

**Court of Appeals**  
*of the*  
**State of New York**

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MARC S. KIRSCHNER, as Trustee of the REFCO LITIGATION TRUST,  
*Plaintiff-Appellant,*

– against –

KPMG LLP, GRANT THORNTON LLP, MAYER BROWN LLP, INGRAM MICRO,  
INC., CIM VENTURES INC., WILLIAM T. PIGOTT, MAYER BROWN  
INTERNATIONAL LLP, PRICEWATERHOUSECOOPERS LLP, LIBERTY CORNER  
CAPITAL STRATEGIES, LLC, BANC OF AMERICA SECURITIES, LLC, CREDIT  
SUISSE SECURITIES LLC and DEUTSCHE BANK SECURITIES, INC.,

*Defendants-Respondents.*

– and –

BECKENHAM TRADING COMPANY, INC., ANDREW KRIEGER, ERNST  
& YOUNG LLP, TONE N. GRANT, ROBERT C. TROSTEN, REFCO GROUP  
HOLDINGS, INC., PHILLIP R. BENNETT, SANTO C. MAGGIO, EMF FINANCIAL  
PRODUCTS, DELTA FLYER FUND, LLC and ERIC M. FLANAGAN,

*Defendants.*

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ON QUESTIONS CERTIFIED BY THE U.S. COURT OF APPEALS FOR THE  
SECOND CIRCUIT (USCOA DOCKET NO. 09-2020-CV(L), 09-2027-CV(CON))

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**BRIEF OF *AMICUS CURIAE* THE SECURITIES INDUSTRY  
AND FINANCIAL MARKETS ASSOCIATION  
IN SUPPORT OF DEFENDANTS-RESPONDENTS**

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## **CORPORATE DISCLOSURE STATEMENT**

Pursuant to the Rules of the Court of Appeals (22 NYCRR) § 500.1(f), the Securities Industry and Financial Markets Association states that it is not a corporate entity and has no parents, affiliates, or subsidiaries.

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The Securities Industry and Financial Markets Association ("SIFMA") respectfully submits this proposed brief as *amicus curiae* to support broad application of the *in pari delicto* defense, and narrow application of the "total abandonment" adverse inference exception, consistent with this Court's key precedents, sound policy, and the arguments advanced by the Defendants. SIFMA writes not to repeat the arguments exhaustively analyzed in over 240 pages of briefs by the parties, but to focus on a handful of key precedents and policies that SIFMA believes should dictate resolution of the certified questions.

### **INTEREST OF PROPOSED *AMICUS CURIAE***

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers locally and globally through offices in New York, Washington, D.C., and London. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets.

SIFMA's members assist companies with capital formation activities such as the acquisition of equity and debt financing through the issuance and marketing of public offerings of securities and the preparation and dissemination of prospectuses. SIFMA's members help raise initial capital for new business ventures, facilitate existing companies' access to working capital, execute trades for institutional and retail clients, and provide advice on such key transactions as

acquisitions and divestitures. The activities that SIFMA members assist involve a high degree of risk, especially in volatile markets and nearly unprecedented economic times, but are critical to fostering the unimpeded liquidity and sustainable growth of the U.S. and global economy. Indicative of the important societal role SIFMA's members fulfill is the breadth of participation by SIFMA's members in U.S. capital markets. In 2007, for instance, before the latest global financial crisis broke out, initial public offerings ("IPOs") of securities in the United States amounted to \$65.1 billion, representing 22.7% of the total proceeds from IPOs globally.<sup>1</sup>

As discussed below, SIFMA's members are already subject to massive litigation risk wholly apart from the types of claims brought here on behalf of a trustee standing in the shoes of the principal wrongdoer. Increasingly, however, SIFMA's members also find themselves enmeshed in lawsuits initiated by trustees representing bankrupt companies that have themselves committed massive frauds through the conduct of their own executives and owners. In their effort to enlarge the bankruptcy estates under their administration, the trustees sue non-bankrupt institutions that assisted the bankrupt company in raising capital necessary to its survival (by lending to the corporation, or making a principal investment in the

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<sup>1</sup> See Transaction Services, PriceWaterhouseCoopers LLP, *2007 US IPO watch: Analysis and trends*, at 16 (2007), available at [http://www.pwc.com/en\\_US/us/transaction-services/assets/2007\\_us\\_ipo\\_watch.pdf](http://www.pwc.com/en_US/us/transaction-services/assets/2007_us_ipo_watch.pdf).

corporation, or providing brokerage or clearing services, or engaging in other facets of the securities business for the benefit of the corporation), and accuse these institutions of doing exactly that, *i.e.*, keeping the company away from the brink of collapse. Seeking bluntly to impose the costs of the company's collapse on these third parties, the trustees – again standing in the shoes of the principal wrongdoers – blame third parties for failing to detect the fraudulent representations by the company's own insiders or conspiring with those insiders to prolong the company's survival.

These lawsuits, if allowed to proceed past the pleading stage, exact considerable and unwarranted costs on the third party defendants and on the capital markets in general. The economic stakes are enormous: the alleged damages are usually staggering and the discovery costs are typically enormous. In the present action alone, the Trustee claims damages in excess of \$2 billion. Not infrequently, the overwhelming cost of defending against such immense assertions of liability, and the disruptive effect of the litigation on a company's operations, inevitably place inordinate pressure on the third parties to negotiate a settlement, irrespective of the merits of their defense. In this respect, these suits resemble securities class actions – where less than one percent of the cases are ultimately resolved through

trials and only about one percent are resolved through summary judgment.<sup>2</sup> Thus, regardless of their ultimate merits, these cases achieve significant settlement value merely by surviving motions to dismiss.

Against this backdrop, it is easy to see why the proper application of the *in pari delicto* defense, and New York's narrow "adverse interest/total abandonment" exception to that rule, are of fundamental importance to SIFMA's members. Were this Court to accept the Trustees' positions over the well-reasoned application of the adverse interest exception proposed by Defendants and endorsed by most lower New York courts, the exception would eviscerate the *in pari delicto* doctrine, and the primary malefactors – and the trustees that stand in their shoes – would be able to transfer much of the cost of the corporation's own wrongdoing to SIFMA's members and other third parties. Such a shift would depart from the very purposes of the *in pari delicto* defense and this Court's key precedents, and undermine the strong public policy underlying that defense.

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<sup>2</sup> See Stephen J. Choi & A.C. Pritchard, *The Supreme Court's Impact on Securities Class Actions: An Empirical Assessment of Tellabs*, at 32 (Jan. 8, 2010), (Table 1: Sample Description, Panel B: Suit Outcome (If Known)), available at [https://editorialexpress.com/cgi-bin/conference/download.cgi?db\\_name=ALEA2010&paper\\_id=34](https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=ALEA2010&paper_id=34) (noting that only two out of 517 securities class actions analyzed had been resolved through a trial verdict or judgment on the pleadings and only six out of the 517 actions had been resolved through summary judgment).

Because of the obvious interest of its members in the outcome of this case, SIFMA respectfully requests that it be allowed to present its views, as *amicus curiae*, on the proper scope of the adverse interest exception.

## **ARGUMENT**

### **I. Securities Firms Already Face Massive Liability Risk, Apart from Actions Brought on Behalf of Principal Wrongdoers**

Contrary to the assertion of the Trustee (Trustee Reply Br. at 2), this case is not about whether outsiders alleged to be complicit in an insider fraud "should enjoy an automatic 'get out of jail free' card at the pleading stage." Financial firms are subject to massive liability under a panoply of statutes and common law actions – in individual actions brought directly by innocent victims of the company's misconduct, actions brought by creditors who can satisfy the elements of direct causes of action, actions brought by regulators, criminal prosecutions, and class actions brought on behalf of purchasers and sellers of equity and debt securities. The difference is that these remedies are provided to investors and creditors or are entrusted to the sound discretion of government officials, not to the principal wrongdoers or persons standing in their shoes.

For example, financial firms are subject to liability under (i) Section 11 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77k, *see* 15 U.S.C. § 77k(a)(5), (b)(3) (allowing any investor who acquired a security pursuant to any registered offering to recover its losses from the underwriters of those

securities by showing that there were material misrepresentations or omissions in a registration statement, as long as the underwriter does not meet its burden of proving due diligence); (ii) Section 12(a)(2) of the Securities Act, 15 U.S.C. § 77l(9)(2) (allowing purchasers of securities to recover against any person who sold them the security by means of a misleading prospectus or oral communications as long as the seller shall not sustain its burden of proving that it did not know, and, acting with reasonable care, could not have known, of the untruth or omission); (iii) Section 15 of the Securities Act, 15 U.S.C. § 77o (imposing liability, in favor of investors and bondholders, on any person who controls any person liable under Sections 11 or 12 of the Securities Act); (iv) Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (2010) (allowing investors to recover against "any person" who uses or employs a manipulative or deceptive device or contrivance in connection with the sale of securities); (v) Section 9 of the Exchange Act, 15 U.S.C. § 78i (imposing liability, in favor of investors, on any person who engages in various manipulative activities in connection with a securities transaction); and (vi) Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a) (imposing liability on those entities that control persons who are liable under other provisions of the Exchange Act).

The Securities and Exchange Commission, of course, can and does prosecute broker-dealers and other financial institutions for virtually any violation of the federal securities laws, and can prosecute persons who aid and abet such violations as well. *See* 15 U.S.C. § 78t(e). U.S. Attorneys can and do bring criminal actions against investment banks and others for any "willful" violation of the federal securities laws, e.g., *see* 15 U.S.C. § 78ff, as well as for mail fraud, under 18 U.S.C. § 1341, wire fraud, under 18 U.S.C. § 1343, or conspiracies or attempts to commit mail or wire fraud. *See* 18 U.S.C. § 1349. State Attorneys General and other state regulators have available a wide variety of criminal and civil actions that they routinely bring against those who engage in actual or alleged misconduct in connection with securities transactions, and individual investors and creditors can bring negligence, fraud and other actions in state and sometimes federal court so long as they satisfy the requirements for such actions.

Wholly apart from the type of action the Trustee seeks to bring here, the United States is already the most litigious nation in the world, and that burden falls disproportionately on financial services firms. Financial firms accounted for about 40 percent of securities suits filed in 2008 and 2009 and suits against

companies in the financial sector are still far more common than suits against companies in any other industry group.<sup>3</sup>

Consider class actions alone. Between 1997 and 2008, an average of 197 securities class actions were filed each year in the federal courts.<sup>4</sup> Financial services firms are by far the most frequent targets of securities class actions in each of the last three years.<sup>5</sup> The three largest class action settlements alone – all of which occurred in the last five years and two of which were funded principally by financial services firms that were not the primary wrongdoers – totaled \$16.6 *billion* dollars.<sup>6</sup> Financial services firms are already the target of choice in the most litigious nation in the world. While that does not mean that firms will always act appropriately in any industry, it does mean that the absence of even more litigation is probably not the explanation for such lapses.

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<sup>3</sup> See Advisen Ltd., *Securities Litigation Surges Following a Quiet First Quarter*, at 4 (2d Quarter 2010), available at [http://corner.advisen.com/pdf\\_files/sec\\_lit\\_Q22010.pdf](http://corner.advisen.com/pdf_files/sec_lit_Q22010.pdf).

<sup>4</sup> See Cornerstone Research, *Securities Class Action Filings 2009: A Year in Review*, at 2 (2010), available at [http://www.cornerstone.com/files/Publication/7bf1f035-199d-49c9-bcaa-8596402982f2/Presentation/PublicationAttachment/3c555519-b90f-48c9-9040-8dbf2892ed95/Cornerstone\\_Research\\_Filings\\_2009\\_YIR.pdf](http://www.cornerstone.com/files/Publication/7bf1f035-199d-49c9-bcaa-8596402982f2/Presentation/PublicationAttachment/3c555519-b90f-48c9-9040-8dbf2892ed95/Cornerstone_Research_Filings_2009_YIR.pdf).

<sup>5</sup> See *id.* at 12-13, 23.

<sup>6</sup> See Cornerstone Research, *Securities Class Action Settlements: 2009 Review and Analysis*, at 18 n.2 (2010), available at [http://www.cornerstone.com/files/Publication/1ab95c24-3653-41ca-909f-e996035c1c48/Presentation/PublicationAttachment/abdb055f-1e09-4a16-9a0f-ebb0cc432145/Cornerstone\\_Research\\_Settlements\\_2009\\_Analysis.pdf](http://www.cornerstone.com/files/Publication/1ab95c24-3653-41ca-909f-e996035c1c48/Presentation/PublicationAttachment/abdb055f-1e09-4a16-9a0f-ebb0cc432145/Cornerstone_Research_Settlements_2009_Analysis.pdf).

Thus, contrary to the Trustee's argument, this is a case not about whether financial institutions are being awarded a "get out of jail free" card, but whether the courts should lend their good offices to recoveries on behalf of the principal wrongdoers, or trustees standing in their shoes. As discussed below, the very essence of the *in pari delicto* doctrine is that the one party that is barred from recovery in the case of a serious fraud is the principal wrongdoer itself, and that includes a trustee standing in the shoes of the principal wrongdoer.

**II. The *In Pari Delicto* Defense Disables a Primary Corporate Wrongdoer, or a Trustee Succeeding to that Wrongdoer's Claims, from Recovering from Equally or Less Culpable Third Parties**

The very essence of the *in pari delicto* doctrine is that courts should not help a wrongdoer – or someone standing in the wrongdoer's shoes – recover against a defendant for assisting or failing to prevent the commission of a wrong for which the wrongdoer was itself at least equally and potentially more at fault. Allowing a defendant, under those circumstances, to successfully defend itself and avoid liability by pointing to its accuser's own wrongdoing reflects an ancient legal principle, well entrenched in both Roman law tradition and common law jurisprudence, that courts should not assist a claimant in recovering in connection with its own wrongdoing.

In the early case of *Holman v. Johnson*, (1775) 1 Cowp. 341, 98 Eng. Rep. 1120 (K.B.), Lord Mansfield, Lord Chief Justice of England, explained this principle in categorical terms:

The principle of public policy is this; *ex dolo malo non oritur actio* [from a dishonorable cause an action does not arise]. No Court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own standing or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the Court says he has no right to be assisted. It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. . . . [W]here both [plaintiff and defendant] are equally in fault, *potior est conditio defendentis* [defendant's claim is more potent].

*Id.* at 343, 98 Eng. Rep. at 1121. *See also, e.g., Stone v. Freeman*, 298 N.Y. 268, 271 (1948) ("[N]o court should be required to serve as paymaster of the wages of crime, or referee between thieves."); *Riggs v. Palmer*, 115 N.Y. 506, 511 (1889) ("No one shall be permitted to profit by his own fraud, or to take advantage of his own wrong, or to found any claim upon his own iniquity, or to acquire property by his own crime."); *Saratoga County Bank v. King*, 44 N.Y. 87, 94 (1870) ("The inflexible rule is, that no remedy can be had in a court of justice on an illegal contract or transaction, where both parties are *in pari delicto*."); *Stecher v. 85th Estates Co.*, 43 A.D.3d 732, 736 (1st Dep't 2007) ("It is well-settled law that parties to a fraudulent or illegal transaction who are *in pari delicto* may not invoke judicial aid to undo the consequences of their illegal acts.") (citation omitted)

(quoting *Miltenberg & Samton, Inc. v. Mallor*, 1 A.D.2d 458, 461 (1st Dep't 1956).

This Court embraced this longstanding principle well over a century ago. *See Ernst v. Crosby*, 140 N.Y. 364, 367 (1893) ("If the lessor of premises knows and intends that they will or may be used for unlawful purposes, the lease is void, and *the obligations of the parties will receive no aid from the courts for their enforcement.*") (emphasis added). And the Appellate Division has recognized this as well. "[I]n view of plaintiff's equal responsibility for the illegality of the transaction," courts in such cases "leave both parties where [they] found them." *Diversified Group Inc. v. Sahn*, 259 A.D.2d 47, 51-52 (1st Dep't 1999).

### **III. The Narrow Exception that Applies When an Insider "Totally Abandons" the Corporation's Interests Does Not Apply When the Insider's Conduct Confers Substantial Benefits on the Corporation**

The "adverse interest" exception is a narrow exception to the *in pari delicto* doctrine that should almost never require a shifting and highly fact-oriented disposition of claims. This Court articulated the exception as follows:

To come within the exception, the agent must have *totally abandoned* his principal's interests and be acting *entirely* for his own or another's purposes. It cannot be invoked merely because he has a conflict of interest or because he is not acting primarily for his principal.

*Center v. Hampton Affiliates, Inc.*, 66 N.Y.2d 782, 784-85 (1985) (emphasis added). The word "totally" means "[i]n a total manner or degree; wholly,

completely, entirely, altogether."<sup>7</sup> The word "abandon" means "[t]o give up absolutely."<sup>8</sup> The word "entirely" means "[w]holly, completely, perfectly; without exception or reservation."<sup>9</sup> These are absolute formulations – words clearly constructed to avoid ambiguity where there is a benefit to both the insider and the corporation and to provide the most narrow of exceptions in the rare case (such as simple theft or looting) where the conduct benefits only the insider.

The Court's decision in *Center* underscores the narrowness of the "adverse interest" exception. In *Center*, the plaintiff contended that stock due to have been transferred to him had wrongfully been transferred instead to the defendant corporation. *See Center*, 66 N.Y.2d at 783-84. The latter, seeking to portray itself as a *bona fide* purchaser of the shares, unaware of and, thus, unaccountable for plaintiff's claims, argued that the knowledge and actions of its agent, who might have been aware of the wrongfulness of the share transfer to the corporation, should not be automatically attributed to the company. *See id.* at 784-85. This Court firmly turned aside that contention, ruling that "[t]o come within the [adverse interest] exception, the agent must have *totally abandoned* his principal's interests and be acting *entirely* for his own or another's purposes. It

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<sup>7</sup> 2 *Oxford English Dictionary*, 3359 (compact ed. 1971).

<sup>8</sup> 1 *Oxford English Dictionary*, 2 (compact ed. 1971).

<sup>9</sup> 1 *Oxford English Dictionary*, 877 (compact ed. 1971).

cannot be invoked merely because he has a conflict of interest or because he is not acting primarily for his principal." *Id.* (emphasis added). The Court stressed that a litigant cannot avoid the fundamental agency law axiom of imputation through boilerplate assertions that the agent's true purpose was to enrich himself at the expense of the principal. The Court specifically found insufficient "[d]efendants' moving papers," which contained "only conclusory allegations that [the attorney/agent] was seriously conflicted throughout these transactions and that he and [the original owner of the stock] tried to defraud the corporation." *Id.* at 785.

By emphasizing the narrow scope of the "adverse interest" exception and confirming the stringent requirements for pleading the exception, this Court rejected the exact open-ended interpretation endorsed by the Trustee here. This narrow and limited exception is completely inconsistent with an alleged fraud complaint that Judge Lynch correctly observed was "saturated by allegations that Refco received substantial benefits" from the insiders' alleged wrongdoing. (A37.) "The Swiss Army knife of presumptions, usable in all circumstances, is that a person is presumed to intend the natural consequences of his actions . . . ." <sup>10</sup> At the time of the fraud, the actions here enabled Refco to maintain its attractiveness to

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<sup>10</sup> Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 Cardozo L. Rev. 1553, 1613-14 (2008). *See, e.g., Personnel Adm'r of Massachusetts v. Feeney*, 442 U.S. 256, 278 (1979) (stressing "the presumption, common to the criminal and civil law, that a person intends the natural and foreseeable consequences of his voluntary actions").

investors, encourage customers to do business with Refco, and raise close to \$2 billion that it used for a variety of corporate purposes. (A52, A69-70, A83, A143, A144.) These benefits, even though they did not survive beyond the unmasking of the fraud, cannot be squared with "totally abandoning" Refco's interests during the course of the fraud and acting "entirely" for the insiders' benefit. "The relevant issue is short term benefit or detriment to the corporation, not any detriment to the corporation resulting from the unmasking of the fraud."<sup>11</sup> Stated another way, if a case involving these types of massive benefits preceding the unmasking of the fraud falls within the adverse interest/total abandonment exception to the *in pari delicto*, then, in the words of Judge Lynch, the narrowly drawn adverse interest exception will have been "transform[ed] . . . from a 'narrow' exception, into a new, and nearly impermeable rule barring imputation." (A39) At best, it will have been converted into a shifting and highly fact-oriented basis for addressing potentially catastrophic liability claims, which "is not a 'satisfactory basis for a rule of liability imposed on the conduct of business transactions.'"<sup>12</sup>

In its certification decision, the Second Circuit asks, *inter alia*, "whether the adverse interest exception is satisfied by showing that the insiders

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<sup>11</sup> *In re Wedtech Corp.*, 81 B.R. 240, 242 (S.D.N.Y. 1987).

<sup>12</sup> *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188 (1994) (citation omitted).

intended to benefit themselves by their misconduct." *Kirschner v. KPMG LLP*, 590 F.3d 186, 194-95 (2d Cir. 2009) (A22). SIFMA submits that conduct that enables a company to survive for many years and raise billions of dollars that it uses for corporate purposes defeats the "total abandonment" standard of *Center*, even if that conduct also benefits insiders. The standard in *Center* is not whether an insider intended to benefit himself or herself; but whether his or her conduct was a "total abandonment" of the corporation's interests and was "entirely" for the insider's benefit. *See Center*, 66 N.Y.2d at 784-85. Indeed, the Court in *Center* stated that even conduct that was "primarily" for the benefit of the insider did not satisfy the "total abandonment" exception. *See id.* at 785. That is dispositive of the Second Circuit's question.

#### **IV. The *In Pari Delicto* Defense Does Not Depend on Psychoanalyzing the Insider's Subjective Motivation**

There is the subsidiary issue of what role "intent" plays at all in assessing the "total abandonment" standard, as opposed to the objective short-term benefits of the fraud on the company before it is unmasked. As set forth above, the "Swiss Army knife" of presumptions is that an individual is presumed to intend the natural consequences of his or her conduct, and, therefore, if that conduct enables a corporation to survive, to continue to attract investors and customers, and to raise billions of dollars for corporate purposes, any requirement of a showing that an individual intended to benefit the corporation is satisfied. To the extent that the

Trustee argues intent requires, instead, an inquiry anchored not in demonstrable and objective facts surrounding the actual benefits obtained for the corporation, but a totally subjective analysis of what is ultimately unknowable – *i.e.*, the subjective motivation of the insider – it should be rejected. That standard would provide just the type of shifting and highly fact-oriented litigation that provides no predictive value whatsoever and no guidance to those who provide services to participants in the securities business.<sup>13</sup>

Indeed, concerns about grounding liability on ascertaining an individual's or many individuals' subjective motivation caused the United States Supreme Court, in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991), to reject liability standards that are not "anchor[ed] in demonstrable fact" and instead are based on "plaintiff's 'subjective hypothesis.'" *Id.* at 1092. The Court expressed concern about the possibility of litigation that was based on allegations that statements made were not genuinely believed, and stated that "disbelief or undisclosed motivation, standing alone, [are] insufficient to satisfy the element of fact that must be established in actions alleging securities fraud." *Id.* at 1096. The same considerations have long caused federal courts to hold that the "securities laws . . . were never intended to attempt any such measures of psychoanalysis or reported self-analysis. The unclean heart of a director is not actionable, whether or

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<sup>13</sup> See *Central Bank*, 511 U.S. at 188.

not it is 'disclosed,' unless the impurities are translated into actionable deeds or omissions both objective and external."<sup>14</sup> SIFMA submits that efforts to ground the *in pari delicto* defense and the total abandonment standard on a psychoanalysis of the unclear hearts of executives, who themselves may not even be able to parse their myriad motivations, should be rejected in favor of a standard grounded in demonstrable fact, *i.e.*, here the actual benefits achieved by the corporate wrongdoer during the course of the fraud.

**V. The Creditors Have Their Own Direct Causes of Action and Should Not Recover by Standing in the Shoes of the Principal Corporate Wrongdoer**

The Trustee emphasizes that the Trustee himself and the creditors for whose benefit he seeks to recover are not the actual wrongdoers. Refco and its insiders are. But there is no question here that the Trustee stands in the shoes of Refco<sup>15</sup> which, in the absence of showing that the "total abandonment" standard has been satisfied, bears responsibility for the fraud of its executives.<sup>16</sup> Any argument that the Trustee should have greater rights than Refco itself should be addressed to Congress as a matter of federal bankruptcy law rather than to the

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<sup>14</sup> *Stedman v. Storer*, 308 F. Supp. 881, 887 (S.D.N.Y. 1969); *accord, e.g., Biesenbach v. Guenther*, 588 F.2d 400, 402 (3d Cir. 1978).

<sup>15</sup> *See Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 416-17, 434 (1972).

<sup>16</sup> As set forth in the Second Circuit's opinion, the Litigation Trustee was appointed to "pursue any claims and causes of action transferred from the bankruptcy estates" of the Refco entities, and the Trustee brought its action standing "in the shoes of [the Refco entities]." *Kirschner*, 590 F.3d at 190 (A12).

judiciary. Indeed, in 2005 a draft bill was prepared that included a section entitled, "Inapplicability of *In Pari Delicto* to Trustee Actions," but never made it out of Committee.<sup>17</sup>

The creditors, if they have been wronged, can bring their own actions and have done so in this very matter, and defendants may assert whatever defenses are available in actions brought by creditors. There is no reason creditors should be able to recover more by standing in the shoes of the principal corporate wrongdoer.

#### **VI. A Broad Application of the *In Pari Delicto* Defense Will Not Encourage Misconduct**

There is no basis at all for the Trustee's purported concern that in the absence of a significant change to the clear import of this Court's decision in *Center*, third party service providers will be encouraged to engage in misconduct. As we discussed at the outset, financial institutions already have to navigate in an environment in which they are the most frequent target of massive federal and state litigation in the most litigious country in the world. Apart from whatever other incentives they have to comply with the law, the constant threat of massive class actions, SEC actions, criminal prosecutions, and actions by persons other than the

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<sup>17</sup> See Steven P. Caley, *In Pari Delicto in the Bankruptcy Courts – Big Changes in the Offing* Metropolitan Corporate Counsel, June 2006, available at [http://www.kelleydrye.com/publications/articles/0308/\\_res/id=Files/index=0/0308.pdf](http://www.kelleydrye.com/publications/articles/0308/_res/id=Files/index=0/0308.pdf).

principal wrongdoer provide ample incentive. Again, that does not mean that all financial institutions will always act appropriately, but it does mean that the legal incentives exist for them to act appropriately. That, by the way, is also true for Refco insiders who are now in jail and who have lost their careers, their reputation, their freedom, their livelihood, and their assets; they did not commit fraud because the laws are too weak – they committed fraud because they did not expect to be caught and convicted. The remedy for every wrong is not to encourage yet more litigation on behalf of the primary corporate wrongdoer, but to allow the massive remedies that already exist and that can be brought directly by the victims of any wrongdoing to play out. As to those claims, however, a trustee standing in the shoes of the wrongdoer has no role.

Moreover, to the extent deterrence enters into the equation, the total abandonment standard has the salutary effect of incenting corporations to carefully choose and monitor their own officers and directors, rather than to be able to shift responsibility for their conduct to outsiders. That is where deterrence is likely to be most effective, and there is no sound reason to dilute that effect.

## **VII. The Court Should Not Address Issues Well Outside the Scope of the Certification Request**

Finally, we write briefly to express SIFMA's concern about the Trustee's use of the certification process to address issues that were never addressed below and that are far outside the certification (such as repealing the

*Wagoner* rule and doing away with the *in pari delicto* defense in favor of comparative fault). The Trustee does this based on the Second Circuit Court of Appeals' standard language in certification orders inviting this Court "to expand upon or vary the terms *of these questions* as that Court deems appropriate." *Kirschner*, 590 F.3d at 195 (A22) (emphasis added). We do not understand this formulation to be an invitation to address issues far afield from the certification order and far afield from anything that the parties had briefed in his case as it percolated up through the District Court and to the Court of Appeals. There will be plenty of cases percolating through the State court system, in which these issues can first be raised, briefed, and initially determined by the intermediate appellate courts, that provide a better vehicle for this Court to consider whether to fundamentally revisit issues that the Second Circuit did not confront, address, or certify. Moreover some of these issues (such as the *Wagoner* rule) have significant federal components, which should not be addressed by this Court in the absence of the clearest direction by the Second Circuit.

## CONCLUSION

For the foregoing reasons, the Court should respond to the certified questions by holding that the total abandonment/adverse interest exception to the *in pari delicto* defense is not satisfied by showing that insiders intended to benefit themselves and that fraudulent conduct that produces huge short-term benefits to the company at the time of the fraud is inconsistent with the total abandonment/adverse interest exception.

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Respectfully submitted,



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