UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

LEAD PLAINTIFFS' REPLY TO THE UNDERWRITER DEFENDANTS' AND GRANT THORNTON LLP'S OBJECTIONS TO LEAD PLAINTIFFS' AMENDED MOTION FOR PRELIMINARY APPROVAL OF THE PROPOSED SETTLEMENT WITH BAWAG

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Lead Plaintiffs respectfully submit this reply to the objections of the Underwriter Defendants[1] and Grant Thornton LLP ("Grant Thornton") (collectively, "Defendants") to Lead Plaintiffs' amended motion for preliminary approval of the settlement with Defendant BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft ("BAWAG").[2]

PRELIMINARY STATEMENT

When the BAWAG settlement agreement was originally presented to the Court for preliminary approval, Defendants objected to the fact that the agreement did not contain a "complete contribution" bar order and a specific provision for judgment reduction, arguing that "the PSLRA Requires a Judgment Reduction Clause."[3] Among other things, Defendants argued that the agreement needed to contain a judgment reduction provision that "'specif[ies] how that full and sufficient compensation [for loss of contribution rights] will be calculated.'"[4] When the Court suggested that the judgment reduction "calculation" could be left for a later day, the Underwriter Defendants disagreed, arguing: "[W]e are asking the court to set the formula for

[1] The "Underwriter Defendants" are Credit Suisse Securities (USA) LLC (formerly Credit Suisse First Boston LLC), Goldman, Sachs & co., Banc of America Securities LLC, Merrill Lynch, Pierce, Fenner & smith Incorporated, Deutsche Bank Securities Inc., J.P. Morgan Securities Inc., Sandler O'Neill & Partners, L.P., HSBC Securities (USA) Inc., William Blair & Company, L.L.C., Harris Nesbitt corp., CMG Institutional Trading LLC, Samuel A. Ramirez & Company, Inc., Muriel Siebert & Co., Inc., The Williams Capital Group, L.P., and Utendahl Capital Partners, L.P.

[2] Grant Thornton LLP's Opposition to Lead Plaintiffs' Amended Motion for Approval of Partial Settlement with Defendant BAWAG is referred to as "GT Opp." The Underwriter Defendants' Memorandum of Law in Opposition to Lead Plaintiffs' Amended Motion for Preliminary Approval of Partial Settlement with Defendant BAWAG is referred to as "UW Opp."

[3] Grant Thornton LLP's Response to Lead Plaintiffs' Motion for (I) Preliminary Approval of Partial Settlement with Defendant BAWAG, (II) Preliminary Certification of Class for Purposes of Settlement, (III) Preliminary Approval of Form and Manner of Notice, and (IV) Scheduling of Final Approval Hearing, dated Sept. 25, 2006, at 3.

[4] The Underwriter Defendants' Memorandum of Law in Opposition to Lead Plaintiffs' Motion for Preliminary Approval of Partial Settlement with Defendant BAWAG, dated Oct. 5, 2006 ("UW Oct. 5 Opp."), at 4 (quoting *Denney v. Deutsche Bank, AG*, 443 F.3d 253, 274 (2d Cir. 2006)).

judgment reduction . . . and to tell us now in advance of discovery and in advance of trial preparation, what the formula is." Transcript of argument on Nov. 15, 2006 ("Tr."), at 16.

In their amended settlement agreement, Lead Plaintiffs and BAWAG have included a complete bar order (to which Defendants do not object) and a judgment reduction provision designed to track the requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA") in a case with claims arising under different laws (*i.e.*, claims pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934) and on behalf of different types of investors (*i.e.*, stock and bond purchasers, initial offering purchasers and secondary market purchasers). Unhappy with the judgment reduction provision, Defendants now purport to retreat from their prior positions and argue that the issue as to how judgment reduction should be calculated should be left for a later day. *See, e.g.*, GT Opp. at 5 ("While there may or may not be different injuries to different classes of plaintiffs, that is a determination for another day"); *id.* at 3 (issue whether damages under Securities Act § 11 and Exchange Act § 10(b) are common damages is one that "the Court need not address . . . in a vacuum today"); UW Opp. at 6 (the amended BAWAG agreement "attempts to prejudge questions about the commonality of damages that cannot be decided at this time"); *id.* at 12 ("the question of the commonality of damages is often left for determination at a later stage"). Yet, Defendants propose a judgment reduction provision that would give them a ***full*** credit for the ***amount*** paid by BAWAG to settle plaintiffs' various claims, regardless of how that settlement is subsequently allocated and whether damages are later held to be "common" or not. *See id.*, Exhibit A. As set forth below, this would guarantee an undeserved windfall for the non-settling Defendants.

Defendants have succeeded in delaying preliminary approval of the BAWAG settlement for months by insisting that the settlement include a specific judgment reduction provision. Now

that Lead Plaintiffs and BAWAG have included such a provision based on the PSLRA and subject to an allocation plan (which will require further review and approval from the Court before it is effective), the proposed settlement should receive preliminary approval from the Court. While Defendants argue that the proposed judgment reduction provision violates the PSLRA and the common law of this Circuit, these arguments are without merit. As discussed below, a similar judgment reduction provision was approved by Judge Cote in nearly identical circumstances in *WorldCom*, and the law of this Circuit explicitly recognizes that a judgment reduction should apply only to "common damages" – a concept that is wholly consistent with the PSLRA and the judgment reduction provision proposed by Lead Plaintiffs. In the alternative, as Lead Plaintiffs previously argued, the proposed settlement (as now amended with the complete contribution bar order) should receive preliminary approval without any specific judgment reduction clause, leaving issues as to application of the PSLRA and common law judgment reduction requirements for resolution at trial.

THE JUDGMENT REDUCTION PROVISION

On September 8, 2006, Lead Plaintiffs filed a motion for preliminary approval of the settlement with BAWAG. Grant Thornton and the Underwriter Defendants objected because the settlement did not include an express judgment reduction provision. The Underwriter Defendants also sought a "complete contribution" bar order. On November 15, 2006, the Court held a hearing on the proposed settlement and directed the parties to attempt to resolve the objections. Following the hearing, Lead Plaintiffs and BAWAG agreed to insert a Complete Contribution Bar Order and a judgment reduction provision into the settlement agreement. The judgment reduction provision provides that any final verdict against a non-settling defendant shall be reduced by:

> The greater of: (i) an amount that corresponds to the percentage of responsibility of the Settling Defendants for the damages awarded to the Class or Class member on the claim on which Judgment is entered against any of the Non-Settling Defendants; or (ii) the amount paid by or on behalf of the Settling Defendants to the Class that is allocated to the claim (pursuant to the Allocation Plan) on which Judgment is entered against any of the Non-Settling Defendants. The Allocation Plan shall be proposed by Lead Plaintiffs and subject to approval by the Court.

See Amended Judgment ¶ 11.6 (attached to November 28, 2006 letter from James J. Sabella).

This judgment reduction provision accounts for the fact that the Class has settled claims against BAWAG under both the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") on behalf of investors in Refco common stock and bonds, including those who purchased during the initial public offering of securities and, thereafter, in the open market. These claims are based on different statutory provisions, provide for different measures of damages, and compensate different class members for different types of harm. For instance, some class members have suffered damages under the Securities Act for the decline in the value of Refco stock from the price at which it was offered ($22) to the value of the stock at the end of the Class Period ($0.65). *See* 15 U.S.C. § 77k(e). Other class members have a separate measure of damages under the Exchange Act for the decline in the value of Refco stock from prices ***above*** the offering price (the stock traded as high as $28) down to the price at the offering price or lower. *Id.* Still other class members have suffered damages under the Securities Act or the Exchange Act for the decline in the value of Refco's bonds from their purchase price to their value at the end of the Class Period.

While some class members have suffered damages under both the Securities Act and the Exchange Act, Defendants such as the Underwriter Defendants who are sued only under the Securities Act could ***in no event*** be held responsible for damages that the Class might recover under the Exchange Act. It stands to reason that a Defendant who faces liability only under the

Securities Act should not receive a windfall judgment credit if the Class settles Exchange Act claims against another Defendant. As discussed below, such a result is contrary to long-established principles of law and would result in injustice to injured class members.

The proposed judgment reduction recognizes these issues and ensures that each non-settling Defendant will receive an appropriate judgment credit against the maximum amount of damages for which the non-settling Defendant could be held responsible based on the claims asserted against that Defendant. This ensures that Defendants will receive the protections to which they are entitled under the PSLRA and the common law of this Circuit, without prejudicing the Class by "double-counting" the BAWAG settlement to artificially reduce the Class' recoverable damages against non-settling Defendants.

ARGUMENT

I. THE JUDGMENT REDUCTION PROVISION IS CONSISTENT WITH THE PSLRA

Defendants contend that the proposed judgment reduction provision violates the "clear, mandatory language" of the PSLRA. UW Opp. at 7; *see also* GT Opp. at 2-3. This argument is without merit. The PSLRA requires that a settling defendant receive a judgment reduction that takes into account the settlement amount and the percentage of fault of the settling defendant – which the judgment reduction provision does. The PSLRA states:

> If a covered person enters into a settlement with the plaintiff prior to final verdict or judgment, the verdict or judgment shall be reduced by the greater of (i) an amount that corresponds to the percentage of responsibility of that covered person; or (ii) the amount paid to the plaintiff by that covered person.

15 U.S.C. § 78u-4(f)(7)(B). The PSLRA does not impose a requirement on the Court to insert any ***specific*** judgment reduction language into a final settlement order. Indeed, as the Court recognized at the November 15, 2006 hearing, the PSLRA does not require a court to include

any judgment reduction language in the final order approving a settlement. *See* Tr. at 14. Rather, the PSLRA sets forth two general requirements – the amount paid and the fault of the settling defendant – which are covered by the judgment reduction provision in the current settlement.

In support of their position, Defendants cite *In re WorldCom, Inc. Securities Litigation*, No. 02 Civ. 3288, 2005 WL 335201, at *10 (S.D.N.Y. Feb 14, 2005). In that case, Judge Cote rejected a proposed judgment reduction provision that ignored the two factors required by the PSLRA (the amount paid and the fault of the settling defendant) and purported to reduce the final judgment based on the financial wherewithal of the settling defendant. *See id.* at *15. Thus, the portion of the proposed judgment reduction provision rejected in *WorldCom* bears no relation to that proposed here.[5]

Moreover, as previously pointed out by Lead Plaintiffs, in an earlier settlement in *WorldCom*, Judge Cote approved a judgment reduction provision that contained language nearly identical to that proposed here. *See In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288, 2004 WL 2591402, at *13-14 (S.D.N.Y. Nov. 12, 2004); *see also* Lead Plaintiffs' Reply dated October 5, 2006, at 4 (noting that the judgment reduction provision approved by Judge Cote in *WorldCom* reduced the non-settling underwriter defendants' liability by "the amount from the settlement fund that is allocated to the Securities Act claims for which the non-settling underwriters may be found liable"). In fact, the similarities between the judgment reduction provision approved in *WorldCom* and this case are striking. In this case, as in *WorldCom*, a lead

[5] Significantly, Judge Cote had no issue with the "claims-allocation" portion of the proposed judgment reduction in *WorldCom*, and only rejected the provision because of its reduction based on the financial wherewithal of the settling defendant. *See id.* at *5 (proposed judgment provided that judgment would be reduced by the amount paid "as allocated to claims for which contribution would be sought"). Indeed, the parties were permitted to revive the settlement without the financial wherewithal component of the judgment reduction provision, but the lead plaintiff elected instead to exercise its option to cancel the settlement.

plaintiff has reached a settlement with a defendant who faced claims under both the Securities Act and the Exchange Act. *WorldCom,* 2004 WL 2591402, at *13-14. And, in this case, as in *WorldCom*, the non-settling defendants included, among others, a syndicate of underwriters (including many of the same banks here) who faced claims only under the Securities Act and an accounting firm facing claims under both the Securities Act and the Exchange Act. *Id.*[6]

The Underwriter Defendants attempt to justify their position by making a broad appeal to the PSLRA's legislative intent to deal with "abusive claims." *See* UW Opp. at 8 n.6. This argument has no place here; this case does not involve any "abusive claim." Notwithstanding the Underwriter Defendants' reflexive invocation of the PSLRA's "purpose," the PSLRA was not intended to allow non-settling defendants to invoke a post-trial judgment reduction to evade their fair share of liability for serious wrongdoing.[7]

Defendants also argue that "[t]he PSLRA makes no distinction in its judgment reduction provision for situations in which Lead Plaintiffs have chosen to bring different claims under different statutes . . . ." UW Opp. at 10. That argument, however, is premised on the misplaced

[6] Faced with these facts, Defendants make a few half-hearted and inconsistent attempts to distinguish *WorldCom*. The Underwriter Defendants argue that the Court was not asked to "rule" on the claims-allocation language in *WorldCom*. UW. Opp at 7 n.5. This argument of course ignores the fact that the claims allocation language was quoted in the *WorldCom* opinion. Grant Thornton, on the other hand, appears to argue that the Underwriter Defendants are sufficiently protected by their ability to object to the plan of allocation and the division of the settlement fund between the Securities Act and the Exchange Act (GT Opp. at 4, n.3) – a point with which Lead Plaintiffs wholeheartedly agree. Grant Thornton fails to recognize, however, that it will be provided the same opportunity as the Underwriter Defendants. In any event, because Grant Thornton faces claims under both the Securities Act and the Exchange Act, its ultimate liability will be reduced by the full amount of BAWAG's fault or the amount paid by BAWAG, no matter how the settlement is allocated.

[7] As they did in their prior submissions, the Underwriter Defendants also argue that the Court should adopt the language from the settlement agreement in *In re Global Crossing Ltd. Securities Litigation*, No. 02 Civ. 910 (S.D.N.Y.). *See* UW Br. at 6, 14. In making such argument, the Underwriter Defendants choose simply to ignore that when they previously urged this Court to adopt that language, the Court explained that the *Global Crossing* provision was merely language that the parties in that case had agreed on, not language that the Court had imposed. Tr. at 20 ("[T]hat agreement, of course, is not any kind of precedent; it is just what the parties agreed to in some other case."). In this light, the Underwriter Defendants' continued heavy reliance on the language from the *Global Crossing* agreement is misplaced.

notion that the PSLRA requires ***specific*** judgment reduction language for all final settlement orders, when it does not. Rather, as set forth above, the PSLRA sets forth two general requirements – the amount paid and the fault of the settling defendant – which are covered by the judgment reduction provision in the current settlement.

Perhaps recognizing that their argument is supported by neither case law nor misplaced appeals to the legislative intent of the PSLRA, the Underwriter Defendants next argue that it would be unfair for judgment reduction to turn on a plan of allocation, because the plan of allocation will "for all practical purposes" be determined "unilaterally" by Lead Plaintiffs. UW Opp. at 9. The Underwriter Defendants are wrong. Any plan of allocation must be approved by the Court. If the Underwriter Defendants believe that the plan of allocation ultimately proposed by Lead Plaintiffs unduly prejudices them, they will have the opportunity to raise that objection with the Court at that time – as did the underwriters in *WorldCom*. *See WorldCom*, 2004 WL 2591402, at *13-14. Thus, the Underwriter Defendants' conjecture that the plan of allocation will be heavily weighted toward Section 10(b) claims because they are "deep pocket" defendants – as opposed to an allocation based on a careful and fair assessment of the strength of the Exchange Act and Securities Act claims against BAWAG (UW Opp. at 9) is meritless and premature (and also ignores that such an allocation would necessarily reduce the value of the Class's claims against other Exchange Act Defendants such as Grant Thornton.)

II. THE JUDGMENT REDUCTION PROVISION COMPORTS WITH THE COMMON LAW OF THIS CIRCUIT

Defendants contend that the proposed judgment reduction provision is inconsistent with this Circuit's concept of "common damages." UW Opp. at 10; *see also* GT Opp. at 4.[8] Even

[8] While Defendants appear to now take the position that the proposed judgment reduction provision ***separately*** violates the PSLRA and the common law of this Circuit, the Underwriter Defendants previously argued that the PSLRA and the common law of this Circuit were ***identical***. *See* UW Oct. 5

Defendants are forced to concede, however, that the Court cannot determine now whether damages are "common" in this case. *See* GT Opp. at 5 (acknowledging that there may be "different injuries to different classes of plaintiffs, [but] that is a determination for another day"); UW Opp. at 12-13 ("the question of the commonality of damages" is "premature" and "can be left for determination at a later stage").

Despite this concession, Defendants somewhat inconsistently cling to the notion that all damages suffered by class members in this case are common damages. In support, they rely on the Second Circuit's decisions in *Singer v. Olympia Brewing Co.*, 878 F.2d 596 (2d Cir. 1989) and *Gerber v. MTC Elec. Tech. Co. Ltd.*, 329 F.3d 297 (2d Cir. 2003). Broadly speaking, these cases stand for the proposition that non-settling defendants receive a dollar-for-dollar judgment reduction for settlement amounts paid for common damages arising out of a single injury. From this, Defendants argue that all members of the class have suffered a "single injury" – "damages due to the drop in the value of Refco securities" – and therefore all of the Class's damages are common damages. UW Opp. at 11. This argument does not withstand scrutiny.

To begin with, Defendants' position does not comport with the facts of the case. In this case, damages are "common" neither among class members nor defendants. First, as discussed above, some class members have suffered damages under the Securities Act for their purchases of Refco stock, and other class members only for their purchases of Refco bonds. Other class members have damages only under the Exchange Act for their purchases of Refco stock or bonds. Thus, for instance, a class member who has been damaged solely under the Exchange Act as a result of her purchase of Refco bonds does not have "common" damages with a class member who has been damaged under the Securities Act for purchases of Refco stock. Second,

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Opp. at 5-6 (stating that PSLRA rule "is, in effect, the same capped proportionate share rule approved by the Second Circuit in *Gerber*").

the damages between defendants are not "common" either. For instance, the Underwriter Defendants share ***no*** responsibility for the Exchange Act damages the Class is seeking from Grant Thornton (and was, prior to the settlement, seeking from BAWAG). While some class members may have been damaged under both the Securities Act and the Exchange Act, those damages are calculated differently and, in any event, to the extent Lead Plaintiffs achieve any settlements with defendants such as BAWAG (responsible for both Exchange Act and Securities Act violations) any proposed allocation of such settlements will be subject to Court scrutiny and potential objections by non-settling Defendants prior to Court approval. In addition, the Court will have the ability to ensure that the Class, in the aggregate, does not receive more than 100% of its damages after trial.

Thus, there is no merit to Defendants' argument that the proposed judgment reduction provision would somehow permit class members to recover ***twice*** for the same injury. UW Opp. at 11-12; GT Opp. at 4. The "one satisfaction" rule cited by Defendants prevents plaintiffs from recovering more than 100% of their potential damages. This rule ensures that a plaintiff with $100 of aggregate damages in a case against two defendants cannot settle with Defendant A for $50 and then recover $100 at trial against Defendant B for a total recovery of $150. Nothing in the proposed judgment reduction provision violates this rule. Lead Plaintiffs are not seeking to use the existence of multiple claims to achieve a recovery that is greater than total damages. In addition, the Court will be able to ensure this result after any trial. By contrast, Defendants' proposed judgment reduction formula ***guarantees*** that the Class will be unable to recover full damages at trial because (as set forth above) it grants non-settling Defendants who face liability only under the Securities Act a windfall judgment credit for settlements of Exchange Act claims against other Defendants.

While the Underwriter Defendants assert that "the cases in this Circuit uniformly discuss the requirement of common damages, not common claims" (UW Opp. at 11 n.10), this is not correct. In *Singer*, the Second Circuit held that any judgment reduction must be "deducted from the ***claim*** or judgment in the litigated case, and not from the ***potential claim*** or judgment in the settled case." 878 F.2d at 601 (emphasis added). In *In re Masters Mates & Pilots Pension Plan & IRAP Litig.*, 957 F.2d 1020, 1030 (2d Cir. 1992), the Circuit reiterated this rule, explaining that *Singer* held "the settlement must be deducted from the ***claim*** or judgment in the litigated case." (quoting *Singer*, 878 F.2d 600-01 (emphasis added)). As the Underwriter Defendants themselves previously acknowledged, one of the "general principles" articulated by *Masters Mates* is that "a court should not approve a settlement bar that grants a nonsettling defendant a judgment reduction less than the amount paid by settling defendants ***toward damages for which the nonsettling defendant would be jointly and severally liable.***" UW Oct. 5 Opp. at 4 (quoting *Masters Mates*, 957 F.2d at 1031 (emphasis added)). Similarly, in *Gerber*, the Second Circuit approved a judgment reduction provision entered by the district court that expressly allocated settlement amounts to various elements of "damages." *Gerber*, 329 F.3d at 304 (allocating settlement amount among "prejudgment interest," "out-of-pocket" damages, and "attorneys' fees."). Thus, the common law of this Circuit does not prohibit the judgment reduction provision contained in the amended BAWAG settlement.

III. IF THE COURT DECLINES TO ENTER THE JUDGMENT REDUCTION PROVISION, THE SETTLEMENT SHOULD BE APPROVED WITHOUT ANY EXPRESS JUDGMENT REDUCTION PROVISION

As discussed above, the initial settlement between BAWAG and Lead Plaintiffs did not include any express judgment reduction provision. Indeed, Lead Plaintiffs advocated that it would be "premature at this stage of the litigation to attempt to provide 'specificity' as to how the judgment reduction formula would be applied, particularly since no plan of allocation for the

BAWAG settlement monies has yet been determined."[9] At the hearing on November 15, the Court expressed considerable agreement with that position, stating:

> [I]t is premature, is it not, to try to decide today what the extent or nature of a judgment credit would be.
>
> The judgment credit as a matter of law is what the PSLRA says it is. There is no requirement in the PSLRA that these guys provide in their settlement agreement for what judgment credit you are going to get.

Tr. at 14.

Lead Plaintiffs believe that the judgment reduction in the amended settlement provides an appropriate balance between Defendants' insistence that the settlement include express judgment reduction language and the fact that the ***amount*** of the credit cannot be determined at this point in time. However, if the Court were inclined not to approve the judgment reduction provision, Lead Plaintiffs respectfully submit that the amended BAWAG settlement should be approved without any explicit judgment reduction provision, rather any final judgment shall be reduced at trial in accordance with the PSLRA and the common law to the extent applicable and all such issues should be left for a later stage in the litigation. *See Gerber*, 329 F.3d at 305 ("The non-settling defendants know that they will get a credit amounting to the greater of (1) the settlement attributed to common damages, or (2) the settling defendants' proportionate share of the total damages. They therefore know that the settling defendants' wrongdoing is relevant, and can develop their trial strategy accordingly. We find no error in the district court's decision to leave the determination of the actual amount of the judgment credit for calculation at trial because the

[9] Lead Plaintiffs' Reply to Grant Thornton LLP's Response to Lead Plaintiffs' Motion for Preliminary Approval of the Proposed Settlement with BAWAG, dated Oct. 5, 2006, at 2.

non-settling defendants will get the full settlement amount as a credit, unless the settlement damages are not common, an issue which is obviously contingent on the outcome of the trial.").[10]

CONCLUSION

For all of the foregoing reasons, Defendants' objections to the amended BAWAG settlement should be denied and preliminary approval of the proposed BAWAG settlement should be granted.

Dated: New York, New York
January 5, 2006

Respectfully submitted,

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[10] Importantly, the Underwriter Defendants' proposed judgment reduction language (UW Opp., Exhibit A) is ***not*** acceptable to Lead Plaintiffs. While the Underwriter Defendants argue that a judgment reduction must adhere to the PSLRA's "clear, mandatory language" and incorporate the concept of "common damages" (*id.* at 7, 11), the Contribution Bar Order they propose does neither. *See id.* Exhibit A (purporting to give non-settling defendants a judgment credit equal to the ***total*** amount paid by BAWAG to the Class, and failing to account for the concept of "common damages").