UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re REFCO, INC. SECURITIES LITIGATION	:	05 Civ. 8626 (GEL)

LEAD PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF MOTION TO MODIFY THE PSLRA STAY TO PERMIT LIMITED DOCUMENT DISCOVERY

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Lead Plaintiffs Pacific Investment Management Company, LLC and RH Capital LLC (collectively, "Lead Plaintiffs") respectfully submit this memorandum of law in support of their motion to modify the discovery stay set forth in Section 21D(b)(3)(B) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-4(b)(3)(B), as amended by the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), to permit Lead Plaintiffs to conduct limited document discovery.

PRELIMINARY STATEMENT

Lead Plaintiffs seek a limited modification of the PSLRA discovery stay in order to permit the investors who purchased the stock and bonds of Refco, Inc. (together with its predecessors and subsidiaries, "Refco" or the "Company") between August 5, 2004 and October 17, 2005 (the "Class") to obtain copies of documents that have already been gathered and produced in several other contexts. This modification is necessary to mitigate the severe and potentially irreversible prejudice that the Class has already suffered, and is likely to suffer in the future, as Lead Plaintiffs fall further behind other interested parties who are exploiting their access to millions of pages of highly relevant documents to pursue their agendas concerning Refco's stunning collapse. For example, litigants in other cases are already using the discovery available to them – but not available to Lead Plaintiffs – to engage in settlement discussions as to their claims that threaten to exhaust the ability of at least one defendant to satisfy claims asserted on behalf of the Class in this litigation (the "Action"). In contrast, there will be no prejudice to the parties from whom discovery is sought (collectively, the "Producing Parties") because the materials that Lead Plaintiffs seek are merely copies of what has already been produced (or shortly will be produced) to others.

Specifically, as discussed in Point I below, Lead Plaintiffs seek an order that will modify the discovery stay such that they can obtain the following three categories of documents:

(1) All documents that Refco or the defendants in this Action have already produced, or will be producing, to the United States Securities and Exchange Commission (the "SEC"), the United States Attorney for the Southern District of New York (the "U S Attorney"), the examiner appointed in Refco's Bankruptcy proceedings (the "Examiner"), Refco's Official Committee of Unsecured Creditors (the "Creditors' Committee"), Refco's *Ad Hoc* Committee of Senior Subordinated Noteholders (the "*Ad Hoc* Committee"), and any other regulatory, governmental or investigative agencies or other private parties involved in reviewing the facts and circumstances giving rise to Refco's demise[1];

(2) All documents that Refco or the defendants in this Action have already produced, or will be producing, in all other litigation arising from Refco's demise; and

(3) All documents that certain non-parties have already produced, or will be producing, in connection with the investigations and proceedings referenced in categories 1 and 2 above

In addition, Lead Plaintiffs seek an order permitting them to serve subpoenas on certain non-parties believed to have relevant information (but who have not yet produced documents to any interested party and who may arguably have no present obligation to preserve pertinent materials) directing the preservation of such materials *See* Point II below

Consistent with Lead Plaintiffs' fiduciary obligation to the Class, it is clear that this litigation will not be resolved – either through trial or settlement – until Lead Plaintiffs have the opportunity to review a significant number of documents from the Producing Parties Thus, the

[1] Refco filed for bankruptcy protection on October 17, 2005, thereby automatically staying all litigation against Refco (including the present motion, as to Refco). *See* 11 U S C § 362(a). Lead Plaintiffs are moving simultaneously in the Bankruptcy Court for a limited modification of the automatic stay so as to permit Lead Plaintiffs to pursue this motion as to Refco. (As set forth in the Declaration of James J Sabella, dated May 17, 2006 ("Sabella Decl "), Lead Plaintiffs' counsel has sought the consent of Refco's counsel to such limited modification of the automatic stay – which is the procedure that Bankruptcy Judge Drain recently approved in another case in which both Lead Counsel here and Refco's counsel were involved – but Refco's counsel has failed to provide a response) Assuming that Judge Drain endorses the procedure he set out in the Delphi matter and issues an order granting a limited modification of the automatic stay, Lead Plaintiffs will advise the Court that this motion can be pursued as to Refco as well as to the defendants in this case

narrow question on this motion is whether it is appropriate to force the Class to wait months while motions to dismiss are briefed and decided, while other interested parties – parties who are in some instances vying for the same sources of recovery as the Class – are reviewing these materials now, and are using this information to bolster their own claims and fuel their own settlement discussions with defendants.

In granting a similar modification to the PSLRA stay in the *WorldCom* securities litigation, Judge Denise Cote recognized the precise concerns articulated here by Lead Plaintiffs:

> All of the investigations and proceedings concerning WorldCom are moving apace. Without access to documents already made available to the U.S. Attorney, the SEC, and in whole or in part to WorldCom's Creditors Committee, [Lead Plaintiff] would be prejudiced by its inability to make informed decisions about its litigation strategy in a rapidly shifting landscape. It would essentially be the only major interested party in the criminal and civil proceedings against WorldCom without access to documents that currently form the core of those proceedings.

In re WorldCom, Inc. Sec. Litig., 234 F. Supp. 2d 301, 305 (S.D.N.Y. 2002) (emphasis added). *See also* cases cited on pp. 13-19 *infra*. Lead Plaintiffs respectfully submit that this motion does not present a close question: the prejudice to the Class in falling behind the other interested parties, and the corresponding lack of prejudice to the Producing Parties, compels the conclusion that the limited relief requested in this motion should be granted.

Indeed, recent events starkly illustrate that the risk of prejudice to the Class in this case is much more tangible than it was in *WorldCom*. On April 3, 2006, Lead Plaintiffs filed their Consolidated Class Action Complaint (as amended on May 5, 2006, the "Complaint"). In the weeks before and after filing the Complaint, and based upon the Court's suggestion at the conference on February 3, 2006, Lead Plaintiffs contacted the defendants, Refco's bankruptcy counsel, and relevant third parties, and attempted to work out agreements whereby those parties would consent to produce to Lead Plaintiffs copies of certain materials they had already

produced to others As described in the accompanying Sabella Declaration these efforts did not result in an agreement

At the same time that Lead Plaintiffs were attempting to work out a consensual resolution of the PSLRA discovery stay, other interested parties with access to documents from the Producing Parties began to leverage that access to race ahead of the Class For instance, as described in more detail below, the Creditors' Committee has obtained access to a broad array of documents from at least twenty-three defendants named in the Complaint and several other third-party targets of Lead Plaintiffs' ongoing investigative efforts, including, (1) eleven current and former directors, officers and employees of Refco, (2) several other participants in the transactions, events, and circumstances surrounding Refco's demise, (3) Refco's accountants and attorneys, and (4) eight of Refco's underwriters

On April 25, 2006, armed with the information that was (and for the most part remains) unavailable to Lead Plaintiffs, the Creditors' Committee filed in theBankruptcy Court an answer and counterclaim against BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft ("BAWAG"), an Austrian bank that engaged in several fraudulent transactions with Refco and is a defendant in this Action.[2] From this position of relative strength, the Creditors' Committee reportedly engaged in settlement discussions with BAWAG and, together with another interested party with access to documents – the U.S. Attorney – is reportedly close to an agreement that various news organizations report will exhaust BAWAG's ability to pay any other claims Even assuming that some *post-hoc* effort may be ongoing to apportion some fraction of this settlement to members of the Class, the ability

[2] The Creditors' Committee simultaneously obtained a temporary restraining order ("TRO") in the Bankruptcy Court freezing over a billion dollars worth of BAWAG's assets in the United States The Creditors' Committee's counterclaims, and the papers supporting the TRO, were filed in heavily redacted form pursuant to a confidentiality order entered in the bankruptcy proceedings

of Lead Plaintiffs to assess any such proposal -- and to evaluate the relative strength of the Class' and Creditors' Committee's claims against BAWAG (as well as BAWAG's actual ability to pay) –is seriously hampered by the lack of access to any of the documents that were undoubtedly scrutinized by every other party to the prospective deal *See* Sabella Decl. ¶ 9.

Thus, as a direct result of the PSLRA discovery stay, Lead Plaintiffs have been placed at a significant disadvantage vis-à-vis the Creditors' Committee in vindicating the Class' claims against BAWAG And Lead Plaintiffs quite reasonably fear that this scenario will play out again with regard to other sources of recovery, as the Committee does what Lead Plaintiffs cannot presently do – review pertinent documents to assess the relative strength of claims and defenses, and if appropriate attempt to resolve those claims before Lead Plaintiffs are in a position to act.

The events relating to the ongoing developments concerning BAWAG demonstrate just one example of the severe and potentially irreversible prejudice to the Class if the discovery stay is not modified as requested herein Put simply, Lead Plaintiffs should be given access to the requested materials in order to proceed expeditiously against defendants and potential defendants and others in order to ensure that the victimized investor Class is granted a fair opportunity to recover from these targets. Lead Plaintiffs' strong interest in ensuring a level playing field with other interested parties clearly outweighs the virtually nonexistent burden that would be placed on the Producing Parties if they were merely required to make another copy of the documents they have already produced to others.

BACKGROUND

Refco was a New York-based financial services firm primarily engaged in the business of providing execution and clearing services for exchange-traded derivatives While Refco was initially founded in 1969 as a provider of execution and clearing services for agricultural

commodities, the Company rapidly expanded its product offerings in response to the introduction of new financial futures products.

By 2004, the Company had purportedly secured a dominant position in the derivatives market and appeared to be a rising star within the industry. In June of that year, the Company's President and Chief Executive Officer Phillip Bennett ("Bennett") and Thomas H Lee Partners, L P ("THL Partners") obtained ownership of the Company and subsequently recapitalized it through a $600 million bond offering. In August 2005, Bennett and THL Partners took Refco public in a highly successful initial public offering of Refco stock (the "IPO")

On October 10, 2005, mere weeks after its IPO, Refco shocked the market when it announced that it had discovered a $430 million uncollectible receivable purportedly owed to it by a Bennett-controlled entity that had been hidden on its books In light of this discovery, Refco announced that its financial statements as of, and for the periods ending, February 28, 2002, February 28, 2003, February 28, 2004, February 28, 2005 and May 31, 2005 should no longer be relied upon. Refco then retained independent counsel and forensic auditors to investigate these matters and pledged to cooperate with the SEC, the Commodity Futures Trading Commission, the New York Stock Exchange and other regulators.

In the wake of the October 10 announcement, Bennett was arrested, and subsequently indicted, on charges of securities fraud. As customers ran for the exits amidst the growing uncertainty caused by the revelation of the Company's fraud, Refco was forced to shut down its Refco Capital Markets unit on October 13 By October 17, merely one week after the initial revelation of the previously-undisclosed $430 million "receivable," Refco filed for Chapter 11 bankruptcy protection

On February 3, 2006, the Court appointed Lead Plaintiffs to pursue this litigation. Lead Plaintiffs' initial complaint was filed on April 3, 2006. Lead Plaintiffs' filed the amended Complaint on May 5, 2006.

OTHER INVESTIGATIONS AND LAWSUITS

A. Governmental Investigations Into Refco's Implosion

In the months following its implosion, Refco came under fire from a host of investigators. The U.S. Attorney has been conducting an ongoing investigation in connection with the securities fraud and related charges on which Bennett was indicted on November 10, 2005. During the course of this investigation, the U.S. Attorney has gathered over 1.3 million pages of documents from, among others, Refco, Refco's former auditor, Grant Thornton LLP ("Grant Thornton"), and a law firm that had provided extensive legal services to Refco and former Refco CEO Bennett, Mayer Brown Rowe & Maw, LLP ("Mayer Brown"). The U.S. Attorney has provided Bennett with copies of these documents. *See* Transcript of Proceedings in *United States v. Bennett*, No. 05 Cr. 1192 (NRB) (S.D.N.Y.) (Sabella Decl. Ex. 6) at 5.

The SEC is also investigating the circumstances surrounding Refco's demise. During the aforementioned hearing in *United States v. Bennett*, the Assistant United States Attorney made reference to documents that the U.S. Attorney had obtained from the SEC, which it had subsequently turned over to Bennett. *Id.* at 4. Accordingly, it appears that the SEC has begun to gather documents in connection with its own investigation of Refco.

B. The Bankruptcy Examiner's Investigation

On March 16, 2006, Judge Drain appointed an Examiner to oversee the Refco bankruptcies pending in the Bankruptcy Court. The order grants the Examiner broad authority to "investigate and to report on any topic that might reasonably result in the assertion of a claim or right by any of the Debtors' estates with the exception of any claim or right of Refco Capital

Markets, Ltd." Sabella Decl. Ex. 7 at ¶ 2. The order further provides that "The Debtors shall provide to the Examiner all non-privileged documents and information that the Examiner deems relevant to discharge the Examiner's duties under this Order." *Id.* at ¶ 5. On March 22, 2006, the Bankruptcy Court appointed Joshua R. Hochberg as the Examiner. Upon information and belief, the Examiner will be given essentially unfettered access to Refco's books, records and computer systems in conducting his investigation into Refco's collapse.

C. The Creditors' Committee's Investigation

The Creditors' Committee has obtained extensive document production by numerous persons and entities in the Refco Bankruptcy proceedings. For instance, on November 3, 2005, the Creditors' Committee moved in the Bankruptcy Court for production of documents by certain current directors and former officers and employees of Refco (including THL Partners), certain counterparties and other participants in the transactions with Refco, and Refco's attorneys and auditors. *See* Sabella Decl. Ex. 8 at 14-16. The discovery requested by the Creditors' Committee overlaps in a significant degree with the discovery that Lead Plaintiffs need in order to investigate the issues surrounding Refco's collapse. For example, the Creditors' Committee sought discovery against:

- eleven of the individuals named as defendants in the Complaint;[3]
- Grant Thornton, THL Partners, BAWAG, and Refco Group Holdings, Inc ("Refco Holdings"), each of which is named as a defendant in the Complaint; and
- A third-party whose prominent involvement with Refco has been widely-reported and whom Lead Plaintiffs are in the process of investigating.

[3] These are (i) Phillip Bennett, (ii) Tone Grant, (iii) Santo Maggio, (iv) Robert Trosten, (v) Thomas H. Lee, (vi) David V. Harkins, (vii) Scott L. Jaeckel, (viii) Scott A. Schoen, (ix) Ronald L. OKelley, (x) Nathan Gantcher, and (xi) Leo R. Breitman.

Id. In describing their need for this discovery, the Creditors' Committee stated that "the Committee must obtain such information to discharge properly its duties," and "to assess fully the Debtors' potential claims against third parties." *Id.* at 20 (emphasis added).

By order dated December 5, 2005, the Bankruptcy Court granted the Creditors' Committee's motion. *See* Sabella Decl. Ex. 5. The December 5, 2005 order permitted the Creditors' Committee to serve voluminous document requests on each of the individuals and entities noted above. In addition, the order contains strict confidentiality requirements designed to restrict access to the documents produced. *Id.* at ¶ 4. An amended order, entered on March 27, 2006, expanded the confidentiality provisions so that these documents could be shared with a (i) ten attorneys from Milbank, Tweed, Hadley & McCloy, LLP ("Milbank"), counsel to the Creditors' Committee; (ii) outside consultants retained by the Creditors' Committee, (iii) ten attorneys from Kasowitz, Benson, Torres & Friedman LLP ("Kasowitz"), conflicts counsel to the Committee; and (iv) the United States Attorney. Thus, starting on December 5, 2005, the Creditors' Committee began obtaining and reviewing documents from at least fifteen of the individuals and entities named as defendants in the Complaint, as well as one of the entities whom Lead Plaintiffs are actively investigating. Because of the PSLRA stay, Lead Plaintiffs have been denied access to that information.

On March 2, 2006, the Creditors' Committee moved in the Bankruptcy Court for an order directing the production of documents from eight of Refco's underwriters, each of whom are named defendants in the Amended Complaint (the "Producing Underwriters").[4] *See* Sabella Decl. Ex. 2. In describing their need for this discovery, the Creditors' Committee again stated

[4] The Producing Underwriters are: (i) J.P. Morgan Securities Inc., (ii) Credit Suisse, f/k/a Credit Suisse First Boston, (iii) Deutsche Bank Securities Inc., (iv) Banc of America Securities LLC, (v) Goldman Sachs & Co., (vi) Sandler O'Neill & Partners, L.P., (vii) Merrill Lynch Pierce, Fenner & Smith Inc., and (viii) HSBC Securities (USA) Inc.

that "the Committee must obtain such information to discharge properly its duties," and "to assess fully the Debtors' potential claims against third parties." *Id.* at 12 (emphasis added).

In response to that motion, the Producing Underwriters moved to withdraw the reference to the Bankruptcy Court, arguing that the discovery sought by the Creditors' Committee should be considered "in the context of all Refco-related discovery" and that "coordination of discovery across all Refco-related actions is desirable."[5] While the banks' motion was denied by the Court on May 16, 2006, it is worth noting here that, in the course of litigating that motion, the Creditors' Committee reiterated the importance of procuring discovery from the Producing Underwriters:

> Judge Drain agreed with the Committee that the Underwriters are obvious sources of information about [Refco] because they underwrote a Refco IPO just a few months before Refco's collapse. As part of that underwriting, the Underwriters conducted due diligence and obtained Refco's most sensitive financial information. The Committee deems its investigation of the Underwriters critical

See Sabella Decl. Ex. 9 at 3.

On March 23, 2006, the Bankruptcy Court granted the Creditors' Committee's motion for discovery against the Producing Underwriters. *See* Sabella Decl. Ex. 3. Lead Plaintiffs understand that the Creditors' Committee and the Producing Underwriters have engaged in negotiations about the scope of that discovery, and that the Producing Underwriters have recently started providing materials to the Creditors' Committee. These documents are being produced pursuant to a strict confidentiality order that bars access to Lead Plaintiffs. Notably, the Bankruptcy Court has entered a confidentiality order that cites the PSLRA discovery stay as a

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[5] *See* Memorandum of Law in Support of the Underwriter Defendants' Motion to Withdraw the Reference, etc., dated Mar. 9, 2006 ("Underwriters' Br.") at 3 (a copy of which is attached as Exhibit 4 to the Sabella Decl.)

basis for prohibiting Lead Plaintiffs from accessing the material being produced by the Producing Underwriters. Specifically, a May 2, 2005 order in the Bankruptcy Court states:

> In particular, any party may apply to the Court for a modification of this Order after such time as the automatic stay of discovery pursuant to the Private Securities Litigation Reform Act ("PSLRA") no longer applies in any of the Refco-related securities litigations pending before the Honorable Gerard E. Lynch in the United States District Court for the Southern District of New York.

See Sabella Decl. Ex. 10 ¶ 9.

In short, at least twenty-three defendants named in this Action have already produced critical documents to the Creditors' Committee, which is presumably preparing to take whatever action those documents suggest is necessary to vindicate the Committee's interests.

D. The *Ad Hoc* Committee's Investigation

The *Ad Hoc* Committee has also obtained extensive document production from Refco. On or about February 2, 2006, the *Ad Hoc* Committee moved to obtain discovery from Refco. Sabella Decl. Ex. 11. The stated reason for this discovery request was to allow the *Ad Hoc* Committee "to determine the rights of the various creditors and parties in interest in these cases." *Id.* ¶ 2. On May 5, 2006, the Bankruptcy Court issued an order granting the *Ad Hoc* Committee's request. The order requires Refco to produce documents to the *Ad Hoc* Committee and to respond to discovery requests within fourteen days of service. Sabella Decl. Ex. 12. The order also provides that these materials can be provided to and reviewed by the *Ad Hoc* Committee's professional advisors at Stroock & Stroock & Lavan LLP and Mesirow Financial Consulting. *Id.* ¶ 4.

E. Internal Investigations Into Refco's Implosion

In addition to the external scrutiny being directed at the Company and others involved in its demise, Refco has begun its own investigation into the circumstances surrounding its

collapse. In fact, Refco's October 10, 2005 announcement stated that it was an "internal investigation" that uncovered the Bennett receivable in the first place. Once this "receivable" was discovered, the Company immediately launched its own investigation into the matter. On October 13, 2005, Refco announced that it had retained former SEC Chairman Arthur Levitt and former U.S. Comptroller of the Currency Eugene Ludwig as special advisors to its board of directors (Levitt soon thereafter withdrew from this position). Further, Refco announced that it had retained Goldman Sachs & Co. ("Goldman Sachs") as its financial advisor in connection with its internal investigation into the Company's collapse. Upon information and belief, the Company will provide Ludwig and Goldman Sachs (which is a defendant in the Action) unfettered access to its books, records and computer systems in connection with their ongoing investigation into the Company's fraud.

F. Related Litigation Not Subject to a Stay of Discovery

Documents relating to the Company's implosion are changing hands not only in connection with the external and internal investigations discussed above, but in the numerous actions pending against Refco and the parties named as defendants in this action to which the stay of discovery mandated by the PSLRA does not apply. *See, e.g., American Financial International Group-Asia, LLC v. Refco, Inc.*, No. 05 Civ. 8988 (class action brought on behalf of customers of Refco F/X Associates, LLC who maintained currency trading accounts with the Company); *Thomas H. Lee Equity Fund v. Bennett,* No. 05 Civ. 9608 (seeking to recover, *inter alia*, damages caused by THL Partners' initial $500 million investment in the Company); *Bankruptcy Trust of Gerard Sillam v. Refco Group LLC,* No. 05 Civ. 10072 (action by bankruptcy trust relating to Sillam's dealing with Refco throughout late 1990s); *BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft v. Refco*

Inc, *et al*, Adv pro No 05-03161 (RDD) (adversary proceeding in Refco bankruptcy proceeding wherein Creditors' Committee has asserted counterclaims against BAWAG). Accordingly, other parties seeking recovery for damages caused by Refco's fraud have access (or will soon have access) to documents relevant to their claims.

EFFORTS TO OBTAIN VOLUNTARY DOCUMENT PRODUCTION

At the conference on February 3, 2006, Lead Plaintiffs' counsel indicated that Lead Plaintiffs intended to move for a limited modification of the PSLRA stay of discovery. *See* Sabella Dec Ex 1 at 17 The Court responded that it appeared to make sense for some document discovery to move forward and it suggested that the parties attempt to work out a reasonable program for document production *Id* at 20-21

Lead Plaintiffs' counsel thereupon contacted counsel for several defendants and also for Refco in an attempt to see if an agreement as to document production could be worked out. The details of these contacts are set forth in the Sabella Declaration Unfortunately, no agreement has been reached. Sabella Decl. ¶¶ 4-6

ARGUMENT

I. THE PSLRA DISCOVERY STAY SHOULD BE LIFTED TO PERMIT DISCOVERY OF DOCUMENTS THAT THE PRODUCING PARTIES HAVE ALREADY PRODUCED, OR THAT THEY WILL PRODUCE IN THE FUTURE, TO AVERT FURTHER PREJUDICE TO THE CLASS

The PSLRA provides that, despite the presumptive stay of discovery, "particularized discovery [may be had where] necessary . . to prevent undue prejudice to [the moving] party." 15 U S C § 78u-4(b)(3)(B) Courts often lift the stay where, as here, as the relief requested relates to documents already produced in connection with pending investigations or related litigation to prevent undue prejudice. *See, e g., In re LaBranche Sec Litig*, 333 F Supp 2d 178, 181 (S D N Y. 2004) (lifting stay as to documents produced in investigations by SEC and New

York Stock Exchange); *In re Royal Ahold N V Sec & ERISA Litig*, 220 F R D 246, 249 (D Md 2004) (lifting stay as to documents produced in internal and external investigations of foreign defendant); *In re Tyco Int'l, Ltd Multidistrict Litig*, MDL No 02-1335-B, 2003 WL 23830479, at *4 (D N H Jan 29, 2003) (lifting stay as to documents produced in related actions not subject to PSLRA stay); *WorldCom*, 234 F Supp 2d at 305 (lifting stay as to documents produced to, among others, SEC, U S Attorney and law firm conducting internal investigation)

Indeed, in *WorldCom*, Judge Cote lifted the stay for the precise reason that the lead plaintiff in that case "would essentially be the only major interested party in the criminal and civil proceedings without access to documents that currently form the core of those proceedings" 234 F Supp 2d at 305 Notably, in *WorldCom* the prejudice to the class was less tangible than that inflicted here because, as discussed above, unlike *WorldCom*, certain interested parties have apparently already exploited the yawning information gap to extract a significant settlement from a financially-strapped defendant – BAWAG

Further, the courts have recognized the need to lift the PSLRA stay not only as to documents already produced but also as to documents that will be produced in the future *See, e g, Tyco*, 2003 WL 23830479, at *4 (lifting stay as to documents to be produced in related ERISA and derivative lawsuits); *WorldCom*, 234 F Supp 2d at 305 (lifting stay as to documents likely to be produced to plaintiffs in related ERISA action); *Royal Ahold*, 220 F R D at 252 (requiring production of documents that will be produced in other litigation)

This Court has acknowledged that insisting on strict enforcement of the stay of discovery given the particular circumstances of this Action may not be appropriate During the February 3, 2006 hearing on the lead plaintiff motions, the Court appeared skeptical that strict enforcement

of the PSLRA stay was practical where, as here, "there are other actions [pending relating to Refco's implosion] that are not subject to the stay."[6] Among other things, the Court stated:

> I don't see off the bat a reason why people who aren't subject to the stay should have their clients sitting on the back burner just because there are other claims that other people have that aren't having discovery proceed. And if there is going to be discovery in other matters, it might make sense to—and that will be a factor bearing in on the stake. It gets a little ridiculous if we are having discovery going forward on essentially the same things and I can't imagine that there is some rule. I don't know whether the other plaintiffs would share anything but I don't know anything that would prevent them from doing so. So it may be a little silly to insist on the stay.

Tr. at 18 (emphasis added).

The Court also indicated that lifting the stay in the Action as to documents already produced (or that will be produced) would further Congressional intent without imposing unreasonable burdens on the Producing Parties:

> But if you look at it realistically, there is this matter of attorneys' fees, you know, and if the plaintiffs have to be generating a lot of paper just to get discovery started when discovery really should start, if there is a lot of this material which has probably been already produced by defendants to different government agencies, and so it seems to me from my experience in these cases . . . the purpose of Congress can well be served by avoiding flatout full discovery while we decide what claims survive while at the same time helping the litigation get started by relatively inexpensive duplication of discovery that has really already been gathered and made in different investigations

Tr. at 20 (emphasis added).

Indeed, cognizant that courts have frequently modified the PSLRA stay so as to permit production of documents already produced to regulators and other investigators, the Underwriters stated in their motion to withdraw the reference that

> to permit certain documentary discovery to begin while at the same time preserving the substantial protections of the PSLRA stay, the Underwriter Defendants are prepared to make available to both the Committee and the

[6] *See* Transcript of Hearing on February 3, 2006 ("Tr.") (a copy of which is Sabella Decl. Exh. 1) at 17.

> plaintiffs in the securities class actions, on a coordinated basis, the voluminous documents already produced by the Underwriter Defendants to government agencies in Refco-related investigations (the"Regulatory Documents"). The Underwriter Defendants are prepared to begin producing these documents, on a rolling basis and under a reasonable timeframe, once the consolidated amended complaint is filed in the consolidated securities litigation.

Sabella Decl Ex. 4 at 10-11 (emphasis added). The foregoing also extinguishes any claim that producing documents to Lead Plaintiffs somehow gives rise to undue cost or burden on the Underwriters

Lead Plaintiffs satisfy the requirements for lifting the PSLRA stay in this action because they seek a particularized set of materials and can show that, without access to these documents, they have been, and will continue to be, prejudiced in their efforts to formulate an informed litigation strategy amid other ongoing (and in some instances, competing) investigations and litigation

A. Lead Plaintiffs Will Be Unduly Prejudiced in Prosecuting The Class' Case If Discovery Is Not Allowed

Lifting the stay of discovery for the limited purposes sought herein will prevent Lead Plaintiffs from suffering undue prejudice. "Undue prejudice requires a showing of improper or unfair detriment that need not reach the level of irreparable harm." *In re Lernout & Hauspie Sec Litig*, 214 F. Supp. 2d 100, 107 (D. Mass. 2002). Without access to the documents sought, Lead Plaintiffs will be unduly hampered in their preparation of their case and their advocacy on behalf of the Class because plaintiffs in other actions, and government regulators, will be able to present and refine their positions and weigh the strengths and weaknesses of their claims based on documents that Lead Plaintiffs will undoubtedly be able to scrutinize at some point but, absent the relief requested here, not now.

The prejudice to Lead Plaintiffs is well-illustrated by recent developments in the Bankruptcy Court. As noted above, the Creditors' Committee and other interested parties have

enjoyed extensive discovery in the Bankruptcy Court, discovery from which Lead Plaintiffs have been specifically excluded And, as described at pp. 8-11 above, the Creditors' Committee has reportedly exploited this advantage to secure a deal with BAWAG that, together with a parallel settlement with the U.S Attorney, will reportedly exhaust BAWAG's ability to pay to resolve the Class' claims in this Action

These are precisely the sort of circumstances that courts have held constitutes prejudice to a plaintiff's litigation and settlement strategy sufficient to justify modifying the PSLRA stay. *See, e g , LaBranche*, 333 F Supp 2d at 183 (lifting stay because "Lead Plaintiffs will be the only interested party without access to those documents and will be prejudiced by their inability to make informed decisions about their litigation strategy"); *WorldCom*, 234 F Supp. 2d at 305 ("Without access to documents already made available to the U S Attorney, the SEC, and in whole or in part to the WorldCom's Creditors' Committee and the documents that will in all likelihood soon be in the hands of the ERISA plaintiffs, [lead plaintiff] would be prejudiced by its inability to make informed decisions about its litigation strategy in a rapidly shifting landscape"); *Royal Ahold*, 220 F R D at 252 (lifting stay and requiring production by defendant because without access to those documents the securities plaintiffs could suffer a "severe disadvantage in formulating their litigation and settlement strategy," particularly if the parties proceeded quickly to settlement negotiations, as the court had urged them to do)

As the other interested parties pursue relatively unhindered discovery in numerous external and internal investigations, as well as in criminal and civil proceedings, Lead Plaintiffs are deprived of information that is essential to protect their interests in a "rapidly shifting landscape." *WorldCom*, 234 F Supp 2d at 305. Accordingly, to avert further prejudice, the

Court should lift the stay as to documents already produced (or to be produced) by the Producing Parties to level the playing field.

B. Lead Plaintiffs' Requests Are Particularized

Lead Plaintiffs seek a limited set of documents, production of which will not be burdensome. To satisfy the PSLRA's particularity requirement, "[plaintiffs] must adequately specify the target of the requested discovery and the types of information needed." *Lernout & Hauspie*, 214 F. Supp. 2d at 108. Here, Lead Plaintiffs seek discovery of documents already produced, or that will be produced, in connection with governmental and internal investigations or in criminal or civil lawsuits relating to the same core of operative facts. These categories of documents are sufficiently narrow. *See, e.g., Royal Ahold*, 220 F.R.D. at 250 (stating that documents "produced in connection with internal and external investigations . . . describes a 'clearly defined universe of documents'" in assessing whether the requests are particularized) (internal citations omitted); *see also WorldCom*, 234 F. Supp. 2d at 306 (finding request for documents already produced in other identified proceedings is "particularized" for purposes of lifting PSLRA stay).

The mere fact that the documents Lead Plaintiffs seek may be voluminous does not defeat a finding that their requests are particularized. In *Royal Ahold*, the court rejected an argument that the plaintiffs' request was "not particularized" because their motion called for production of a voluminous amount of documents, noting:

> The defendants counter that a request as large as the plaintiffs' – Royal Ahold estimates the volume at one million pages – cannot qualify under the statute; a set of documents is not 'particularized,' they argue, simply because it is 'identifiable.' Yet if 'particularized' is not synonymous with 'identifiable,' neither does it necessarily mean 'small.'

220 F.R.D. at 250 (internal citations omitted). Here, the Producing Parties should be readily able to identify those documents that they have produced (or will produce) to third parties and other litigants in connection with Refco-related matters.

Moreover, the burden on the Producing Parties with respect to documents they have already compiled, organized, reviewed and produced, or those that they will produce in investigations or other lawsuits, is slight. *See, e.g., Singer v. Nicor, Inc.*, No. 02 C 5168, 2003 WL 22013905, at *2 (N.D. Ill. Apr. 23, 2003) ("such a production would not place an undue burden on the defendants, since they had already reviewed and compiled the documents when they produced them to the other agencies"); *Royal Ahold*, 220 F.R.D. at 253 ("the burden of production on the defendants should be relatively slight in this case because the requested materials have been produced already to other parties"); *In re Enron Corp. Sec., Derivative & ERISA Litig.*, Civ. No. H-01-3624, 2002 WL 31845114, at *2 (S.D. Tex. Aug. 16, 2002) ("Lead Plaintiff argues that here the burden would be slight because Enron has already found, reviewed, and organized the documents. The Court agrees. In a sense this discovery has already been made and it is merely a question of keeping it from a party because of the strictures of a statute designed to prevent discovery abuse.") Any incidental burden will be further reduced by the fact that Lead Plaintiffs are willing to pay the reasonable costs of copying the materials to be produced. *See, e.g., LaBranche*, 333 F. Supp. 2d at 183 (offer to pay costs of production lessens any burden on producing party).

II. THE PSLRA DISCOVERY STAY SHOULD BE LIFTED TO PERMIT LEAD PLAINTIFFS TO SERVE SUBPOENAS ON NON-PARTIES TO ENSURE THE PRESERVATION OF EVIDENCE

The Court should also lift the stay on a limited basis to permit Lead Plaintiffs to serve on certain non-parties subpoenas directing the preservation of documents.

The PSLRA provides that, despite the presumptive stay of discovery, "particularized discovery [may be had where] necessary to preserve evidence." 15 U.S.C. § 78u-4(b)(3)(B). In recognition of the fact that "the imposition of a stay of discovery may increase the likelihood that relevant evidence may be lost," Congress enacted Section 78u-4(b)(3)(C) of the PSLRA. Senate Report No. 104-98, 104th Congress, *reprinted in* 1995 U.S.C.C.A.N. 679, 693 (1995). Section 78u-4(b)(3)(C) provides:

> During the pendency of any stay of discovery pursuant to [the PSLRA], unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure

15 U.S.C. § 87u-4(b)(3)(C). The courts have recognized that permitting plaintiffs to serve subpoenas directing third parties to preserve evidence "further[s] Congress' intent by subjecting relevant evidence to a 'stay put' directive whether in the hands of the parties, or in those of third parties . . ." *In re Grand Casinos, Inc. Sec. Litig.*, 988 F. Supp. 1270, 1272 (D. Minn. 1997). In *Grand Casinos*, plaintiffs requested that the court lift the PSLRA stay "solely for the limited purpose of allowing them to serve [s]ubpoenas *duces tecum* upon certain third parties." *Id.* The plaintiffs in *Grand Casinos* expressly represented that they would not seek to enforce the subpoenas but, rather, desired to "place the third-persons on notice that [their] action exist[ed], and to impose an affirmative duty on those persons to preserve the sought-after evidence until a ruling on Defendants' Motion to Dismiss." *Id.* Finding that the issuance of such subpoenas would further Congress' interest in ensuring the preservation of all relevant documents, the court

granted plaintiffs leave to serve subpoenas on third-parties [7] *See also Gervis v. Berg*, No. 00-CV-3362, 2005 WL 3299436, at *3 (E.D.N.Y. Nov. 29, 2005) (lifting PSLRA stay to permit plaintiffs to serve subpoena on third party directing it to preserve documents)

Lead Plaintiffs should be permitted to serve subpoenas on non-parties (including prospective defendants in this Action) directing them to preserve documents relating to the fraud at Refco. The service of such subpoenas is particularly necessary where, as here, Lead Plaintiffs allege that Refco and others engaged in fraud, in part, to cover up customer trading losses incurred during the late 1990s. Because "the ordinary document retention policies of some companies might well result in the destruction of relevant files in the ordinary course of business," Lead Plaintiffs should be permitted to serve subpoenas requiring parties believed to have relevant information to preserve such documents. *Grand Casinos*, 988 F. Supp. at 1272.

[7] The court in *Grand Casinos* noted that it "need not reach a decision on whether Plaintiffs should be allowed to enforce the Subpoenas, during the course of the stay, as that issue [was] not before [it] in view of the Plaintiffs' express representation that such an enforcement would not be effected." *Id.* at 1273 n.1

CONCLUSION

For the foregoing reasons, the PSLRA's discovery stay should be modified as set forth herein.

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Respectfully submitted,

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