New York County Clerk's Index No. 601805/02

Court of Appeals

STATE OF NEW YORK

EBC I, INC., F/K/A ETOYS INC.,
BY THE POST-EFFECTIVE DATE COMMITTEE,

Plaintiff-Appellant,

—against—

GOLDMAN SACHS & CO.,

Defendant-Respondent.

BRIEF OF *AMICUS CURIAE* THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANT-RESPONDENT

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The Securities Industry and Financial Markets Association ("SIFMA") respectfully submits this proposed brief as *amicus curiae* in support of Defendant-Respondent Goldman, Sachs & Co. ("Goldman Sachs") and of the decision of the Appellate Division, which properly applied this Court's previous ruling in this action in affirming the order of the Supreme Court granting summary judgment to Goldman Sachs. SIFMA writes to focus on points of particular interest to its membership.

SIFMA'S INTEREST IN THIS CASE

SIFMA is a trade association that brings together the shared interests of hundreds of securities firms, banks, and asset managers. These financial institutions are the gateway to the capital markets in the United States, linking thousands of companies to millions of investors. Among other things, SIFMA members underwrite equity and debt offerings for domestic and foreign issuers, broker securities trades, publish research, and make private equity investments in large and small companies. In short, SIFMA's members are essential to every aspect of global capital markets.

SIFMA's mission is to support a strong financial industry, investor opportunities, capital formation, job creation, and economic growth. An important function of SIFMA is to represent the interests of its members in cases addressing issues of widespread concern in the securities and financial markets. Many of

these cases arise in the State of New York, which is a global financial hub and the center of the capital markets and financial services industry in the United States, and the law of which is critical to the efficient and effective functioning of the marketplace. Virtually all of SIFMA's members have offices in New York; financial services account for 15 percent of real gross product for both New York State and New York City and for more than a third of business income tax revenue in New York City; more than 328,000 individuals in New York City alone are employed in financial services jobs; and New York law is overwhelmingly chosen to govern the contracts that enable securities to be offered to the public. See Michael R. Bloomberg & Charles E. Schumer, Sustaining New York's and the US' Global Financial Services Leadership 10, 35-36 (Jan. 22, 2007), http://www.nyc.gov/html/om/pdf/ny_report_final.pdf.

This case presents such issues of widespread concern. Initial public offerings ("IPOs"), like the eToys IPO at issue in this action, are critically important to the effective functioning of the economy and the financial services industry. IPOs in the United States generate significant capital: approximately $50 billion was raised in initial public offerings in 2012 alone. See SIFMA, U.S. Corporate Underwriting Activity (Mar. 13, 2013), http://www.sifma.org/research/statistics.aspx (follow "US Key Stats" hyperlink). U.S. capital markets depend on a predictable and fair legal and regulatory

environment in which both issuer and underwriter understand their obligations at the beginning of an underwriting relationship and are able to allocate by agreement the risks and rewards of a public offering. See Bloomberg & Schumer, supra, at 12, 16, 73, 76 (stressing importance of fair and predictable legal and regulatory environment).

It is essential to the effective functioning of the markets for this Court to affirm the judgment of the Appellate Division, which applied this Court's prior decision in this case in a manner that offers predictability to underwriters and issuers in standard underwriting relationships. Plaintiff-Appellant, a Post-Effective Date Committee of Creditors of eToys, Inc. ("Creditors" or "Plaintiff"), makes arguments that—if accepted—could create factual issues as to whether every underwriting relationship formed under New York law carries with it not only the legal obligations created by statutes, regulations, and the terms of the parties' contracts but also equitable and conflicting duties of uncertain scope not agreed to by the parties. The implication of those duties would have a dramatic effect on accepted and time-honored understandings embedded in the relationship of the lead underwriter to the issuer and to other underwriters in the underwriting syndicate and the investing public, making it more difficult for financial services companies to underwrite offerings and more difficult for prospective issuers to raise financing from the public markets. Because of the significant impact of the

Creditors' arguments on the functioning of the marketplace and the interest of SIFMA's members in the outcome of this case, SIFMA respectfully requests that it be allowed to present its views as *amicus curiae*.

PRELIMINARY STATEMENT

In its prior opinion in this matter, this Court held that an underwriter who has independently accepted an advisory role with an issuer separate and apart from the underwriting relationship and characterized by a high level of trust and confidence could owe under some circumstances a fiduciary duty to disclose conflicts of interest to an issuer even if the standard underwriting relationship ordinarily would not create such a duty. This Court's holding was narrow: it was limited to a motion to dismiss and it required plaintiffs to prove that, in addition to the typical underwriting relationship, the issuer demanded and the underwriter accepted fiduciary duties as the issuer's advisor.

The Creditors' arguments to this Court essentially seek to make what this Court characterized as an exception to the rule that a fiduciary relationship would not exist between an underwriter and an issuer operating at arm's-length into the rule itself. Desirous of imposing fiduciary duties post-hoc on Goldman Sachs, the Creditors have explored and detailed every facet of the parties' relationship in the hope that this Court will determine that such evidence, taken as a whole, suffices to create a triable issue that Goldman Sachs agreed to be eToys's

advisor. What the Creditors attempt to obscure is that all of the "evidence," in isolation and in combination, is typical of virtually every issuer-underwriter relationship in every IPO—each of the actions that the Creditors identify is integral to the underwriting process itself and there is absolutely no evidence that Goldman Sachs agreed to assume any separate advisory relationship or fiduciary duties. Underwriters in every firm commitment underwriting receive confidential and sensitive information from the issuer and perform services antecedent to the offering in order to determine whether they desire to undertake the risk of forming an underwriting relationship with the issuer. The Creditors' argument would have the underwriter assume fiduciary duties—not even legal or contractual duties—in the absence of an advisory contract and before the underwriter even completed those steps necessary to determine whether it was prepared to assume duties at all to the issuer.

The Creditors' argument threatens substantial harm to underwriters and to the IPO process more generally. Under this Court's prior opinion, underwriters and issuers can avoid the creation of a fiduciary relationship, with the costs and risks attendant to both parties in such a relationship, by maintaining a standard commercial underwriting relationship and not forming a separate advisory relationship and agreeing to the assumption of fiduciary duties. If the Creditors' argument were accepted and triable issues could arise as to whether underwriters

assumed fiduciary obligations based on nothing more than what is inherent in virtually all IPOs, the threat of fiduciary obligations would go hand-in-hand with being an underwriter. Issuers would see their access to the capital markets erode in such an environment. What is more, the Creditors' argument would also undermine a federal securities regulatory scheme that operates on a uniform, nationwide basis, supplanting it with a patchwork of common-law rules that vary state to state. This Court should reaffirm its prior holding and hold here that the evidentiary hurdle for creating a factual issue as to the existence of a fiduciary relationship is one that the Creditors have failed to clear.

ARGUMENT

I. THIS COURT CORRECTLY HELD THAT THE UNDERWRITER-ISSUER RELATIONSHIP ORDINARILY DOES NOT GIVE RISE TO FIDUCIARY DUTIES

The Creditors rest their argument on a misreading of this Court's prior ruling in EBC I, Inc. v. Goldman, Sachs & Co., 5 N.Y.3d 11 (2005), sustaining a portion of the Creditors' complaint against a motion to dismiss. In that decision, the Court held that the existence of a contractual underwriting relationship did not as a matter of law preclude the issuer from alleging that it also enjoyed a fiduciary relationship with its underwriter separate and apart from the terms of the contract. Id. at 20. In so holding, however, the Court made clear that to establish such a relationship, the issuer must prove that "apart from the terms of the contract, the

underwriter and issuer created a relationship of higher trust" that went "beyond that which arises from the underwriting agreement," and was "advisory . . . [and] independent of the underwriting agreement." Id. at 20, 22. The Court stated that it would be prepared, if the evidence showed the mutual creation of such a relationship, to accept that the parties agreed to a "fiduciary duty to this limited extent." Id. at 20 (emphasis added).

In so holding, however, the Court did not depart from—but rather reaffirmed—critical postulates of New York commercial law. The Court stressed "the general rule that fiduciary obligations do not exist between commercial parties operating at arm's length," id. at 22, because a fiduciary relationship is "grounded in a higher level of trust than normally present in the marketplace between those involved in arm's length business transactions," id. at 19 (citing Ne. Gen. Corp. v. Wellington Adver., Inc., 82 N.Y.2d 158, 162 (1993)). The Court also stressed that "'[i]f the parties . . . do not create their own relationship of higher trust, courts should not ordinarily transport them to the higher realm of relationship and fashion the stricter [fiduciary] duty for them.'" Id. at 20 (omission in original) (quoting Ne. Gen., 82 N.Y.2d at 162). Applying these principles, the Court held that a firm commitment underwriting relationship between an underwriter and issuer—the most common of underwritings and the arrangement at issue in this case—does not

give rise to a fiduciary relationship absent exceptional, "limited" circumstances. Id. at 20-22.

Indeed, that EBC I did not dramatically rewrite New York law of fiduciary duty is made clear by the decision this Court rendered after EBC I in People v. Wells Fargo Insurance Services, Inc., 16 N.Y.3d 166 (2011). In that case, this Court held that an insurance broker—someone who (unlike an underwriter) generally is an agent of an insured in "a principal-agent relationship [that] is, by nature, a fiduciary relationship"—does not ordinarily have a duty to disclose to its customers contractual arrangements it has made with insurance companies on the opposite side of the transaction with the insured. Id. at 171. At least in the absence of evidence of conduct "contrary to industry custom," this Court held that "[a] regulation, prospective in effect, is a much better way of ending a questionable but common practice than" addressing it case-by-case "by creating a new common-law rule." Id. at 171-72. A fortiori, here, where—unlike the relationship between insured and broker—the relationship between underwriter and issuer is normally nonfiduciary in nature, the contention that the underwriter failed to disclose its arrangements with its customers cannot support a claim of

breach of fiduciary duty absent exceptional circumstances. Compare EBC I, 5 N.Y.3d at 20-22, with Wells Fargo, 16 N.Y.3d at 171-72.[1]

II. THE SUPREME COURT AND APPELLATE DIVISION CORRECTLY HELD THAT THE CREDITORS' EVIDENCE FAILED TO SHOW A FIDUCIARY RELATIONSHIP

The Supreme Court and Appellate Division properly understood this Court's prior ruling in EBC I to hold that the relationship between underwriter and issuer is nonfiduciary and that the Creditors would be required, before proceeding to trial on a breach of fiduciary duty claim against underwriter Goldman Sachs, to submit evidence of the offer of a fiduciary relationship separate and apart from the standard issuer-to-underwriter relationship, and the acceptance of that relationship by Goldman Sachs. See EBC I, Inc. v. Goldman Sachs & Co., 91 A.D.3d 211, 214-17 & n.1 (1st Dep't 2011) ("[I]n applying EBC I [in HF Mgmt. Servs. L.L.C. v. Pistone, 34 A.D.3d 82 (1st Dep't 2006)], this Court reaffirmed the principle that the underwriter-issuer relationship is nonfiduciary."); EBC I, Inc. v. Goldman Sachs & Co., No. 601805/2002, slip op. at 4, 8-12 (Sup. Ct. N.Y. Cnty. Nov. 4, 2010) (finding that documentary evidence established no fiduciary relationship had been created by the parties and no basis in law for eToys to rely upon Goldman

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[1] Further, this Court reasoned that insurance brokers generally do not have a duty to disclose their contractual arrangements because of their divided loyalties as agents of both the insured and the insurer. Wells Fargo, 16 N.Y.3d at 171. Lead underwriters similarly have duties to issuers, co-underwriters, their customers, and the public.

Sachs).[2] The only argument that the Creditors assert to rebut those holdings is that the courts below ignored certain evidence that they claim points to a separate fiduciary relationship. See Brief of Plaintiff-Appellant ("Pl.'s Br.") (Nov. 14, 2012). Aside from being procedurally improper,[3] the evidence purportedly ignored by the courts below in fact is commonplace in virtually every underwriting relationship and public offering. Accordingly, that argument—if accepted—could improperly turn what this Court has characterized as the "limited" exception when the parties to an underwriting "create" a separate and independent advisory relationship, EBC I, 5 N.Y.3d at 20-22, into the rule where it would be up to a jury to determine whether any underwriting relationship was fiduciary in nature.

The Creditors argue that Goldman Sachs agreed to assume fiduciary duties because it: (a) "held itself out as an expert in all aspects of IPOs" in a "pitch book" in which it advertised that it offered "Wall Street's best, most experienced internet retail team" and that "eToys's Interests Will Always Come First" if it were selected as lead underwriter, Pl.'s Br. at 6-7; (b) "took complete charge" and

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[2] See also HF Mgmt. Servs., 34 A.D.3d at 84 (EBC I "underscored the non-fiduciary nature of the relationship between underwriter and issuer."); id. ("New York law . . . essentially does not recognize the existence of a fiduciary obligation that is based solely on the relationship between an underwriter and issuer.").

[3] SIFMA agrees with Goldman Sachs that because the Appellate Division affirmed the Supreme Court's judgment without modification, this Court has no jurisdiction to review the findings of fact below and may properly review only the legal sufficiency of those facts. See N.Y. Const. art. VI, § 3; Bates Adver. USA, Inc. v. 498 Seventh, L.L.C., 7 N.Y.3d 115, 119-20 (2006) ("We may not revisit Supreme Court's affirmed factual findings underpinning the determination of breach, which are supported by the record.").

"managed each and every aspect of the IPO" in the course of which it received eToys's "most important confidential and proprietary information," id. at 2, 8, 32; and (c) engaged in such conduct "months before" the contract between eToys and Goldman Sachs (the "Underwriting Agreement") was signed, id. at 21. See also Reply Brief of Plaintiff-Appellant ("Pl.'s Reply Br.") (Jan. 29, 2013), at 16-17.

As the courts below correctly understood, the argument offered by the Creditors—if accepted and followed to its logical conclusion—could potentially turn every underwriting relationship into a fiduciary relationship. The courts below correctly held that the underwriter would have to accept fiduciary duties and agree to a relationship separate and apart from the standard issuer-underwriter relationship before the law would imply duties in equity apart from the legal duties created by the standard relationship. See EBC I, 91 A.D.3d at 216 ("'[A] fiduciary duty cannot be imposed unilaterally.'") (quoting Marmelstein v. Kehillat New Hempstead, 45 A.D.3d 33, 37 (1st Dep't 2007), aff'd, 11 N.Y.3d 15 (2008)); EBC I, No. 601805/2002, at 9-10 ("This court will not rewrite the plain language of the documents to instill a duty of which the two sophisticated parties, should they have desired, may have contracted."). Plainly that is not the case here.

1. The Pitch Book

The Creditors argue first that Goldman Sachs agreed to act as a fiduciary for eToys because it made a sales pitch to eToys in which it described its

expertise in IPOs and the services it would offer to eToys, including the experience of its internet retail team, and stated that "eToys's Interests Will Always Come First." Pl.'s Br. at 6-7, 32. But the market for financial services could not function—and certainly could not function efficiently—if financial services firms competing for underwriting assignments could not advertise to prospective clients the services the firms offer and prospective clients could not receive that information without creating a fiduciary relationship. It is commonplace that underwriters "pitch" their services and qualifications to potential clients. See, e.g., 3A Harold S. Bloomenthal & Samuel Wolff, Securities and Federal Corporate Law § 8:2 (2d ed. 2001) (underwriters "seek out potential candidates for a public offering"); William J. Grant, Jr., Overview of the Underwriting Process, in Securities Underwriting: A Practitioner's Guide 26 (Kenneth J. Bialkin & William J. Grant, Jr., eds. 1985) (describing underwriters' competition for business); Eric W. Wooley, How to Prepare an Initial Public Offering: The Underwriters' Perspective, in How to Prepare an Initial Public Offering 2012, at 169 (2012) (underwriters "pitch their services to win a mandate to act as a bookrunner of an IPO"). Pitches are the means by which issuers are informed of the respective qualifications of any of the numerous underwriters that compete for their business and by which underwriters inform issuers of those qualifications. See, e.g., Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y., 447 U.S. 557, 561-62

(1980) ("Commercial expression . . . assists consumers and furthers the societal interest in the fullest possible dissemination of information.").

It cannot be that provision of information from underwriter to issuer incidental to their agreement to first form an underwriting relationship could somehow turn the relationship into one "separate and apart" from the issuer-underwriter relationship. See Pl.'s Br. at 27.[4] Indeed, as the Supreme Court—and the Appellate Division in affirming its decision—correctly recognized, "puffery" such as that typically used in a sales pitch cannot create the legal basis for a fiduciary relationship. EBC I, No. 601805/2002, at 12; see also DeBlasio v. Merrill Lynch & Co., No. 07 Civ 318(RJS), 2009 WL 2242605, at *30 (S.D.N.Y. July 27, 2009) ("[T]hat the broker . . . represents, as part of his sales pitch, that he is particularly well qualified to [offer investment advice] does not alter the limited scope of the broker's legally enforceable obligations. . . . [N]o reasonable investor would expect that these vague and general advertisements created any sort of extra-contractual relationship extending beyond the terms specified in [the] agreements.") (first omission and second brackets in original) (internal quotation

[4] Further, if fiduciary duties arose between prospective counterparties prior to contract formation as a mere consequence of pitching for business, underwriters would be able to market their expertise only at the intolerable cost of preventing them from ever opting not to enter into an underwriting agreement with the issuer, which underwriters in fact do, consistent with, among other things, the function they must play under federal law. See Gregory M. Priest, Practical Aspects of the Initial Public Offering, in Understanding the Securities Laws 1996, at 104 (1996) ("Because the underwriting agreement is generally not signed until after the marketing efforts are completed, the contractual commitment is not finally made until just prior to selling the shares.").

mark omitted); Café La France, Inc. v. Schneider Sec., Inc., 281 F. Supp. 2d 361, 373 (D.R.I. 2003) ("A sales pitch, however, does not a fiduciary relationship create. Were that the case, each of millions of commercial transactions that take place every day would give rise to duties that far exceed the scope of the relationships that created them.").[5]

2. Expertise and Access to Confidential Information

Nor, contrary to the Creditors' argument, can the claim that Goldman Sachs had expertise, which it used to manage various aspects of the IPO, and that it received "confidential and proprietary information" of eToys in the course of so doing, be sufficient to create a fiduciary relationship separate and apart from the ordinary nonfiduciary relationship between underwriter and issuer. See Pl.'s Br. at 8, 32-33. It should go without saying that one of the things that every issuer secures when it engages the services of an underwriting syndicate is each underwriter's expertise in distributing the issuer's shares to the underwriter's

[5] Courts have held that puffery cannot create legal obligations in several diverse areas of law. See, e.g., Rombach v. Chang, 355 F.3d 164, 174 (2d Cir. 2004) (securities law); Time Warner.Cable, Inc. v. DIRECTV, Inc., 497 F.3d 144, 159-60 (2d Cir. 2007) (false advertising); Sotheby's Fin. Servs., Inc. v. Baran, 107 F. App'x 235, 238 (2d Cir. 2004) (negligent misrepresentation); Anderson v. Bungee Int'l Mfg. Corp., 44 F. Supp. 2d 534, 540-41 (S.D.N.Y. 1999) (sales under U.C.C.). In each of these areas of law, puffery is non-actionable even though it is directed at uncounseled investors and consumers. There is even greater reason to hold that puffery cannot create fiduciary obligations when the audience is a sophisticated issuer represented by counsel and seeking to rely upon puffery to create "one of the highest duties of care and loyalty known in the law." See In re Hunter, 6 A.D.3d 117, 133 (2d Dep't 2004) (Crane, J., concurring in part and dissenting in part) (internal quotation mark omitted), aff'd, 4 N.Y.3d 260 (2005).

customers in a manner that conforms to the federal regulatory scheme. Similarly, in every firm commitment underwriting, the lead underwriter will perform an initial valuation of the issuer, participate in the process of determining the size and composition of an offering, and organize and manage "road show" meetings during which the underwriter introduces management and the issuer to the underwriter's customers and prospective purchasers in order to build a book of investor demand. See Grant, supra, at 27 (underwriters are expected to perform an initial valuation of the issuer); David B. Rea & William J. Grant, Jr., The Syndication and Marketing Process, in Securities Underwriting: A Practitioner's Guide 289 (Kenneth J. Bialkin & William J. Grant, Jr., eds. 1985) (underwriters organize and manage the road show); Wooley, supra, at 167 ("The underwriter is an essential player in the IPO process who performs a number of critical functions. . . . [,]setting the timeline for the IPO process and orchestrating the efforts of each of the other parties involved."); Letter from Mary L. Schapiro, Chairman, S.E.C., to Darrell E. Issa, Chairman, Comm. on Oversight and Gov't Reform, U.S. House of Representatives 5 n.16 (Apr. 6, 2011), http://www.sec.gov/news/press/schapiro-issa-letter-040611.pdf (underwriters build a book of investor demand).[6]

[6] See also 1 Thomas Lee Hazen, Treatise on the Law of Securities Regulation 191 (6th ed. 2009) (underwriter is an "essential link in the process of offering securities for public consumption"); McDermott Will & Emery LLP, et al., The IPO and Public Company Primer: A Practical Guide to Going Public, Raising Capital and Life as a Public Company 56 (2012), http://www.mwe.com/ (follow "Publications"; search in "Articles & Books") (underwriter "plays

An underwriter could hardly be expected to commit to an offering—and neither it nor the issuer would have the information to each independently assess the price at which to offer shares in such an offering—without having the opportunity to meet the clients who will be the ultimate purchasers in the offering and to assess their level of interest. And, the federal regulatory regime envisions that underwriters will possess the necessary expertise to guide issuers through the IPO process. See PricewaterhouseCoopers, Roadmap for an IPO: A Guide to Going Public 16 (Nov. 2011), http://www.pwc.com/us/en/ (search title).[7]

It should also go without saying that, in the course of executing a normal underwriting assignment, every underwriter will be privy to "important confidential and proprietary information" of the issuer. See Pl.'s Br. at 8. Under Section 11 of the Securities Act of 1933, every underwriter agrees to be liable for

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a critical role in the success of the IPO"); Priest, supra, at 101 (lead underwriter "plays a major role in the registration and offering processes").

7 It is for this reason that New York courts have repeatedly held that financial professionals' requisite expertise in the areas in which they are employed is insufficient to create fiduciary obligations. See, e.g., King Cnty., Wash. v. IKB Deutsche Industriebank AG, 863 F. Supp. 2d 288, 314 (S.D.N.Y. 2012) ("[A] fiduciary relationship does not arise from a party's superior knowledge about an investment product . . . ."); Sebastian Holdings, Inc. v. Deutsche Bank AG., 78 A.D.3d 446, 447 (1st Dep't 2010) ("[A]lleged reliance" on a "defendant's superior knowledge and expertise" does not create a fiduciary relationship between "parties engaged in arm's-length transactions."); SNS Bank, N.V. v. Citibank, N.A., 7 A.D.3d 352, 355 (1st Dep't 2004) (A "plaintiff's 'subjective claims of reliance on defendants' expertise' d[o] not give rise to a 'confidential relationship.'"). The courts below thus correctly discounted evidence of Goldman Sachs's expertise. EBC I, 91 A.D.3d at 216 (eToys's "mere expression of confidence in Goldman Sachs's expertise" was "wholly insufficient to create a 'relationship of higher trust than would arise from the underwriting agreement alone.'"); EBC I, No. 601805/2002, at 11 ("It is axiomatic that an investment bank will have expertise in its line of business and that its expertise will surpass that of its IPO client, the issuer.").

any misstatements or omissions of material fact in the registration statement for the offering, subject only to the defense that the underwriter, "after reasonable investigation, [had] reasonable ground to believe and did believe" that the information in the registration statement was true and that no information was omitted that was required to be disclosed. See 15 U.S.C. § 77k(a), (b)(3). Importantly, the standard of reasonableness is "that required of a prudent man in the management of his own property." 15 U.S.C. § 77k(c). In order to establish the due diligence defense under the federal securities laws, every underwriter—not just Goldman Sachs—would have to access the confidential and proprietary information of the issuer.[8] Thus, the structure of the federal securities laws itself contemplates that before a security is offered to the public an underwriter will have had access to confidential and sensitive information of the issuer and will have satisfied itself, based on that information, that the offering documents do not contain any material misstatement or omission.

Indeed, the Second Circuit has made clear that "[n]o greater reliance in our self-regulatory system is placed on any single participant in the issuance of securities than upon the underwriter. . . . Prospective investors look to the

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[8] See John J. Clarke, Jr. & Lisa Firenze, How to Prepare an Initial Public Offering: Due Diligence and Potential Liabilities, in How to Prepare an Initial Public Offering 2012, at 90-98 (2012) (listing 90 categories of documents that should be reviewed and topics that should be discussed during the due diligence process, including interviews with the company's principal customers, off-balance sheet or under-recorded liabilities and contingencies, and the company's short- and long-term projections).

underwriter—a fact well known to all concerned and especially to the underwriter—to pass on the soundness of the security and the correctness of the registration statement and prospectus." Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 370 (2d Cir. 1973), overruled on other grounds, 430 U.S. 1 (1977); see also In re WorldCom, Inc. Sec. Litig., 346 F. Supp. 2d 628, 657 (S.D.N.Y. 2004) ("Th[e] design [of Section 11 of the Securities Act] reflects Congress' sense that underwriters . . . bear a 'moral responsibility to the public [that] is particularly heavy.'") (final brackets in original) (quoting Gustafson v. Alloyd Co., 513 U.S. 561, 581 (1995)); HF Mgmt. Servs., 34 A.D.3d at 86 ("[T]he statutorily-imposed duty of underwriters is to investors."); 2 Thomas Lee Hazen, Treatise on the Law of Securities Regulation 250-51 (6th ed. 2009) ("[T]he underwriter plays a special role in the due diligence process since investors rely on the underwriter's investigation of the issuer.").[9]

3. The "Preexisting Relationship"

Ultimately, the Creditors rely on the claim that eToys and Goldman Sachs had a preexisting relationship: "The breach of fiduciary duty claim alleged that eToys and Goldman had an advisory relationship of trust and confidence that developed months before and independent from the Underwriting Agreement."

[9] This Court, too, has recognized underwriters' responsibilities to investors. EBC I, 5 N.Y.3d at 21 n.4 ("The underwriter's responsibility with regard to a registration statement is to provide full and adequate information to investors concerning the distribution of the securities and the issuing company.").

Pl.'s Br. at 21. It is here, however, that the Creditors' claim is the most thin. The Creditors do not claim that eToys had a preexisting relationship with Goldman Sachs to provide services other than the services, described above, that are integral to and inherent in every firm commitment underwriting. Instead, stripped of adjectives, their claim is that Goldman Sachs performed the services that every underwriter performs in connection with every firm commitment underwriting, but performed those services "months before" the parties signed the Underwriting Agreement making clear that no fiduciary relationship was created.[10]

However, it is standard in every underwriting that the underwriting agreement describing the relationship between underwriter and issuer will not be signed until shortly before the effective date of the registration statement and the commencement of the offering. See, e.g., Grant, supra, at 28 ("[T]here is no definite contract entered into until well after the process has started . . . ."). Until

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[10] eToys selected Goldman Sachs as lead underwriter in late January 1999; the Underwriting Agreement was finalized on May 19, 1999; and trading began on May 20, 1999. Pl.'s Br. at 6, 13-14. This timeline is typical of how long the IPO process generally takes and when the underwriting contract is signed. See Grant, supra, at 33 (For first-time issuers, "the investigation, preparation, and processing time are all quite extensive. The entire process generally takes two to four months, and where there are special problems it can take longer."); Wooley, supra, at 167 ("An IPO generally requires at least 16 weeks to complete from the time underwriters become involved until the offering is priced, but in many cases the period is significantly longer."). The IPO process is time-consuming because there are many different tasks that must be completed: the parties must "allow[] sufficient time for the due diligence process, the preparation of the registration statement, the SEC review period . . . , and the road show." Priest, supra, at 106. The preparation and filing of the registration statement with the SEC alone generally takes more than a month. See Grant, supra, at 35. Goldman Sachs, together with the other members of the underwriting syndicate, completed each of these typical, time-consuming tasks in underwriting the eToys IPO.

that time, there are no duties that the issuer can demand from the underwriter and no commitment that the underwriter has made to the issuer.[11] Nor, in the typical underwriting relationship, could there be. Until the underwriter has performed its initial valuation, managed the road show, built a book of investor demand, and conducted due diligence, it will not have made (and should not make) a commitment to bring the offering to market. The market expects that an underwriter will not engage in an offering if it is one to which the underwriter is unwilling to commit its financial and reputational capital. In addition, since in the case of an IPO the issuer's securities have no established market value, neither party is able, until shortly before the offering, to commit to the most important financial term of the underwriting agreement—the price at which the issuer is willing to sell and the underwriter is willing to buy the offered securities. See Grant, supra, at 26-28.

Thus, the Creditors are wrong that a preexisting fiduciary relationship can be inferred from the mere fact that Goldman Sachs provided some services

[11] See, e.g., Arthur D. Kowaloff & Stephen B. Flood, Pricing, Effectiveness, and Closing, in Securities Underwriting: A Practitioner's Guide 330 (Kenneth J. Bialkin & William J. Grant, Jr., eds. 1985) ("The binding underwriting agreement is not usually signed until within twenty-four hours of the expected effective date of the registration statement, often on the morning of effectiveness. Therefore, throughout the process of preparing the registration statement and during the period between filing the registration statement and the SEC's notifying the registrant as to its effectiveness, . . . [there is] no assurance that the offering will ever take place."); Priest, supra, at 104 ("Because the underwriting agreement is generally not signed until after the marketing efforts are completed, the contractual commitment is not finally made until just prior to selling the shares.").

regarding the underwriting prior to signing the Underwriting Agreement. Those services are of that type that would be necessary for Goldman Sachs and any other underwriter to agree to sign an Underwriting Agreement and assume duties to the issuer. Indeed, what is conspicuous from the Creditors' brief is the absence of reference to any evidence that Goldman Sachs had a preexisting agreement to act as anything other than a typical underwriter in the eToys offering.

III. ALLOWING THE CREDITORS' BREACH OF FIDUCIARY DUTY CLAIM TO SURVIVE SUMMARY JUDGMENT WOULD DISRUPT THE EFFICIENT OPERATION OF THE SECURITIES MARKETS

The Creditors would have it that evidence that amounts to nothing more than the underwriter's performing only those services commonplace in underwriting relationships is sufficient to create a triable issue of fact that the underwriter was acting as a fiduciary, particularly where an offering is made at a price that turns out to be lower than what the issuer's expert in a post-hoc analysis says that the offering would have been able to yield had all parties acted with perfect prescience and the issuer desired to sell its stock at the maximum price that the market could absorb. That argument is contrary to the explicit language of EBC I and New York law and, if accepted, would be disruptive to the "certainty and predictability" essential to the effective and efficient functioning of the securities markets. See Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 188 (1994) (discussing the "undesirable result of

decisions . . . offering little predictive value to those who provide services to participants in the securities business") (quoting Pinter v. Dahl, 486 U.S. 622, 652 (1988)) (internal quotation marks omitted).

A. Certainty Is Critical To Underwriters To Offset The Inherent Risks Of Underwriting

The securities offering process in the United States is governed by a detailed set of laws, regulations, and contractual provisions, each of which sets forth precise, and generally uniform, understandings regarding the respective roles and responsibilities of the issuer, the underwriter, and all of the other participants in the securities offering process. In 2008, underwriters committed over $17 billion to just one IPO alone; and in 2012, underwriters contributed $16 billion to another (less the underwriters' discount). See PricewaterhouseCoopers, 2010 US IPO Watch Analysis and Trends 2 (Mar. 2011), http://www.pwc.com/us/en (search title) (noting that Visa's $17.9 billion offering in 2008 was the United States' largest as of 2010); Renaissance Capital, US IPO Market: 2012 Annual Review 3 (Jan. 2, 2013),
http://www.renaissancecapital.com/ipohome/review/2012USReview.pdf. In a typical offering, underwriters may commit from $50 million at the low end to nearly $18 billion at the high end: the median deal size in 2012 was $124 million. See Renaissance Capital, supra, at 2. These are enormous sums of money; public offerings create tremendous risk for the firm commitment underwriter.

When an underwriter buys securities from the issuer in a firm commitment underwriting, the underwriter is obligated to pay the issuer for the full amount of the offering to which it has committed, regardless of whether the underwriter can resell the securities. The issuer receives the purchase price from the underwriter when it delivers the shares to the underwriter; however, the underwriter does not receive anything unless it resells those shares to the public. If the offering is priced too high and is unsuccessful, the underwriter can suffer significant financial loss as well as serious embarrassment and reputational damage. See United States v. Morgan, 118 F. Supp. 621, 649 (S.D.N.Y. 1953); 1 Louis Loss, Joel Seligman & Troy Paredes, Securities Regulation 494 (4th ed. 2006) (explaining that firm commitment underwritings "shift[] the risk of the market (at least in part) to the investment bankers"). This concern is not merely hypothetical. Even if the underwriter is able to sell all of the securities it has purchased at a price that exceeds its purchase price, the underwriter still incurs tremendous risk. If the securities fall below the offering price and there is a misstatement or omission in the offering materials, the underwriter will be held strictly liable for the loss suffered, regardless of scienter or negligence, in the absence of a satisfactory due diligence defense. See 15 U.S.C. § 77k.

Given the significant risks associated with underwriting public offerings, before committing to participate in an offering, every underwriter will

carefully review all of the risks (financial, commercial, litigation, and reputational) of that offering, typically through each firm's own internal "commitment committee." See Wooley, supra, at 170 (discussing work of commitment committee). If the issuer is interested in selling the securities for a price that is too high and that creates too much risk that the underwriter will not be able to sell the securities, or if there are other litigation or reputational risks inherent in the offering, the underwriter can and will decide not to participate in the offering (and to forego any payment from the issuer), even if it has participated in every step of the offering and helped carry out the due diligence process and meetings with investors. See Steven M. Davidoff, In Goldman Sachs's Retreat From I.P.O., a Signal to Investors, N.Y. Times, Nov. 21, 2012, at B4 (reporting Goldman Sachs withdrew as lead underwriter for public offering of Russian cell phone operator MegaFon on the London Stock Exchange); Olivia Oran & Soyoung Kim, Exclusive: Deutsche Bank Walks Away from iWatt IPO, Reuters, June 27, 2012, available at http://www.reuters.com/ (search title) (reporting Deutsche Bank resigned as lead underwriter for iWatt Inc. IPO following valuation dispute); see also Joseph McLaughlin & Charles J. Johnson, Corporate Finance and the Securities Laws § 2.03 (4th ed. 2006) ("If, at the time of pricing, the underwriters are not comfortable that all of the securities can be sold, . . . the offering may be postponed."); Letter from Mary L. Schapiro, Chairman, S.E.C., to Darrell E. Issa,

Chairman, Comm. on Oversight and Gov't Reform, U.S. House of Representatives 4 (Aug. 23, 2012),
http://www.wrhambrecht.com/pdf/SEC_Response_08232012.pdf ("[N]either the underwriters nor the company alone can dictate the price. The underwriters are not required to accept the company's desired price, and the company can decide not to proceed with the offering if it is not comfortable with the pricing terms.").

B. The Creditors' Argument Would Be Detrimental To The Securities Markets

By arguing for a standard that, if accepted, could create a triable issue of fact for all underwriters as to whether or not they assumed the role of advisors to the issuers, the Creditors would put underwriters (and ultimately their clients, the issuers) in an intolerable position. Fiduciary duties, unlike the legal duties created by regulation or contract, are "necessarily fact-specific." See EBC I, 5 N.Y.3d at 19; see also, e.g., Ne. Gen., 82 N.Y.2d at 165 (characterizing fiduciary duties as "sweeping"); Salomon Bros., Inc. v. Huitong Int'l Trust & Inv. Corp., No. 94 CIV. 8559 (LAP), 1996 WL 675795, at *2 (S.D.N.Y. Nov. 21, 1996) ("[T]he scope of a fiduciary relationship depends on the factual nature of the relationship.") (internal quotation mark omitted). The fiduciary relationship is among the most solemn in law. As this Court described it, the duty of a fiduciary requires "[n]ot honesty alone, but the punctilio of an honor the most sensitive." Meinhard v. Salmon, 249 N.Y. 458, 464 (1928); see also In re Hunter, 6 A.D.3d at 133 (fiduciaries owe "one

of the highest duties of care and loyalty known in the law") (Crane, J., concurring in part and dissenting in part) (internal quotation mark omitted). A fiduciary owes a duty of "undivided and undiluted loyalty to those whose interests the fiduciary is to protect." Birnbaum v. Birnbaum, 73 N.Y.2d 461, 466 (1989). In addition, "a fiduciary must disclose to its principal any interest in a particular transaction that causes the fiduciary's loyalties to be divided." Wells Fargo, 16 N.Y.3d at 171.

Under the Creditors' argument, by which a factual issue would potentially be created as to whether any underwriter is also a fiduciary, no underwriter would be able to determine in advance the duties it is assuming, no commitment committee could assess with certainty in advance the risks the underwriter would be taking in purchasing a security, and no manual issued by a compliance department could determine in advance, and uniformly, what procedures the underwriter should undertake and what disclosures it should make in order to mitigate that risk.

By definition, assuming the existence of a fiduciary relationship, the question of what information a fiduciary must disclose, and what information may be considered to be material, will be fact-specific. The law of this State as reflected in EBC I and the authorities recognized by the courts below permits the parties to control for those risks. Two sophisticated parties can determine in advance whether or not they want to enter into a fiduciary relationship, and if they

determine to do so in advance, they can prescribe the duties that are required by that fiduciary relationship. See Pappas v. Tzolis, 20 N.Y.3d 228, 232-33 (2012); Ne. Gen., 82 N.Y.2d at 160.[12] Under New York law, unless a sophisticated party decides to accept a fiduciary relationship, a fiduciary relationship will not be implied. See, e.g., Musalli Factory for Gold & Jewellry v. JPMorgan Chase Bank, N.A., 261 F.R.D. 13, 26 (S.D.N.Y. 2009) ("[U]nilateral trust or confidence 'does not automatically create a fiduciary relationship; the trust or confidence must be accepted as well.'"), aff'd, 382 F. App'x 107 (2d Cir. 2010); Ne. Gen., 82 N.Y.2d at 160 ("[A] fiduciary relationship does not arise by operation of law, but must spring from the parties themselves, who agree to and accept the responsibilities that flow from such a contractual fiduciary bond.") (emphasis added);

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12 That is why this Court has long recognized that "where parties have entered into a contract, courts look to that agreement 'to discover . . . the nexus of [the parties'] relationship and the particular contractual expression establishing the parties' interdependency.'" EBC I, 5 N.Y.3d at 19-20 (alterations in original) (quoting Ne. Gen., 82 N.Y.2d at 160); see also Ne. Gen., 82 N.Y.2d at 162 ("Before courts can infer and superimpose a duty of the finest loyalty, the contract and relationship of the parties must be plumbed."); Cmty. Counseling & Mediation Servs. v. New Visions for Pub. Sch., 18 Misc. 3d 1124(A), at *4 (Sup. Ct. Kings Cnty. Jan. 31, 2008) ("Where there is a contract governing the relationship between the parties, the court first looks to the agreement to determine whether they intended to create a fiduciary relationship."). It was therefore proper for the Supreme Court and Appellate Division to review the contracts between Goldman Sachs and eToys, because they are documentary evidence of whether a fiduciary relationship was accepted by the alleged fiduciary. See EBC I, 91 A.D.3d at 214-15; EBC I, No. 601805/2002, at 8-10. For the same reasons it was proper for the Supreme Court to consider the documentary evidence evincing that the parties knew how to establish an advisory relationship and that when they did so, by letter agreements in December 2000 and December 2001, the parties expressly ruled out "a fiduciary or agency relationship" between Goldman Sachs and eToys. See EBC I, No. 601805/2002, at 9-10; Brief of Defendant-Respondent ("Def.'s Br.") (Jan. 10, 2013) at 15-16, 43-44.

Marmelstein, 45 A.D.3d at 37 ("[A] fiduciary duty cannot be imposed unilaterally.") (internal quotation marks omitted).[13]

In this case, the Creditors argue that Goldman Sachs should have disclosed that it would be allocating IPO shares to favored customers with the hope of receiving additional investment banking business from its institutional clients. Pl.'s Br. at 18-19, 43-45. But there is nothing in the rule that the Creditors propose that would prevent a different issuer or a different creditors' committee in the future (perhaps after another bankruptcy) from claiming that their underwriter failed to disclose that it would be allocating shares to an individual customer to whom the underwriter hopes to provide M&A advice on a particular transaction, to customers to whom the underwriter generally provides advisory services, or any number of other facts that might be considered to be material, or from arguing that the existence of issues of fact requires the matter to be determined by a jury.

The rule that the Creditors urge thus would create a "heads, I win, tails, you lose" dilemma. It may be easy for an expert to say after-the-fact what the

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[13] The same principle is also expressed in the law regarding reasonable reliance. If there is no evidence of a party's acceptance, the alleged beneficiary's post-hoc reliance on the alleged fiduciary is not considered reasonable under the circumstances. See, e.g., Thermal Imaging, Inc. v. Sandgrain Sec., Inc., 158 F. Supp. 2d 335, 344 (S.D.N.Y. 2001) (holding that plaintiff's reposal of trust in defendant had not created a fiduciary relationship where such reposal of trust was "entirely unjustified"); WIT Holding Corp. v. Klein, 282 A.D.2d 527, 529 (2d Dep't 2001) ("A fiduciary relationship may exist where one party reposes confidence in another and reasonably relies on the other's superior expertise or knowledge, but an arms-length business relationship does not give rise to a fiduciary obligation.") (internal citation omitted). It was thus proper for the Supreme Court to find "no basis in law for eToys to justifiably rely so completely upon Goldman" Sachs. EBC I, No. 601805/2002, at 11.

market was prepared to pay for a security; it is impossible for anyone to say with certainty before-the-fact what it would pay. No underwriter can know in advance for sure the maximum clearing price for a securities offering. Markets are fluid and dynamic. A price that the market might appear willing to pay for a security at one moment may be gone the next. And, even if the prices could be predicted with absolute certainty, few issuers are willing to offer securities at the highest price that they could obtain or to ask for the highest price at the risk of a failed offering. The law normally leaves the allocation of risk between parties on opposing sides of a transaction to bargaining between the parties: if the price is too high, the underwriter will be left with the loss; if the price turns out to be too low, the issuer will not be able to recover that shortfall.

Under the Creditors' argument, however, by which every underwriter is a fiduciary, every underwriter is at risk of being deemed a guarantor for the issuer that the issue will be sold at the highest possible price, measured after-the-fact.[14] If the securities are sold to the underwriters at a price that turns out to be above the clearing price, and the underwriters are not able to resell the securities in the offering, the underwriters (and underwriters alone) will be left holding the bag:

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[14] The Creditors request as damages an award of the difference between the offering price and what their expert after-the-fact and with the benefit of hindsight asserts should have been the offering price. See Foerster Report at 23; Second Am. Compl. ¶ 87. Even the Creditors' expert conceded that those purported damages are unrelated to the fleeting maximum price of nearly $80 achieved on the first day of trading (the price of $180 mentioned once in the Creditors' Reply Brief is a clear typographical error, see Pl.'s Reply Br. at 33).

there is no recourse against the issuer. And, under the Creditors' scenario, if the securities are sold at a price under which they could have been resold, the underwriters and underwriters alone would be responsible for any difference between that resale price and the price the Creditors' expert says the market would have accepted, so long as the Creditors can credibly allege after-the-fact that there is some "material fact" that the underwriters failed to disclose to the issuer. Under those circumstances, where obligations are case-specific and underwriters would lose either way, few investment banks would take on an underwriting assignment. And, if few investment banks take an underwriting assignment, few issuers would have their securities underwritten by a reputable firm.

Indeed, not only would the Creditors' argument leave both underwriters and issuers uncertain regarding the underwriters' obligations of disclosure, the argument—if accepted—would put the two in an untenable position with perhaps the most important constituency: the ultimate investor. Federal securities regulations require the issuer and the underwriter in the registration statement to "[i]dentify each such underwriter having a material relationship with the registrant and state the nature of the relationship." 17 C.F.R. § 229.508(a) (2012); see also In re WorldCom, 346 F. Supp. 2d at 689. Rules such as this requiring disclosure of relationships that could create conflicts of interest are designed to "protect investors and the public interest. . . . in offerings." See Order

Approving Proposed Rule Change, Exchange Act Release No. 34-60113, at 26 (June 15, 2009), available at http://www.sec.gov/rules/sro/finra/2009/34-60113.pdf (discussing similar conflicts of interest prohibited by FINRA rules). Among the "material relationships" that must be identified are advisory or fiduciary relationships between underwriters and issuers. See KKR Fin. Corp., SEC Staff Comment Letter ¶ 88 (July 3, 2006). Such conflicts of interest could impact "the pricing of such offerings and the conduct of due diligence when a member participates in such offerings." See Exchange Act Release No. 34-60113, at 2. As the United States District Court for the Southern District of New York has stated, "[i]nformation regarding relationships that undermine the independence of an underwriter's judgment about the quality of the investment can be material to an investor." In re WorldCom, 346 F. Supp. 2d at 689.

The Creditors' argument, if accepted, would put issuers and underwriters doing an offering in an impossible position, with investors the victim. Under their argument, the exercise of duties that all underwriters perform is sufficient to create a fact issue as to whether—in addition to the underwriting obligation—the underwriter has assumed a fiduciary or advisory relationship with the issuer. At the same time, not even the Creditors claim that such facts require a court to determine that a fiduciary relationship exists; the Creditors would leave that question to the jury. Thus, once again, the Creditors' position that a fiduciary

relationship can be created absent the express agreement of the underwriter would leave the issuer and the underwriter in an uncertain position. The two could not affirmatively state that a fiduciary relationship existed—especially when, as in this case, the underwriter does not believe it has fiduciary duties and the issuer has not asked the underwriter to assume fiduciary duties. But, under the Creditors' argument, the two could not be safe from a post-hoc conclusion that a fiduciary relationship existed that should have been disclosed.

In the end, if the Creditors' argument were accepted, it would be the markets and the investors who would suffer. See Cent. Bank of Denver, 511 U.S. at 189 (recognizing that "the increased costs incurred by professionals because of the litigation and settlement costs . . . may be passed on to their client companies, and in turn incurred by the company's investors"). Underwriters would be hesitant to undertake underwriting assignments for fear that a jury would after-the-fact recharacterize the nature of the duties they agreed to perform, issuers would find fewer if any underwriters willing to undertake underwriting assignments for them, and—even assuming that an issuer and an underwriter were willing to agree to terms under these circumstances—the investors (as well as the parties) would be left uncertain as to the nature of a relationship that the Creditors here are asking that a jury determine on a post-hoc basis.

IV. ACCEPTANCE OF THE CREDITORS' ARGUMENT WOULD UNDERMINE THE FEDERAL SECURITIES REGULATORY REGIME

This Court, and the federal courts, has repeatedly expressed concern about the exercise of "regulation, through the imposition of common-law tort liability or otherwise, [that] adversely affects the ability of a Federal administrative agency to regulate comprehensively and with uniformity in accordance with the objectives of Congress." Guice v. Charles Schwab & Co., 89 N.Y.2d 31, 47 (1996); see also Int'l Paper Co. v. Ouellette, 479 U.S. 481, 496 (1987) (holding that affected-state common-law claims conflicted with the EPA's ability to administer the Clean Water Act because such claims would subject defendants "to a variety of common-law rules established by the different States" that would "undermine the important goals of efficiency and predictability in the [EPA's] permit system"); Credit Suisse First Bos. Corp. v. Grunwald, 400 F.3d 1119, 1136 (9th Cir. 2005) (holding that allowing state common law to trump NASD rules "would result in a patchwork of inconsistent state . . . regulations that would interfere with Congress's intent in delegating SRO regulatory authority to the Commission"); Engine Mfrs. Ass'n v. U.S. E.P.A., 88 F.3d 1075, 1079 (D.C. Cir. 1996) (noting that "the possibility of 50 different state regulatory regimes raised the spectre of an anarchic patchwork of federal and state regulatory programs, a prospect which threatened to create nightmares" for those regulated) (internal

quotation mark omitted); Bloemendaal v. Morgan Stanley Smith Barney L.L.C., No. EDCV 10-1455 DSF (PLAx), 2011 WL 2161352, at *7 (C.D. Cal. May 23, 2011) ("[A]llowing state law to regulate how securities firms supervise and restrict insider trading would 'create a patchwork of laws that would interfere with Congress's chosen approach of delegating nationwide, cooperative regulatory authority to the Commission,' the NYSE, and Defendant.").

Acceptance of the Creditors' arguments would implicate precisely the concerns expressed in Guice and these other cases. Congress, the Securities and Exchange Commission ("SEC"), and the self-regulatory organizations supervised by the SEC have passed laws and rules that "regulate comprehensively and with uniformity" almost every aspect of the public offering process. There exist laws and rules regarding who may underwrite an IPO, see FINRA Rule 5110(b) (2010); what types of diligence must be done in connection with an IPO, see 15 U.S.C. § 77k; what must be told to purchasers in an IPO, see 15 U.S.C. § 77g; see also 15 U.S.C. § 77aa; what an underwriter may say to its client and what it must keep confidential, see Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 at Title V (1999) (codified and codified as amended in scattered sections of 12 U.S.C. & 15 U.S.C.); 17 C.F.R. § 248.10 (2009); FINRA Rule 5131(d) (2011); and to whom an underwriter may sell shares in an IPO, what arrangements it may have

with those customers, and the terms under which it may sell shares, see FINRA Rules 5131(b) (2011), 5110(c) & (f) (2010).

For example, the Financial Industry Regulatory Authority ("FINRA")[15] has extensively studied and explicitly considered—on a nationwide basis—what arrangements an underwriter may have with the customers to whom it allocates shares in an IPO and what arrangements it may not have, consistent with the underwriter's duties to its clients. FINRA Rule 5131(a) provides, on a uniform basis, that "[n]o member . . . may offer or threaten to withhold shares it allocates of a new issue as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member." FINRA Rule 5131(a) (2011) (emphasis added). The rule also recognizes that underwriters will have customer relationships with the clients to whom they allocate shares in an IPO and does not prohibit them from allocating shares to such clients or having such relationships, as long as they do not receive "excessive compensation in relation to those services." FINRA Regulatory Notice 10-60, at 2 n.4 (Nov. 2010), available at http://www.finra.org/Industry/index.htm (follow "Notices"). FINRA has explained that it:

> [D]oes not intend that this prohibition interfere with legitimate customer relationships. For example, this provision is not intended to prohibit a member from

[15] FINRA is a self-regulatory organization subject to SEC oversight. Its rules, which receive SEC approval before taking effect, have the force of law. 15 U.S.C. § 78s(b)(1).

> allocating new issue shares to a customer because the customer has separately retained the member for other services, when the customer has not paid excessive compensation in relation to those services.

Id. This rule, thus, expressly condones the actions that Goldman Sachs is alleged to have taken.[16]

This rule has a lengthy pedigree. Its accompanying clarification is identical to the limitation of the proposed prohibition on quid pro quo allocations announced by FINRA's predecessor, the National Association of Securities Dealers ("NASD") in its August 2002 Notice to Members about NASD Rule 2712, the relevant text of which is identical to FINRA Rule 5131(a) and its corresponding Regulatory Notice. NASD Notice to Members 02-55, at 524-25 (Aug. 2002), available at http://www.finra.org/Industry/index.htm (follow "Notices") (NASD Rule 2712 is "not intended to prohibit a member from allocating IPO shares to a customer because the customer has separately retained the member for other services, when the customer has not paid excessive compensation in relation to those services."). NASD clarified that it was seeking

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[16] The Creditors allege that Goldman Sachs allocated shares of the eToys IPO to certain investors with the hope of generating additional business with those investors. Pl.'s Br. 15-18. However, the Creditors never allege that Goldman Sachs allocated these shares in exchange for excessive compensation. See Pl.'s Br. 15-19; 43-45. Thus, FINRA Rule 5131(a) expressly permits Goldman Sachs's alleged conduct.

an "appropriate[] balance[]" between protecting the IPO process and "avoid[ing] undue interference with legitimate customer relationships." Id. at 525.[17]

FINRA Rule 5131, like other FINRA rules, SEC regulations, and laws, is the product of extensive analysis of the role of the underwriter in a firm commitment underwriting. FINRA Rule 5131 was considered over the course of eight years and is the result of (1) recommendations from an IPO Advisory Committee (which itself received input from all constituencies involved in the IPO process, including investment bankers, venture capitalists, investors, listed companies, trade organizations, and academics); (2) four rounds of notice and comment; and (3) input from the New York Stock Exchange ("NYSE"), NASD, FINRA, and the SEC. See Prohibition of Certain Abuses in IPOs, Exchange Act Release No. 34-50896, at 11 (Dec. 20, 2004), available at http://www.sec.gov/rules/sro/nyse/34-50896.pdf.[18] The Creditors seek a ruling

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[17] Likewise, the SEC published proposed Rule 106 to Regulation M, which would have prohibited underwriters from, "directly or indirectly," "attempt[ing] to induce, induc[ing], solicit[ing], requir[ing], or accept[ing] from a potential purchaser of an offered security in connection with an allocation of the offered security, any consideration for such offered security in addition to that stated in the registration statement." 69 Fed. Reg. 75,783, 75,795 (proposed Dec. 17, 2004) (to be codified at 17 C.F.R. pt. 242). The SEC stated that "the proposed rule is not intended to interfere with legitimate customer relationships. For example, this provision is not intended to prohibit a firm from allocating IPO shares to a customer because the customer has separately retained the firm for other services, when the customer has not paid excessive compensation in relation to those services." Id. at 75,785. However, in the eight years following this proposal, the SEC has never adopted Rule 106 as a final rule. See 17 C.F.R. §§ 242.100-105 (2005) (Rules 100-105 have been codified; Rule 106 has not).

[18] The years-long iterative process that brought FINRA Rule 5131 into existence involved substantial time and effort from NYSE, NASD, FINRA, the SEC, industry members, and the public at large, and contains the collective wisdom of all of these entities. In August 2002, the

from this Court that is at odds with FINRA Rule 5131. Moreover, even if the impetus behind a state common-law rule is in harmony with a federal rule or regulation—"[c]onflict is imminent when two separate remedies are brought to bear on the same activity." Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 380 (2000) (internal quotation marks omitted); see also Guice, 89 N.Y.2d at 48. FINRA has devised a program of sanctions that are imposed upon members that violate FINRA rules, a program that itself was the product of careful study, notice,

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NYSE and the NASD, "at the request of the SEC, established an IPO Advisory Committee . . . to address . . . [harmful IPO practices], review the IPO process as a whole, and make recommendations to address these issues and improve the process in general." Exchange Act Release No. 34-50896, at 10-11. The IPO Advisory Committee issued a report in May 2003 proposing 20 recommendations to address these issues. See NYSE/NASD IPO Advisory Comm., Report and Recommendations (May 29, 2003), available at http://www.finra.org/Industry/Regulation/Guidance/ReportsStudies/. Meanwhile, on August 21, 2002, NASD published a Notice to Members regarding proposed Rule 2712 (the precursor of FINRA Rule 5131), opening a 20-day comment period on the proposed rule. NASD Notice to Members 02-55. Following publication of the IPO Advisory Committee Report, NASD proposed several amendments to proposed Rule 2712 addressing the Committee's recommendations and solicited comments on the proposed amendments. NASD Notice to Members 03-72 (Nov. 2003), available at http://www.finra.org/Industry/index.htm (follow "Notices"). NASD received 39 comment letters in reply. Exchange Act Release No. 34-50896, at 24. On December 20, 2004, the SEC notified the public that NASD had amended Rule 2712 (and that NYSE had amended its similar Rule 470) and solicited comments on the amendments, Exchange Act Release No. 34-50896, and the SEC received 12 comment letters, Notice of Amendment 3, Exchange Act Release No. 34-61690, at 3 (Mar. 11, 2010), available at http://www.sec.gov/rules/sro/nasd/2010/34-61690.pdf. On March 11, 2010, the SEC notified the public that FINRA (having succeeded NASD) had again amended what was formerly Rule 2712 and had become Rule 5131, and it again solicited comments. Exchange Act Release No. 34-61690. The SEC finally granted accelerated approval of Rule 5131 on September 29, 2010. Order Granting Accelerated Approval, Exchange Act Release No. 34-63010 (Sept. 29, 2010), available at http://www.sec.gov/rules/sro/nasd/2010/34-63010.pdf.

and comment, and it does not provide for the type of civil damages that the Creditors seek from this Court. See FINRA Rule 8310 (2008).[19]

Congress and the regulatory and self-regulatory agencies have also passed rules regarding the information that underwriters must keep confidential and the information that they may share with clients such as eToys. For example, FINRA Rule 5131(d) requires lead underwriters to give regular reports to issuers about indications of interest from institutional and retail clients, including the names and orders of each institutional investor and the aggregate demand of retail investors. This rule is the product of careful consideration and is part of a comprehensive scheme to make the securities industry function as efficiently as possible while protecting all participants.[20]

[19] This Court considered a similar conflict in Guice. There, the issue was whether broker-dealers had breached fiduciary duties owed to investors when the broker-dealers sold securities from certain wholesalers to the investors without fully disclosing that the wholesalers were paying them "kickbacks" in exchange for the sales. Guice, 89 N.Y.2d at 36-38. This Court found that the SEC had considered forbidding the kickback practice or imposing detailed disclosure requirements about kickbacks, but that it had declined to do so. Id. at 40-43. As a result, it held that permitting the plaintiffs to bring claims for breach of state-law fiduciary duties would create irreconcilable conflict with the SEC's deliberate decision to permit the kickback practice. Id. at 45. The same reasoning requires rejecting the Creditors' claims here. FINRA has unequivocally affirmed that underwriters are permitted to allocate IPO shares to a customer because the customer has retained the underwriter for other services. FINRA Regulatory Notice 10-60, at 2 n.4. Allowing an issuer's breach of fiduciary duty claim to survive summary judgment when its evidence establishes nothing more than "legitimate customer relationships" would contradict Rule 5131(a).

[20] Similarly, the Gramm-Leach-Bliley Act prohibits a financial institution from disclosing any nonpublic personal information about consumers unless it has given the consumer notice and an opportunity to opt out. 15 U.S.C. § 6802(a). It is also the product of careful consideration and part of a comprehensive regulatory scheme.

The imposition of disclosure obligations by States interferes with this comprehensive regulatory network. The Creditors' argument, if accepted, would interfere with the objectives of Congress and the regulatory agencies in establishing these rules on a nationwide and uniform basis. See Guice, 89 N.Y.2d at 46-47; see also Int'l Paper, 479 U.S. at 496; Grunwald, 400 F.3d at 1135-36. Investment banking firms agree to underwrite securities for companies throughout the United States. Under the Creditors' argument, those firms would potentially be subject to fiduciary duties the scope of which would be defined by the law of many different States. Thus, instead of being able to contract that a particular State's law will govern the parties' agreement, underwriters sued for breach of fiduciary duty would be left uncertain as to which State's law would apply to the dispute. See, e.g., Padula v. Lilarn Props. Corp., 84 N.Y.2d 519, 521 (1994) ("In the context of tort law, New York utilizes interest analysis to determine which of two competing jurisdictions has the greater interest in having its law applied in the litigation."); Caudle v. Towers, Perrin, Forster & Crosby, Inc., 580 F. Supp. 2d 273, 280 (S.D.N.Y. 2008) (applying New York's "interest analysis" to determine which State's law to apply to claim for breach of fiduciary duty).

Although eToys is a Delaware company and the parties agreed that the applicable law governing their contract is New York law, a different creditors' committee appointed on behalf of a company based in a different State could argue

that Delaware, California, or Illinois law defines the scope of the fiduciary duties the underwriter has agreed to assume, and that a jury in that State should be asked to determine the nature of the fiduciary relationship and whether it has been breached. See Mitchell v. U.S. Airways, Inc., 858 F. Supp. 2d 137, 157 (D. Mass. 2012) (stating its "concern for patchwork de facto regulation resulting from jury verdicts" and noting that such a result would force defendants "to comply with a jury's 'ad hoc compliance scheme' (and potentially, multiple juries' conflicting compliance schemes) and effectively be regulated thereby"). The underwriters would not know with certainty in advance what law would apply or the content of any fiduciary duty implied by that law. The result would be exactly what the Guice Court warned against—investment firms engaged in a nationwide activity would be subjected to a patchwork of different laws, each with somewhat different content. Guice, 89 N.Y.2d at 46-47; see also Int'l Paper, 479 U.S. at 496; Grunwald, 400 F.3d at 1135-36.

It may be that when an underwriter has agreed to accept an advisory assignment separate and apart from the underwriting relationship that carries with it a duty to disclose, the underwriter should be judged according to those separate obligations it has agreed to assume. See EBC I, 5 N.Y.3d at 20-22. The duties in those circumstances would be the function of the specific agreement struck

between the investment firm and its client.[21] But the Creditors' argument here asks the Court to rule that there is a triable issue of fact in the absence of any such specific agreement, and their argument thus cannot be accepted without subjecting all underwriters to what this Court in Guice described as "a chaotic regulatory structure" that it is "unlikely—to say the least—that Congress intended." See Guice, 89 N.Y.2d at 47 (internal quotation mark omitted).

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[21] This specific concern about conflicting laws undermining the federal regulatory scheme was not present when this case was last before this Court. There, unlike the allegations now before the Court, the Creditors had argued that investors were "obligated to kick back to Goldman a portion of any profits that they made" from selling eToys securities and that such kickbacks had amounted to 20-40% of the investors' profits. EBC I, 5 N.Y.3d at 18 (internal quotation mark omitted). These allegations did not raise the same concerns because they suggested conduct that may not have been expressly permitted under the federal regulatory scheme.

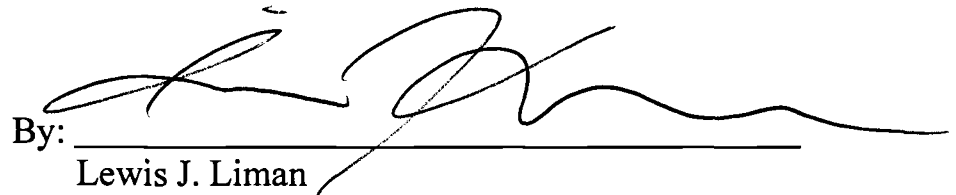
CONCLUSION

For the foregoing reasons, SIFMA respectfully requests that this Court affirm the order of the Appellate Division, affirming the grant of summary judgment in favor of Goldman Sachs.

Dated: New York, New York
April 12, 2013

Respectfully submitted,

CLEARY GOTTLIEB STEEN & HAMILTON LLP



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