over the debtor and its property. It seems that in this oblique attempt to transplant the Bankruptcy Act to the Exchange Act, through the mechanism of the 1970 Act, the SIPA court has been given excessive administrative jurisdiction and an insufficient portion of adjudicatory jurisdiction.<sup>79</sup>

## II. PROBLEMS OF DETERMINING EXCLUSIVE JURISDICTION OVER THE DEBTOR INVOLVED AND ITS PROPERTY

### A. *The Nature of the Debtor's Property*

The property of a debtor being liquidated under SIPA frequently will not be physically located on the premises of the broker-dealer, and may not even be in the possession of its agents or under its control. Moreover, much of the property which the debtor will have in its possession or under its control is likely to be owned by customers of the broker-dealer, and therefore will be property which the debtor is holding in safekeeping or as collateral for a loan to a margin customer.

Such property of customers, if not "specifically identifiable," becomes part of the "single and separate fund."<sup>80</sup> The trustee is given specific power to recover for the single and separate fund property transferred by the debtor illegally, and for the purposes of such recovery, the property is "deemed to have been the property of the debtor."<sup>81</sup>

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debtor. See Note, *The Securities Investor Protection Act of 1970; An Early Assessment*, 73 COLUM. L. REV. 802, 838-40 (1973). For another illustration of a situation in which SIPC has been treated as a "super-creditor," see note 99 *infra*.

<sup>79</sup> THE REPORT OF THE COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 2d Sess. (Part I, ser. 13034-4; Part II, ser. 13034-5) (July 1973) [hereinafter cited as Bankruptcy Report], has reached substantially similar conclusions about misallocation of administrative and judicial functions in ordinary bankruptcy. At present, SIPA trustees receive court approval for such inconsequential administrative matters as selling the debtor's office furniture and equipment; that same court may nevertheless lack jurisdiction over critical matters such as pledged securities.

<sup>80</sup> SIPA § 6(c)(2)(B), 15 U.S.C. § 78fff(c)(2)(B) (1970).

<sup>81</sup> SIPA § 6(c)(2)(D), 15 U.S.C. § 78fff(c)(2)(D) (1970). A construction argument could be made that since property recoverable as an illegal transfer, such as unlawfully hypothecated securities, is deemed to be "property of the debtor," it should be subject to the jurisdictional grant to the SIPA court, under section 5(b)(2) of SIPA, 15 U.S.C. § 78eee(b)(2) (1970), as to the "debtor involved and its property." If such a construction were accepted, the party in possession could not successfully assert a failure of summary jurisdiction by virtue of the party's making a substantial adverse claim.

The preponderant value of assets of the debtor and its customers will be in securities and cash. Such securities are highly volatile and may dissipate in value very quickly after a bankruptcy, particularly in situations where the debtor has been making a market in, or otherwise sponsoring securities long in, its own proprietary accounts or the accounts of its customers.

As explained above, in an ordinary liquidation proceeding pursuant to chapters I through VII of the Bankruptcy Act, the assertion of an adverse claim by a person in the possession of the bankrupt's property will defeat the summary jurisdiction of the bankruptcy court. Even in a reorganization proceeding, where the court has the power to interfere with valid liens and reclassify creditors, the court's summary jurisdiction may be lost over property which the debtor has transferred to a person who has not filed a claim or otherwise participated in, or become a party to, the bankruptcy proceedings.

There are a variety of situations in which conflicting claims—by a trustee, customer of the debtor, or other persons—on moneys or securities which immediately prior to the bankruptcy were in the possession or under the control of the debtor, might most expeditiously be adjudicated by the SIPC court. However, if the persons in possession of such property on the filing date of the proceeding are not parties to the proceeding and are in a position to assert substantial adverse claims to the property, a serious challenge to the jurisdiction of the SIPC court to adjudicate these claims may be made.

### B. *Pledged Property*

In the ordinary course of business as a broker and dealer in securities, a firm will receive securities and cash as collateral for loans, and, in turn, will act as a pledgor of securities and cash. In the process of a SIPC liquidation, two types of claims may alternatively be asserted by or against the debtor with respect to such property. These are the claims of a secured creditor with a perfected lien on property, and the claims of set-off.<sup>82</sup> Ordinarily, the person attempting to establish the position of a secured creditor with a perfected lien will be doing so pursuant to the provisions of section 9-305 of the Uniform Commercial Code, claiming that status as a lienholder was acquired when possession of the securities or cash was obtained. Section 9-104(i) of the Code pro-

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<sup>82</sup> See Bankruptcy Act § 68, 11 U.S.C. § 108 (1970).

vides an exemption for rights of set-off. This does not make set-off a mutually exclusive right from that of a secured creditor with a perfected lien. Rather, these are alternate rights arising from different relationships between the debtor and creditor with respect to the property pledged or given.

The most common type of account, in which a broker-dealer will be holding securities as collateral for a loan, is that of the margin account customer. In such an arrangement, the customer owes the amount of his debit balance to the broker-dealer and such debt is collateralized by securities in the customer's account. It is often the case, however, that the broker-dealer will have rehypothecated such customer's securities with a bank in order to obtain the funds necessary to finance the broker-dealer's margin accounts. Pursuant to the SEC's hypothecation and customer protection rules,<sup>83</sup> the bank should be on notice, when making such a loan, that the securities hypothecated are customers' securities to the extent that such securities are fully paid for, or in excess of applicable margin requirements. However, failing broker-dealers frequently have not complied with either the hypothecation or customer protection rules of the SEC, and customers' securities have been commingled with other securities and pledged as collateral in day loans or overnight loans from banks to broker-dealers. In such a situation, a SIPC trustee may have a valid claim against the bank. On the other hand, the bank, under certain circumstances, may be protected in its right to retain securities so pledged, even though the pledge was wrongful.

Another form of commercial arrangement in which a broker-dealer acts as pledgee is the obtaining by a broker-dealer of securities loans for a cash deposit. This type of borrowing may originate because of short sales by customers.<sup>84</sup>

There are many classes of transactions in which a broker-dealer pledges its property, or the property of its customers, in order to obtain a loan. The most common type of pledge relationship will arise with those banks with which a broker-dealer has established banking relationships. The most significant type of short-term financing for the average clearing firm will be its broker's loan, which is usually indispensable to the continuation of its business. The nature of this loan will fluctuate from night to day: at night, it is a secured loan; during the day, it is an unse-

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<sup>83</sup> Rules 15c2-1 and 15c3-3 under the Exchange Act, 17 C.F.R. § 240.15c2-1, 3-3 (1973).

<sup>84</sup> See § 6(h) of Regulation T, 12 C.F.R. § 220.6(h) (1974).



cured loan. The bank's status with respect to the collateral pledged for such a loan will ordinarily be that of a secured creditor. In addition, the bank probably will have rights of set-off where the broker-dealer has other accounts at the bank.

A broker-dealer is also likely to have loans granted against securities being drafted by the lending bank to other broker-dealers, pursuant to debtor's orders. For purposes of the 1970 Act, these transactions, as between the debtor and the broker-dealers involved, most likely constitute open contractual commitments pursuant to section 6(d).<sup>85</sup> However, so far as the bank is concerned, these clearing arrangements are fully secured extensions of credit.<sup>86</sup>

The broker-dealer may also have made stock loans to other broker-dealers for cash deposits. These deposits probably are instruments with respect to which the lending broker-dealer has a perfected lien under section 9-305 of the Uniform Commercial Code.<sup>87</sup> Such lending broker-dealers also should have rights of set-off with respect to the cash deposits.

More conventional types of deposits, common to any business enterprise, are also likely to have been made by a bankrupt broker-dealer. Examples of such deposits are those to landlords as security for a lease, to manufacturers who have leased equipment to the broker-dealers, to the telephone company and other utilities, and similar arrangements. Deposits more unique to the securities industry will have been made to stock clearing corporations of securities and commodities exchanges.

There would appear to be no reason to treat the type of conventional deposit of cash to a landlord, a manufacturer, or a utility any differently in a SIPC liquidation than in any other bankruptcy proceeding. However, where customers' securities have been pledged by broker-dealers to persons who are not parties to the SIPC proceeding, it would appear extremely detrimental to the interests of the debtor's estate and the customers of the debtor, as well as SIPC, were a trustee to be compelled to litigate any claims he might have against the pledgees in any forum other than the bankruptcy court.

The present structure of the 1970 Act requires that customers

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<sup>85</sup> SIPA § 6(d), 15 U.S.C. § 78fff(d) (1970).

<sup>86</sup> See § 2(g) of Regulation U, 12 C.F.R. § 221.2(g) (1974).

<sup>87</sup> See *In re Atlantic Times, Inc.*, 259 F. Supp. 820 (N.D. Ga. 1966), *aff'd sub nom. Sanders v. Nat'l Acceptance Co.*, 383 F.2d 606 (5th Cir. 1967); Coogan, Kripke & Weiss, *The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements*, 79 HARV. L. REV. 229, 263 (1965).

who have valid claims against a SIPC trustee receive either the securities long in an account on the filing date of the SIPC proceeding, or the cash value on that date of such securities in lieu of delivery in kind. If the trustee is unable to deliver the securities in kind, whether or not the securities were fully paid for by the customer, the customer must, in effect, suffer a forced sale of the securities on a filing date. Therefore, to the extent the trustee is unable to recover customers' securities from pledgees, those customers will be forced to take cash in lieu of such securities. Prior to the time of the distribution, the securities may fluctuate in value. If the trustee is compelled to litigate his claim to any such securities in a plenary action, even greater fluctuation in value could occur. At the same time, SIPC has taken the position that it is not authorized to advance funds to a trustee for repayment of any bank loans even if his object be the recovery of customers' securities. Accordingly, the only practical way in which a trustee may recover such securities is through litigation.

As set forth above, the court in a SIPC proceeding can stay the enforcement of liens or rights of set-off, but may not abrogate them. Consequently, although a trustee would be able to prevent a pledgee from foreclosing on collateral during the time litigation was pending in another forum, such a stay would not seem to be in the best interests of either the estate or the creditor: one, or the other, or both, would be forced to take a market risk during the course of this litigation concerning the respective rights to the pledged securities.

In an ordinary liquidation proceeding, a creditor could defeat the summary jurisdiction of the bankruptcy court over such a dispute by asserting a claim of right to the pledged securities. Whether the court would retain jurisdiction in a reorganization proceeding remains a more open question. It can be argued that, even if a reorganization court were to retain such jurisdiction, a SIPC court might not, because (a) the court has no right to upset liens or interfere with rights of set-off;<sup>88</sup> or (b) the jurisdiction of the SIPC court is simply that of a court in a chapter X proceeding where an order pursuant to section 102 has been entered. To counter this argument, however, a trustee might point out that time is, inevitably, of the essence in a SIPC liquidation; the volatile nature and perishable value of the securities pledged require the SIPC court to retain jurisdiction of any controversy concerning such securities.

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<sup>88</sup> SIPA § 6(c)(1), 15 U.S.C. § 78fff(c)(1) (1970).

### C. *Transfer Agents and Clearing Corporations*

At the present time, the SEC has no authority over transfer agents, depositories, or clearing corporations, unless the depositories or clearing agencies happen to be owned and operated by self-regulatory organizations which are subject to the administrative jurisdiction of the Commission.<sup>89</sup> Since the only members of SIPC are broker-dealers, SIPC has no authority over transfer agents, depositories, or clearing agencies.

At the time a broker-dealer becomes bankrupt, securities and cash of the firm and its customers probably will be located at these transfer agents, depositories, and clearing agencies. Unless these entities file claims in the SIPC liquidation, they will not be parties to the proceedings, and the court will not have personal jurisdiction over them. Any jurisdiction which the court may be called upon to exercise would necessarily apply to the property of the debtor pursuant to section 5(b)(2) of the 1970 Act.<sup>90</sup> Whether such jurisdiction is appropriate where the property in dispute is not that of the debtor, but rather, that of the debtor's customers, is problematic. Furthermore, jurisdiction might be challenged if a claim of right, such as a set-off or lien, were asserted against the property by the transfer agent, depository, or clearing agency. Similar problems might arise with respect to profits from the sale of stock exchange seats in situations where an exchange asserts a right of set-off against a member which has become bankrupt. The justifications for the SIPC court's retention of jurisdiction to adjudicate any such controversies are similar to the reasons set forth above for such retention in the case of pledged property.

Another type of situation in which a trustee might wish to invoke the authority of the SIPC court may arise when distributions of securities are made to customers, and the trustee must transfer these securities into the names of such customers. Under the 1970 Act, the trustee is accorded very little discretion in making distributions of securities to customers, particularly where specifically identifiable property is involved. Nevertheless, the trustee may not have securities in street name in the denomina-

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<sup>89</sup> A principal conclusion of the SEC was that the Commission needed additional authority in the area of securities processing. *STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS*, H.R. DOC. NO. 231, 92d Cong., 1st Sess. (1971). Two currently pending bills, S. 2058 and H.R. 5050, incorporate provisions for the regulation of transfer agents, clearing agencies, and securities depositories.

<sup>90</sup> SIPC § 5(b)(2), 15 U.S.C. § 78eee(b)(2) (1970).

tions owed to customers, particularly if the trustee has been compelled to prorate the securities.<sup>91</sup> If the transfer agent has resigned, or for any other reason is unwilling or unable to follow requests by the trustee to transfer the securities in his possession into customers' names, there would seem to be no way in which the trustee could adjudicate such a controversy before the SIPC court, unless the transfer agent happened to have filed a claim in the bankruptcy proceeding or consented to summary jurisdiction. Happily, this problem has proved to be more theoretical than practical since most transfer agents consent to the summary jurisdiction of the bankruptcy court, an entirely proper method of resolving such transfer problems.

#### D. *Subordinated Lenders*

Most brokerage firms maintain a portion of their capital in the form of subordinated debt. This is specifically permitted pursuant to the net capital rule of the SEC and comparable stock exchange rules.<sup>92</sup> Under the present New York Stock Exchange forms for subordinated loans, either a cash-subordinated loan is made, or a note obligation for a specified sum of money is signed by the lender and is then collateralized by securities. If the securities fluctuate in value, the lender is to bear the risk of gain or loss. In earlier types of New York Stock Exchange agreements, and in many forms of subordinated loan agreements used by the regional stock exchanges, securities rather than cash, or a fixed debt obligation, may be subordinated. If these securities fluctuate in value, it would appear that the risk of gain or loss rests with the broker-dealer. Under applicable SEC rules, securities may be subordinated, although a brokerage account as such may not be.

Although there has been some litigation between subordinated lenders and bankrupt broker-dealers, or their principals, arising out of the numerous broker-dealer failures of the past several years,<sup>93</sup> the rights and obligations of the parties to these agreements continue to be far from clear. Under the 1970 Act,

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<sup>91</sup> Although a customer's securities may be "specifically identifiable" pursuant to section 6(c)(2)(C)(iii) of SIPA, 15 U.S.C. § 78fff(c)(2)(C)(iii) (1970), and rule 15c3-3(j) under the Exchange Act, 17 C.F.R. § 240.15c3-3(j) (1973), the trustee may nevertheless have shortages of that security, and be required to prorate the shares he does have on hand in order to satisfy the claims of all the customers.

<sup>92</sup> Rule 15c3-1(c)(7) under the Exchange Act, 17 C.F.R. § 240.15c3-1(c)(7) (1973); New York Stock Exchange Rule 325; American Stock Exchange Rule 470.

<sup>93</sup> See, e.g., *Hughes v. Dempsey-Tegeler & Co.*, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,133 at 94,525 (D. Cal. Sept. 4, 1973); *Caddell v. Goodbody & Co.*, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,938 at 93,736 (N.D. Ala. Dec. 6, 1972).

subordinated lenders are specifically excluded from the definition of customers.<sup>94</sup>

Even though subordinated lenders may not be entitled to SIPC advances, they usually will file a claim in a SIPC proceeding, hoping at least to be entitled to payment as a general creditor or a subordinated creditor if there are sufficient assets in the estate. However, in a situation where securities, which have been subordinated by a lender, have decreased in value, or were prematurely withdrawn from the firm prior to bankruptcy, the trustee may wish to institute suit against the subordinated lender to recover assets for the bankrupt estate. If the subordinated lender has not filed a claim in the proceeding and, by so doing, has voluntarily submitted himself to the jurisdiction of the court, it would appear that the trustee cannot institute an action against him within the context of the SIPC proceeding.

#### E. *Brokerage Account Customers and Claimants*

The most important purpose of the 1970 Act was to provide insurance coverage within certain specified limits to customers of firms having gone into bankruptcy.<sup>95</sup> Immediately after liquidation proceedings are commenced, the trustee sends claim forms to all of the customers of a broker-dealer whose names he is able to ascertain. At the time claim forms are sent out, the trustee may not know whether the bankrupt owed securities or cash to such customers, or whether such customers owed securities or cash to the bankrupt. Eventually, the trustee may decide to initiate litigation against various customers to collect debit balances in their accounts.

If customers who owe securities or monies to the broker-dealer file claims, the trustee can object to such claims and counterclaim against them within the context of the SIPC proceeding. However, if no claims have been filed by such customers, the trustee must institute litigation against them in separate law suits.

The bankruptcy court would appear, therefore, to have neither summary nor plenary jurisdiction over such customers. Moreover, although a trustee might attempt to sue such customers in the federal courts, alleging that he was bringing suit

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<sup>94</sup> SIPA § 6(c)(2)(A)(ii), 15 U.S.C. § 78fff(c) (2)(A)(ii) (1970).

<sup>95</sup> Duffy, *Reforming SIPC*, REV. SEC. REG. VOL. 7, No. 2 at 985-88 (January 31, 1974).

pursuant to a federal statute, namely, the 1970 Act, this would seem to be a weak jurisdictional handle. More likely, the trustee would be compelled to sue in state court unless he were alleging a violation of the securities acts or there were diversity of citizenship and the amount in controversy were in excess of ten thousand dollars. Although the long-arm statute of most states might permit the trustee to institute litigation where the broker-dealer had its principal place of business, and presumably in the jurisdiction where the bankruptcy proceedings were pending, a customer who dealt with a branch office of the broker-dealer might be able to contest such a claim of jurisdiction.<sup>63</sup>

Although the trustee in litigation proceedings for any other business probably would be faced with the same jurisdictional problems in attempting to collect accounts receivable, this procedure would seem inordinately expensive and complicated in the context of a SIPC litigation. Many customers owing broker-dealers small sums of money might well escape without payment to the debtor simply because the cost of collection in a plenary lawsuit could not be justified. Yet, the same customer might make a claim in another SIPC liquidation and be paid with moneys advanced from SIPC.<sup>67</sup> The facts and the law applicable in a collection case against a broker-dealer customer are relatively simple, and it would seem more equitable and practical for such cases to be conducted before the court which is handling the entire bankruptcy.

#### F. *Officers and Employees*

Officers and employees may also file claims in a bankruptcy

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<sup>66</sup> See, e.g., *Drexel Burnham & Co. v. Silverman*, 75 Misc. 2d 904, 349 N.Y.S.2d 293 (Civ. Ct. 1973) (no long-arm jurisdiction for transaction of business in New York in suit brought by New York brokerage firm against defaulting purchasers where sole connection with the state was purchase order by non-resident individual defendants at plaintiff's Pennsylvania branch office for trade executed on New York Stock Exchange). But where non-resident's activities amount to more than mere solicitation of buy or sell order, jurisdiction may lie. Cf. *Parke-Bernet Galleries, Inc. v. Franklyn*, 26 N.Y.2d 13, 256 N.E.2d 506, 308 N.Y.S.2d 337, (1970) (non-resident individual defendant subject to long-arm jurisdiction where he has defaulted on purchase price for auctioned art pieces when he "borrowed" plaintiff's employee through use of open telephone line to participate in New York auction from outside of the state).

<sup>67</sup> In such a situation, SIPC would not be in a position to avail itself of the provisions of section 68 of the Bankruptcy Act, 11 U.S.C. § 108 (1970). In *SEC v. Morgan, Kennedy & Co.*, the trustee for another firm undergoing liquidation pursuant to SIPA, *Equitable Equities, Inc.*, moved for a stay of any distribution to a customer of *Morgan, Kennedy & Co.*, who was being sued by the *Equitable Equities, Inc.* trustee. Bankruptcy Judge Babitt denied the application. 73 Civ. 1057 (S.D.N.Y., filed March 9, 1973).

proceeding, particularly for wages owed to them by the debtor. If so, the bankruptcy court would seem likely to have jurisdiction, thus enabling the trustee to assert any counterclaims against such persons. However, if no claims are filed by such persons and the trustee has a claim against any of them, the problems discussed elsewhere in this article will prevail. The trustee must institute litigation in the state or federal court depending upon the nature of his claim.

In certain types of situations, the trustee might be able to claim the property of the debtor to be involved in the dispute, and assert jurisdiction on that ground. For example, the trustee might attack draws taken by officers or employees, a common compensation arrangement in brokerage firms. Here again, however, the officers or employees could assert a substantial adverse claim to the property; it is probable that the trustee would lose such a bid for jurisdiction in a SIPC court.

#### G. *General Creditors*

The status of general creditors in a SIPC proceeding is essentially the same as that of general creditors in any other bankruptcy proceeding. However, it is less clear that general creditors become parties to the proceeding by the mere filing of a claim, particularly since such claims are filed with the trustee rather than with the court.<sup>98</sup>

By and large, general creditors are rather neglected in these proceedings. There is no clear authority requiring a first meeting of creditors to be held, since the trustee is selected by SIPC rather than by the creditors. In the earliest SIPC liquidations, many trustees held such meetings solely for the purpose of fixing the time within which claims by creditors had to be filed, and other trustees simply held no such meetings at all. However, it has become the standard practice to have a first meeting of creditors, since SIPC is of the opinion that such meetings are necessary. Moreover, the 1970 Act appears to designate the time within which customer claims may be filed as sixty days after the notice of claim is sent, a shorter period than the six months provided for

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<sup>98</sup> It should be noted that SIPA does not require claims of either customers or creditors to be filed with the trustee or any other particular person. SIPA courts have implied from SIPA § 6(g), 15 U.S.C. § 78fff(g) (1970), which waives the necessity for customers to file formal proofs of claims, that Congress intended to have claims filed directly with the trustee. The courts have followed the practice that claims of both customers and creditors be filed with the trustee, even though creditors are not absolved from the requirement that formal proofs of claims be filed.

in the Bankruptcy Act.<sup>99</sup> In addition, the right of creditors to form a creditors' committee in a SIPA liquidation seems arguable.<sup>103</sup>

Since many of the procedures under the Bankruptcy Act have been fashioned from the point of view of protecting and informing creditors of the bankrupt, and inasmuch as a SIPA proceeding operates from such a radically different point of view, the applicability of many of these procedures is arguable. However, in the absence of procedures specifically described—by Congress, the SEC, SIPA, or some other concerned agency—trustees will be forced to rely on existing bankruptcy procedures and precedents.

### III. EFFECT ON NEW LEGISLATION UPON SIPA

#### A. *The New Bankruptcy Rules*

Since the Rules of Bankruptcy Procedure became effective on October 1, 1973,<sup>101</sup> SIPA liquidations referred to a bankruptcy judge have been conducted pursuant thereto. The practical effect of these rules, in those situations where rule 701-defined "adversary proceedings" are necessary, is that the Federal Rules of Civil Procedure will apply in the bankruptcy court, subject to appropriate modification.

For example, rather than seeking an order to show cause for the turnover of property sought by the trustee for the estate, the trustee files a complaint under rule 703 and serves a summons pursuant to rule 704. Similarly, discovery procedures, pleading rules, counterclaims, joinder, and other procedures are governed by the same principles as is an ordinary suit in a district court under the Federal Rules.

Because bankruptcy court and district court procedures are now practically indistinguishable types of adversary proceedings, it would seem foolish to require a trustee to judge correctly whether summary jurisdiction exists in the bankruptcy court, or whether plenary suit in the district court is mandated. There are

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<sup>99</sup> SIPA § 6(e), 15 U.S.C. § 78fff(e) (1970); Bankruptcy Act § 57(n), 11 U.S.C. § 93(n) (1970).

<sup>103</sup> In *SEC v. Weis Sec., Inc.*, 73 Civ. 2332 (S.D.N.Y., filed May 24, 1973), Bankruptcy Judge Babitt denied a petition to appoint a creditors' committee under section 44(b) of the Bankruptcy Act, 11 U.S.C. § 72(b) (1970), on the grounds that the method of selecting a SIPA trustee is "not compatible" with a creditors' committee, and that the trustee was generally not in opposition to the creditors' position (as per order of January 9, 1974).

<sup>101</sup> Order of Supreme Court of April 24, 1973 (Douglas, J., dissenting) (pursuant to 28 U.S.C. § 2075 (1970)), *appearing at* 411 U.S. 989 (1973).



no meaningful procedural benefits to be obtained by fractionating the court's jurisdiction into summary and plenary suits. Possibly the only substantive difference between such suits is the right to jury trial, but jury trial would not be available or utilized in many plenary suits in any event.

In most cases, a SIPA trustee would prefer to keep all of the liquidation proceedings under one judicial roof. If, however, an adverse claimant refuses to consent to summary jurisdiction, the trustee faces either the expense and delay of contesting the jurisdictional issue or the bringing of a separate plenary suit. Where the liquidation has been referred to a bankruptcy judge, the situation is even more complicated. If the bankruptcy judge determines that summary jurisdiction does not exist, he may now transfer the dispute, pursuant to rule 915(b), to the civil docket of the district court where appropriate. If federal and state claims are involved, the trustee could be met with arguments concerning the presence or absence of pendent jurisdiction over the state claims, so that further division of the suit might take place.

### B. *Report of the Commission on the Bankruptcy Laws*

The Commission on the Bankruptcy Laws of the United States recently presented a lengthy report on the present Bankruptcy Act, accompanied by a draft of a new Bankruptcy Act with explanatory notes. The proposed Bankruptcy Act of 1973 was introduced as H. 10792 in the House of Representatives, on October 9, 1973, and S. 2565 in the Senate, on October 11, 1973. Preliminary hearings were held by the House Committee on the Judiciary, on December 10, 1973, but progress of the bill was halted, the victim of other pressing business.<sup>102</sup> Although a full analysis of the Proposed Bankruptcy Act is beyond the scope of this article, some comments may be made about the possible effects of this proposal upon SIPA liquidations.

The Proposed Bankruptcy Act radically reforms the nature of the bankruptcy process. A major goal of the Commission is to redistribute the workload of the present bankruptcy courts by creating an administrative unit to handle most of the bankruptcy matters, and reserving for the courts only specified matters adjudicative in nature. Under SIPA, the trustee is already performing many of the administrative tasks which Congress realized are not required to be processed by the court. For example, claims are

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<sup>102</sup> Bankruptcy Report, *supra* note 79. Immediately prior to publication of this Article, on September 12, 1974, this bill was reintroduced in the House of Representatives with substantive changes. Time did not permit revision of this Article to discuss these changes.

filed with the trustee and not with the court. In this area, the Proposed Bankruptcy Act is taking a most worthwhile direction by treating much of the liquidation as administrative, rather than judicial. Although the Commission deliberately avoided any substantive amendments to SIPA until proper legislation could be drafted, it did propose a series of conforming amendments. However, certain anomalies would result if the Proposed Bankruptcy Act were passed in its present form and SIPA were not also amended. For example, SIPA incorporates various provisions of the present Bankruptcy Act—such as section 102—which would still be incorporated into SIPA. It is therefore possible that SIPA might incorporate by reference provisions which have gone out of existence with the passage of the Proposed Bankruptcy Act, or that the court might “trace” the old provisions into their newer versions where applicable. Such problems must be clarified directly by amending SIPA prior to, or concurrently with, the enactment of any new Bankruptcy Act.

The most heartwarming proposal by the Commission is to remove at last the distinction between summary and plenary suits. Under Proposed Bankruptcy Act section 2-201, jurisdiction is given to the bankruptcy court to hear “all controversies” that arise under the Bankruptcy Act. The Commission states rather emphatically that,

[t]he distinctions between summary and plenary proceedings, and between the scope of jurisdiction conferred for straight bankruptcy under Chapters I-VII and that conferred by each of the several rehabilitation chapters, which are breeders of pointless litigation over where litigation should be conducted, are all abolished.<sup>103</sup>

SIPA liquidations would be immeasurably aided if the SIPA court had the jurisdiction proposed by the Commission for the new Bankruptcy Act.

### C. *Report of the SIPC Task Force*

Having had a few years of experience administering the 1970 Act, SIPC established a Task Force to study the various shortcomings inherent in SIPA, with a view to proposing remedial

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<sup>103</sup> *Id.*, Part I at 6.

amendments. The Task Force has recently published its report<sup>104</sup> and recommendations, some of which concern the problems discussed in this article.

The Task Force Report recommends that SIPA be amended so as to set forth expressly those provisions of the Bankruptcy Act which should apply in a SIPA proceeding, rather than relying upon the unwieldy partial-incorporation approach.<sup>105</sup> Clearly, acceptance of this recommendation will eliminate an unnecessary variable in SIPA liquidations; we therefore agree with the Task Force Report insofar as SIPA is to be freed from the Bankruptcy Act.

However, in listing those areas in which the Bankruptcy Act procedures should be carried over into the 1970 Act, the Task Force Report merely recommends that the SIPA court have "exclusive jurisdiction over the broker or dealer and its property wherever situated."<sup>106</sup> A great deal more thought should be given, in our opinion, to a jurisdictional provision specifically tailored to SIPA liquidations. For example, it is most unfortunate that the Task Force Report did not specifically recommend that the SIPA court be given summary jurisdiction over nonconsenting adverse claimants in possession of property claimed by the trustee. Nor did the Task Force Report indicate a position upon whether or not plenary suits, if required, are to be subject to the restrictions of section 23 of the Bankruptcy Act.<sup>107</sup> Clarification of these issues would be helpful.

The Task Force Report does recommend that the trustee be given authority to advance SIPC funds to pay or guaranty the debtor's bank loans when necessary to reclaim customers' securities pledged by the debtor as collateral.<sup>108</sup> There would seem to be no reasonable objection by the pledgee-banks to releasing the collateral upon satisfaction of the balance due, so the jurisdictional problems might sometimes be avoided by this recommendation. However, in those instances where the balance outstanding is greater than the collateral being held by the bank, SIPC might be unwilling to advance funds to pay the balance, the bank

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<sup>104</sup> SIPC, *Report to the Board of Directors of the Securities Investor Protection Corporation of the Special Task Force to Consider Possible Amendments to the Securities Investor Protection Act of 1970* (July 1974) [hereinafter cited as the *Task Force Report*].

<sup>105</sup> *Id.* at 34-38.

<sup>106</sup> *Id.* at 36.

<sup>107</sup> Bankruptcy Act § 23, 11 U.S.C. § 46 (1970).

<sup>108</sup> *Task Force Report*, note 104 *supra*, at 10.

might interpose its adverse claim and the trustee would again be confronted with the summary-plenary jurisdictional puzzle. Again, the Task Force Report's suggestion is well taken, but the court should be given jurisdiction over the parties where disputes arise.

Similarly, the Task Force Report proposes that SIPC be authorized to join or enter into contractual agreements with clearing corporations and depositories.<sup>109</sup> Substantively, this is an improvement of some merit, but the 1970 Act should clearly confer jurisdiction in the SIPA court over disputes between SIPC and a recalcitrant transfer agent or depository. Without clarification of the jurisdictional issue, SIPC could become bogged down in the present procedural tangle of where the dispute should be adjudicated.

Another ambiguity the Task Force Report would resolve is the authority for reference of SIPA liquidations to the Bankruptcy judges.<sup>110</sup> The Task Force Report also would increase SIPC's administrative functions, especially in the liquidation of smaller broker-dealers, where no independent trustee would be appointed.<sup>111</sup> A parallel exists between SIPC's role and the role envisioned for a federal administrative unit under the Proposed Bankruptcy Act.<sup>112</sup> However, unless SIPC's authority and the jurisdiction of the SIPA court are clarified and expanded, we believe SIPC will be unable to handle such increased administrative responsibilities expeditiously.

#### CONCLUSION

The 1970 Act is obscure enough to elude concert in interpretation. As a piece of remedial legislation, it should be construed liberally,<sup>113</sup> but the view of the bankruptcy bar and bench toward SIPA is understandably conservative. Congress indiscriminately incorporated the Bankruptcy Act into SIPA, and applicable bankruptcy provisions have been interpreted mechanistically. Moreover, SIPC is not a federal administrative agency, but is, rather, an insurance company which supplies neither SIPA trustees nor staff support for most SIPA liquidations. Consequently, its ability to fashion creative solutions to the problems posed by SIPA liquidations remains limited.

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<sup>109</sup> *Id.* at 31. See text accompanying notes 89-91 *supra*.

<sup>110</sup> *Task Force Report*, note 104 *supra*, at 36.

<sup>111</sup> *Id.* at 29.

<sup>112</sup> *Id.* at 27, 37.

<sup>113</sup> See, e.g., *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1307-08 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1971), *rehearing denied*, 404 U.S. 1064 (1972); *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135, 142 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969).

It is our contention that amendments to the 1970 Act giving more expansive and more explicit jurisdictional authority to the SIPA court would achieve less expensive and speedier liquidations. In particular, the district court judge making an adjudication under section 5(b) should be given specific authority to delegate the proceedings to a bankruptcy judge; the SIPA court should be given both summary and plenary jurisdiction; and SIPC or the SIPA court should be given some specific jurisdictional authority over banks, transfer agents, and clearing houses involved in the debtor's liquidation, as well as over subordinated lenders, customers, officers, and employees of the debtor. In addition, should a new federal bankruptcy statute be enacted, as proposed by the Commission on the Bankruptcy Laws, the 1970 Act should be concurrently amended to conform to the new bankruptcy statute, or else SIPA liquidations should be removed entirely from bankruptcy administration and adjudication.