

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

**LEAD PLAINTIFFS' MEMORANDUM OF LAW IN
OPPOSITION TO THE MOTION TO DISMISS OF
JOSEPH P. COLLINS AND MAYER BROWN LLP**

GRANT & EISENHOFER P.A.

Stuart M. Grant (SG-8157)
James J. Sabella (JS-5454)
Jonathan D. Margolis (JM-1128)
485 Lexington Avenue, 29th Floor
New York, NY 10017
Telephone: (646) 722-8500
Facsimile: (646) 722-8501

- and -

Megan D. McIntyre
Christine M. Mackintosh
Chase Manhattan Centre
1201 North Market Street
Wilmington, DE 19801
Telephone: (302) 622-7000
Facsimile: (302) 622-7100

*Attorneys for Lead Plaintiff Pacific Investment
Management Company LLC and Co-Lead
Counsel for the Putative Class*

**BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP**

Max W. Berger (MB-5010)
John P. Coffey (JC-3832)
Salvatore J. Graziano (SG-6854)
John C. Browne (JB-0391)
Elliott J. Weiss (EW-9833)
Jai K. Chandrasekhar (JC-3789)
Jeremy P. Robinson
David Webber (DW-3876)
1285 Avenue of the Americas
New York, NY 10019
Telephone: (212) 554-1400
Facsimile: (212) 554-1444

*Attorneys for Lead Plaintiff RH Capital
Associates LLC and Co-Lead Counsel for
the Putative Class*

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES	iii
PRELIMINARY STATEMENT	1
STATEMENT OF FACTS	3
A. Refco, Collins and Mayer Brown	3
B. The Fraud	3
C. Defendants’ Active Participation in the Fraud.....	4
D. Defendants Drafted Fraudulent Statements That Refco Used to Issue Securities to Public Investors.....	8
E. Collins Is Indicted by a Federal Grand Jury on Eleven Felony Counts, Including Violations of Rule 10b-5(a), (b) & (c)	11
ARGUMENT	13
I. THE COMPLAINT ALLEGES THAT DEFENDANTS MADE FALSE AND MISLEADING STATEMENTS, THEREBY SATISFYING RULE 10b-5(b)	13
A. The Statements Made by Collins and Mayer Brown	13
B. The Complaint Adequately Alleges That the Mayer Brown Defendants Made False and Misleading Statements	14
II. THE COMPLAINT STATES A CLAIM AGAINST THE MAYER BROWN DEFENDANTS UNDER RULE 10b-5(a) AND (c)	21
A. Plaintiffs’ Scheme Liability Claims Against the Mayer Brown Defendants Comport With <i>Stoneridge</i>	21
1. The Fraud Here Occurred in the Investment Sphere	22
2. Defendants Had Direct Control Over the Company’s Misleading Communications to Investors	23
3. Investors Relied on Defendants’ Fraudulent Conduct	24
B. Plaintiffs Allege Conduct by Defendants That Violates Rule 10b- 5(a) and (c).....	25

III.	THE COMPLAINT GIVES RISE TO A STRONG INFERENCE OF DEFENDANTS’ SCIENTER	30
A.	Plaintiffs’ Well-Pleaded Factual Allegations of Conscious Misbehavior and Recklessness Create an Inference of Scienter That Is Cogent and at Least as Compelling as Any Competing Inference	33
1.	Defendants’ Involvement in the Round-Trip Loan Transactions Gives Rise to an Inference of Scienter That Is at Least as Plausible as Any Other Inference.....	34
2.	Defendants’ Role in Concealing Niederhoffer’s Losses Gives Rise to an Inference of Scienter at Least as Plausible as Any Other Inference	36
B.	Plaintiffs’ Well-Pleaded Factual Allegations of Motive and Opportunity Create an Inference of Scienter That Is Cogent and at Least as Compelling as Any Competing Inference.....	38
IV.	THE COMPLAINT ADEQUATELY ALLEGES RELIANCE.....	39
A.	The Complaint’s Detailed Allegations of Reliance	39
B.	The Applicable Pleading Standards	41
C.	Plaintiffs Are Entitled to a Presumption of Reliance at This Stage of the Litigation.....	42
V.	THE COMPLAINT STATES A CLAIM AGAINST MAYER BROWN FOR CONTROL PERSON LIABILITY.....	46
	CONCLUSION.....	49

TABLE OF AUTHORITIES

	<u>Page</u>
<u>CASES</u>	
<i>Abell v. Potomac Ins. Co.</i> , 858 F.2d 1104 (5th Cir. 1988)	44
<i>Affiliated Ute Citizens of Utah v. United States</i> , 406 U.S. 128 (1972).....	42, 43
<i>In re Alstom SA Sec. Litig.</i> , 406 F. Supp. 2d 433 (S.D.N.Y. 2005).....	19
<i>B.T. Produce Co. v. Robert A. Johnson Sales, Inc.</i> , 354 F. Supp. 2d 284 (S.D.N.Y. 2004).....	4
<i>Basic Inc. v. Levinson</i> , 485 U.S. 224 (1988).....	45
<i>Bell Atlantic Corp. v. Twombly</i> , 127 S. Ct. 1955 (2007).....	41
<i>In re Blech Sec. Litig.</i> , No. 94 Civ. 7696 (RWS), 2002 U.S. Dist. LEXIS 19835 (S.D.N.Y. Oct. 22, 2002).....	48
<i>Cammer v. Bloom</i> , 711 F. Supp. 1264 (D.N.J. 1989)	41, 45
<i>In re Carter-Wallace Sec. Litig.</i> , 220 F.3d 36 (2d Cir. 2000).....	30
<i>Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.</i> , 511 U.S. 164 (1994).....	16, 26, 27
<i>In re Charter Communications, Inc.</i> , 443 F.3d 987 (8th Cir. 2006), <i>aff'd sub nom. Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.</i> , No. 06-43, 2008 WL 123801 (Jan. 15, 2008).....	21, 22
<i>Compudyne Corp. v. Shane</i> , 453 F. Supp. 2d 807 (S.D.N.Y. 2006).....	47, 48
<i>Cromer Fin. Ltd. v. Berger</i> , 245 F. Supp. 2d 552 (S.D.N.Y. 2003).....	48
<i>Cromer Fin. Ltd. v. Berger</i> , No. 00 Civ. 2284 (DLC), 2001 U.S. Dist. LEXIS 14744 (S.D.N.Y. Sept. 20, 2001).....	41

<i>Dietrich v. Bauer</i> , 126 F. Supp. 2d 759 (S.D.N.Y. 2001).....	47, 48
<i>Dirks v. SEC</i> , 463 U.S. 646 (1983).....	16
<i>Eckstein v. Balcors Film Investors</i> , 8 F.3d 1121 (7th Cir. 1993)	43
<i>In re Flag Telecom Holdings, Ltd.</i> , 308 F. Supp. 2d 249 (S.D.N.Y. 2004).....	47, 48
<i>Freeman v. Laventhol & Horwath</i> , 915 F.2d 193 (6th Cir. 1990)	43, 44
<i>Gabriel Capital, L.P. v. NatWest Fin., Inc.</i> , 122 F. Supp. 2d 407 (S.D.N.Y. 2000).....	48
<i>Ganino v. Citizens Utils. Co.</i> , 228 F.3d 154 (2d Cir. 2000).....	30
<i>In re Global Crossing, Ltd. Sec. Litig.</i> , 322 F. Supp. 2d 319 (S.D.N.Y. 2004).....	<i>passim</i>
<i>In re Initial Pub. Offering Sec. Litig.</i> , 471 F.3d 24 (2d Cir. 2006).....	42, 46
<i>Iqbal v. Hasty</i> , 490 F.3d 143 (2d Cir. 2007).....	41
<i>Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co.</i> , 32 F.3d 697 (2d Cir. 1994).....	30
<i>Joseph v. Wiles</i> , 223 F.3d 1155 (10th Cir. 2000)	43
<i>Kassner v. 2nd Avenue Delicatessen, Inc.</i> , 496 F.3d 229 (2d Cir. 2007).....	41
<i>In re Kendall Square Research Corp. Sec. Litig.</i> , 868 F. Supp. 26 (D. Mass. 1994)	16
<i>In re LaBranche Sec. Litig.</i> , 405 F. Supp. 2d 333 (S.D.N.Y. 2005).....	17, 19
<i>Lattanzio v. Deloitte & Touche LLP</i> , 476 F.3d 147 (2d Cir. 2007).....	16, 17

<i>Liberty Media Corp. v. Vivendi Universal, S.A. Sec. Litig.</i> , No. 02 Civ. 5571 (RJH), 2004 U.S. Dist. LEXIS 7015 (S.D.N.Y. Apr. 21, 2004).....	47
<i>Makor Issues & Rights, Ltd. v. Tellabs Inc.</i> , No. 04-1687, 2008 U.S. App. LEXIS 975 (7th Cir. Jan. 17, 2008).....	31, 32
<i>Menkes v. Stolt-Neilsen S.A.</i> , No. 03 Civ 409 (DJS), 2006 U.S. Dist. LEXIS 42644 (D. Conn. June 19, 2006).....	20
<i>Metzner v. D.H. Blair & Co.</i> , 689 F. Supp. 262 (S.D.N.Y. 1988).....	48
<i>Mishkin v. Ageloff</i> , No. 97 Civ. 2690 (LAP), 1998 WL 651065 (S.D.N.Y. Sept. 23, 1998).....	28
<i>Ockerman v. May Zima & Co.</i> , 27 F.3d 1151 (6th Cir. 1994)	43
<i>In re Openwave Sys. Sec. Litig.</i> , No. 07 Civ. 1309 (DLC), 2007 WL 3224584 (S.D.N.Y. Oct. 31, 2007).....	36
<i>In re Oxford Health Plans, Inc.</i> , 187 F.R.D. 133 (S.D.N.Y. 1999)	48
<i>In re Oxford Health Plans, Inc. Sec. Litig.</i> , 51 F. Supp. 2d 290 (S.D.N.Y. 1999).....	32
<i>In re Parmalat Sec. Litig.</i> , 375 F. Supp. 2d 278 (S.D.N.Y. 2005).....	47
<i>In re Parmalat Sec. Litig.</i> , 376 F. Supp. 2d 472 (S.D.N.Y. 2005).....	27, 30
<i>In re Parmalat Sec. Litig.</i> , 383 F. Supp. 2d 616 (S.D.N.Y. 2005).....	29
<i>Pension Comm. of Univ. of Montreal Pension Plan v. Banc of America Sec., LLC</i> , 446 F. Supp. 2d 163 (S.D.N.Y. 2006).....	20, 47
<i>In re Quintel Entm't Inc. Sec. Litig.</i> , 72 F. Supp. 2d 283 (S.D.N.Y. 1999).....	47
<i>In re Qwest Commc'ns Int'l, Inc.</i> , 396 F. Supp. 2d 1178 (D. Colo. 2004).....	38
<i>In re Refco Capital Markets, Ltd. Brokerage Customer Sec. Litig.</i> , No. 06 Civ. 643 (GEL), 2007 WL 2694469 (S.D.N.Y. Sept. 13, 2007).....	28, 29, 41

<i>In re Refco, Inc. Sec. Litig.</i> , 503 F. Supp. 2d 611 (S.D.N.Y. 2007).....	31, 34, 38, 48
<i>Rich v. Maidstone Fin., Inc.</i> , No. 98 Civ. 2569 (DAB), 2002 WL 31867724 (S.D.N.Y. Dec. 20, 2002).....	28
<i>In re Rospatch Sec. Litig.</i> , 760 F. Supp. 1239 (W.D. Mich. 1991)	38
<i>Ross v. Bank South, N.A.</i> , 885 F.2d 723 (11th Cir. 1989)	43
<i>Rothman v. Gregor</i> , 220 F.3d 81 (2d Cir. 2000).....	30
<i>In re Salomon Analyst AT&T Litig.</i> , 350 F. Supp. 2d 455 (S.D.N.Y. 2004).....	26
<i>In re Scholastic Corp. Sec. Litig.</i> , 252 F.3d 63 (2d Cir. 2001).....	15, 16, 17
<i>In re Search of Premises Known as 6455 South Yosemite</i> , 897 F.2d 1549 (10th Cir. 1990)	4
<i>SEC v. Collins & Aikman Corp.</i> , No. 07 Civ. 2419 (SAS), 2007 WL 4480025 (S.D.N.Y. Dec. 21, 2007).....	31
<i>SEC v. First Jersey Sec., Inc.</i> , 101 F.3d 1450 (2d Cir. 1996).....	27, 28
<i>SEC v. PIMCO Advisors Fund Mgmt. LLC</i> , 341 F. Supp. 2d 454 (S.D.N.Y. 2004).....	28
<i>SEC v. U.S. Environmental, Inc.</i> , 155 F.3d 107 (2d Cir. 1998).....	27, 28
<i>Seippel v. Sidley, Austin, Brown & Wood, LLP</i> , 399 F. Supp. 2d 283 (S.D.N.Y. 2005).....	17, 19
<i>Shapiro v. Cantor</i> , 123 F.3d 717 (2d Cir. 1997).....	15
<i>Shores v. Sklar</i> , 647 F.2d 462 (5th Cir. 1981).....	43
<i>Starr ex rel. Estate of Sampson v. Georgeson Shareholder, Inc.</i> , 412 F.3d 103 (2d Cir. 2005).....	43

<i>Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.</i> , No. 06-43, 2008 WL 123801 (Jan. 15, 2008)	<i>passim</i>
<i>Suez Equity Investors v. Toronto-Dominion Bank</i> , 250 F.3d 87 (2d Cir. 2001).....	16
<i>T.J. Raney & Sons, Inc. v. Fort Cobb, Oklahoma Irrigation Fuel Authority</i> , 717 F.2d 1330 (10th Cir. 1983)	43
<i>Teachers' Retirement System of Louisiana v. ACLN, Ltd.</i> , No. 01 Civ. 11814 (LAP), 2004 U.S. Dist. LEXIS 25927 (S.D.N.Y. Dec. 20, 2004)	19
<i>Tellabs, Inc. v. Makor Issues & Rights, Ltd.</i> , 127 S. Ct. 2499 (2007).....	4, 31, 35
<i>In re Van Der Moolen Holding N.V. Sec. Litig.</i> , 405 F. Supp. 2d 388 (S.D.N.Y. 2005).....	47
<i>In re Vivendi Universal S.A. Sec. Litig.</i> , No. 02 Civ. 5571 (HB), 2003 WL 22489764 (S.D.N.Y. Nov. 3, 2003).....	20
<i>Wiley v. Hughes Capital Corp.</i> , 746 F. Supp. 1264 (D.N.J. 1990)	44
<i>In re WorldCom, Inc. Sec. Litig.</i> , 294 F. Supp. 2d 392 (S.D.N.Y. 2003).....	47
<i>In re Worldcom, Inc. Sec. Litig.</i> , 352 F. Supp. 2d 472 (S.D.N.Y. 2005).....	32
<i>Wright v. Ernst & Young, LLP</i> , 152 F.3d 169 (2d Cir. 1998).....	<i>passim</i>

STATUTES AND RULES

Securities Exchange Act

§ 10(b).....	<i>passim</i>
§ 20(a).....	46, 47, 48
15 U.S.C. § 78u-4(b)(2)	30
Rule 10b-5.....	<i>passim</i>

MISCELLANEOUS

Illinois Supreme Court Rules of Professional Conduct,

Rule 1.625

Rule 4.125

Rule 5.1 48-49

New York Lawyer’s Code of Professional Responsibility DR 1-10449

David W. Wiltenburg, *Stoneridge: Supreme Setback for the “Scheme” Theory?*,
N.Y.L.J., Jan. 25, 2008.23

Lead Plaintiffs Pacific Investment Management Company LLC and RH Capital Associates LLC submit this memorandum of law in opposition to the motion of Defendants Joseph P. Collins (“Collins”) and Mayer Brown LLP (“Mayer Brown”) (“Defendants”)¹ to dismiss the Second Amended Consolidated Class Action Complaint (the “Complaint”).

PRELIMINARY STATEMENT

After Lead Plaintiffs filed the Complaint, a federal grand jury indicted Collins for eleven felonies, including two counts of violating Rule 10b-5(a), (b) and (c) (one count relating to Refco, Inc. (“Refco” or the “Company”) bonds and one to Refco common stock) and one count of conspiracy to commit securities fraud. Thereafter, the Supreme Court decided *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43, 2008 WL 123801 (Jan. 15, 2008), concerning liability under Rule 10b-5(a) and (c). The indictment and *Stoneridge* serve to confirm Collins’ and Mayer Brown’s liability in this case.

First, Collins’ and Mayer Brown’s extensive roles in drafting materially false and misleading documents pursuant to which Refco securities were sold to investors (as alleged in the Complaint and further charged in the indictment) coupled with Mayer Brown’s identification to investors (including in those same documents) as Refco’s counsel, provide a sufficient basis at this stage for attributing the false statements therein, for purposes of Rule 10b-5(b), to Collins and Mayer Brown under controlling Second Circuit authority.

Second, under *Stoneridge*, Collins’ and Mayer Brown’s active roles in conceiving, negotiating and implementing the fraudulent transformation of uncollectible customer debts into purportedly collectible Refco receivables, through *seventeen* rounds of sham loan transactions that straddled the end of every financial reporting period, establish at the pleading stage

¹ As used in this memorandum, “Defendants” refers collectively only to Collins and Mayer Brown.

Defendants' liability under Rule 10b-5(a) and (c). Not only were Defendants allegedly instrumental in effectuating the sham transactions, but the *only* purpose of those transactions was to present false and misleading financial information to investors, and Defendants were directly involved in drafting the Offering Memorandum and IPO Registration Statement through which that false and misleading information was conveyed to investors. In the words of *Stoneridge*, the "necessary" and "inevitable" result of Defendants' wrongful conduct was that Refco's offering documents were materially misleading, because the entire purpose of that unlawful conduct was to conceal uncollectible related-party receivables from investors.

The inference of Defendants' scienter is cogent and at least as compelling as any competing inference that can be drawn from the Complaint's allegations. Indeed, it is far stronger. The facts alleged in the Complaint and charged in the indictment demonstrate that Defendants played a vital role in the fraudulent scheme for an extended period of time and knew or recklessly disregarded that the scheme was being conducted for a fraudulent purpose.

The Complaint further alleges numerous facts sufficient to establish the presumption of reliance at this stage, including that Refco bonds and common stock were issued and traded in efficient markets, promptly responded to new information and had substantial trading volume.

Finally, Mayer Brown's control person liability under Section 20(a) is more than sufficiently alleged, including (if even required at this stage) its culpable participation in the fraud based on, *inter alia*, the wrongful conduct of numerous Mayer Brown lawyers who were involved in the fraud and Mayer Brown's failure to supervise those unlawful activities for years.

Accordingly, Collins' and Mayer Brown's motion to dismiss the Complaint should be denied in its entirety and discovery should resume against these Defendants who bear significant fault for their inexcusable role in this massive fraud.

STATEMENT OF FACTS

A. Refco, Collins and Mayer Brown

Before it imploded, Refco was one of the largest brokerage and clearing firms in the international derivatives, currency and futures markets, and Mayer Brown – led by Collins – was Refco’s primary outside counsel for more than ten years. ¶¶ 76-77.² Before that, Collins had represented Refco for nearly ten years at his prior law firm, until he moved to Mayer Brown and took Refco with him as his main client. *Id.*

Collins and Mayer Brown were intimately familiar with Refco’s business, and most of Refco’s important transactions were cleared through Collins (whom press reports referred to as the “go-to-guy at Refco”) or other Mayer Brown attorneys working under Collins’ direct supervision. ¶¶ 77, 711-13. In return, Mayer Brown annually collected approximately \$5 million in legal fees from Refco (or approximately \$40 million in total), which constituted nearly half of Collins’ billings. ¶¶ 78, 714. As the billing partner for Refco, Collins reviewed Refco bills monthly and was aware of all the work that Mayer Brown performed for Refco. *Id.*

B. The Fraud

In the 1990s, a number of Refco’s customers suffered massive trading losses and were unable or unwilling to repay hundreds of millions of dollars of margin loans made to them by Refco. ¶¶ 3, 431-35. Faced with having to write off these huge uncollectible receivables – a catastrophe for the Company and for Collins’ future billings – Refco’s CEO Phillip R. Bennett (“Bennett”), Collins, and other Mayer Brown attorneys conceived and orchestrated a series of fraudulent transactions to conceal these bad debts. ¶¶ 4, 425-26, 436, 438.

² Citations in the form “¶ ___” are to the Second Amended Consolidated Class Action Complaint, except as otherwise indicated.

To avoid writing off the uncollectible receivables, Refco transferred them to Refco Group Holdings, Inc. (“RGHI”), a shell entity with no operations that was owned by Bennett and a former Refco CEO. ¶¶ 3, 31, 96. The Company’s books then reflected a multi-hundred million dollar receivable from RGHI. Knowing that RGHI could not pay this amount, and that investors would perceive such a large related-party receivable negatively, Bennett and Defendants next devised a series of sham transactions to temporarily replace the RGHI receivable on Refco’s books with receivables from unrelated parties. ¶¶ 96, 451. These transactions – which were repeated at the end of every fiscal year from 2000 forward, and at the end of every quarter from at least 2004 until August 2005 – enabled Refco to disguise the uncollectible related-party debts as seemingly legitimate (and collectible) receivables on its public financial statements. *Id.* Promptly after the close of each financial period, these sham transactions were unwound, and the uncollectible receivable from RGHI again appeared on Refco’s books. ¶¶ 5, 451.

C. Defendants’ Active Participation in the Fraud

Collins and Mayer Brown were intimately involved in virtually every aspect of the fraud, including the initial transfer of uncollectible receivables to RGHI, and *seventeen* rounds of sham loan transactions that temporarily transferred the RGHI receivable to third parties so it did not have to be reported as a related-party receivable on Refco’s financial statements.³

First, in October 1997, Collins, Mayer Brown and Bennett negotiated and documented a settlement with respect to trading losses sustained by Refco customer Victor Niederhoffer,

³ As discussed in more detail below, the Collins indictment confirms in detail Collins’ and Mayer Brown’s indispensable role in conceiving and effectuating the fraudulent scheme. A copy of the indictment (the “Collins Indictment”) is attached to the Declaration of James J. Sabella as Ex. 1. The Collins Indictment is a “matter[] of which [the] court may take judicial notice” on this motion. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2509 (2007). *See, e.g., In re Search of Premises Known as 6455 South Yosemite*, 897 F.2d 1549, 1552 (10th Cir. 1990) (taking judicial notice of indictment); *B.T. Produce Co. v. Robert A. Johnson Sales, Inc.*, 354 F. Supp. 2d 284, 287 n.3 (S.D.N.Y. 2004) (same).

whereby Niederhoffer turned over the proceeds of his accounts to the Company. ¶ 440. In return, Refco agreed — in documents prepared by Collins and Mayer Brown — to forgive the much larger amount (approximately \$71 million) Niederhoffer owed the Company. *Id.*; *see also* Collins Indictment ¶ 13. To conceal Refco’s losses on Niederhoffer’s account, Collins, Mayer Brown and Bennett then caused Refco to assign to RGHI the “receivable” for the uncollectible portion of Niederhoffer’s debt (which Collins and Mayer Brown knew Refco had already forgiven). *Id.*; *see also* Collins Indictment ¶ 13. In exchange for this worthless receivable, RGHI agreed — in documents drafted by Mayer Brown—to pay Refco the amount of the uncollectible debt. ¶ 440. Thus, the uncollectible Niederhoffer receivable was removed from Refco’s books and replaced with a purportedly collectible receivable from RGHI.

As Collins and Mayer Brown knew, Refco’s transfer of the Niederhoffer receivable to RGHI was a sham lacking any legitimate business purpose. ¶ 441. There was no valid reason for RGHI to agree to pay Refco \$71 million for the “right” to collect a receivable that was already unenforceable pursuant to documents Collins himself had prepared. *Id.* Moreover, Collins and Mayer Brown knew that RGHI, a non-operating company, also could not pay the amount it purportedly agreed to pay Refco. ¶ 442.

After transferring the uncollectible Niederhoffer receivable to RGHI, Refco used a similar structure to transfer other uncollectible customer receivables to RGHI, increasing the RGHI receivable to hundreds of millions of dollars. ¶ 718. Documents in Collins’ handwriting demonstrate that, by October 1999, Collins and Mayer Brown were aware of multiple “loans” from Refco to RGHI. ¶ 447. By June 2002, Collins and Mayer Brown knew that RGHI “owed” Refco at least \$350 million. ¶ 448; *see also* Collins Indictment ¶ 11.

Although transferring the uncollectible customer receivables to RGHI allowed Refco to conceal their uncollectibility, it still left Refco with a massive receivable owed by a related party, RGHI. Applicable accounting rules require the related-party nature of such a receivable to be disclosed, and investors and regulators view related-party transactions with suspicion. ¶ 450. Accordingly, Bennett — again with his “go to guy” Collins and Mayer Brown—devised a scheme to temporarily replace this related-party receivable with one or more third-party receivables, just long enough for Refco to report them as such in its financial statements. ¶ 451.

Specifically, a few days before Refco closed its books for each financial period, it “loaned” hundreds of millions of dollars from its subsidiary Refco Capital to third parties who simultaneously “loaned” the same amount to RGHI. ¶ 451. Frequently, the loan documents — all of which Mayer Brown drafted — contained “use of proceeds” covenants *requiring* the third party to use its loan proceeds from Refco Capital “only for funding a corresponding loan to [RGHI].” ¶¶ 463, 483, 489, 507, 515. RGHI then used those loan proceeds to temporarily pay down the receivable it owed Refco, thereby eliminating the related-party receivable from Refco’s books. *Id.* No money actually changed hands; all of the third parties had accounts at Refco, and each of these transfers was accomplished through entries on Refco’s books. ¶¶ 470, 568. Then, just days after the financial period ended, these transactions were reversed, Refco paid the third parties a fee for participating in the risk-free “loans,” and the RGHI receivable was right back on Refco’s books. ¶¶ 469, 475, 481, 487, 493, 499, 505, 511, 513, 519.

These “back-to-back” loans — as Mayer Brown referred to them (*see also* ¶ 558) — were repeated at the end of each of Refco’s financial reporting periods. ¶ 452. Mayer Brown attorneys, supervised by Collins, were directly involved in *seventeen* rounds of these sham transactions between 2000 and 2005. ¶¶ 451-52, 457-60, 471, 476, 482, 488, 494, 500, 506, 512,

514, 550-58, 564-65, 567, 569-72, 574. Far from acting as a mere scrivener, Mayer Brown was involved in all aspects of the transactions, including explaining the structure and terms of the loans to potential third-party participants; negotiating the loans; drafting and revising the documentation for the transactions (including loan agreements, promissory notes, guarantees, and indemnification letters); transmitting the documents to the participants; retaining custody of and distributing executed copies of the documents; and marking the third parties' promissory notes to Refco Capital as "paid in full" upon the unwinding of the transactions. *Id.* Mayer Brown even represented the counterparty to at least one of the loans, in addition to representing Refco and RGHI in all of them. ¶ 452. Collins supervised all of these activities, approved bills for this work, personally negotiated and revised some of the loan documents, sent drafts of loan documents to Refco, and discussed the enforceability of the loans with Refco management. ¶¶ 550, 556, 560, 567, 571-72, 574.⁴ Mayer Brown's involvement was so pervasive that when one counterparty decided to stop participating in these transactions, *out of concern that the transactions were securities fraud*, the counterparty sent an email that it would "reimburse Refco for reasonable legal expenses [owed to] Mayer Brown." ¶¶ 559-62.

Like the transformation of the Niederhoffer losses into a receivable from RGHI, the round-trip loans had no legitimate business purpose. Aside from being short-term loans that straddled the end of every financial reporting period — which itself was highly suggestive of fraud — these transactions involved the payment of "interest" to third parties who incurred no

⁴ Collins' handwritten notes regarding a set of round-trip transactions with CIM Ventures in February 2000 show that he understood from the outset the nature, structure and timing of the loans. Those notes state that the loans would be for "one month" and would bracket the end of Refco's fiscal year end, "Feb 15 – March 15." ¶ 550. Collins' notes also show he was aware that CIM Ventures was simply a conduit that would funnel the loan proceeds directly from Refco Capital to RGHI: "Refco Capital Markets → CIM" and "CIM – Refco Group Holdings." *Id.*

economic risk because repayment of their loans was *guaranteed by Refco*.⁵ ¶ 632. Further, while Mayer Brown now claims ignorance that RGHI was using the loan proceeds to pay down the RGHI receivable, Mayer Brown and Collins were well aware that RGHI was an off-balance sheet holding company owned by Refco management that had no liquid assets and no operational functions. ¶ 638. They also knew that RGHI had no legitimate business need for repeated short-term loans of hundreds of millions of dollars on dates coinciding with the close of Refco's financial reporting periods, and no wherewithal to repay the loans. Indeed, when Refco's bankruptcy examiner interviewed Mayer Brown employees, not one of them could articulate any legitimate business purpose for these loans. ¶ 721.

D. Defendants Drafted Fraudulent Statements That Refco Used to Issue Securities to Public Investors

The scheme described above allowed Refco to project the appearance of growth and success, when in reality the Company was losing money.⁶ Moreover, this manipulation of Refco's financial results created and maintained a public market for the Company's securities (¶¶ 733-35), which enabled Bennett and other Refco executives to cash-out their interests and off-load a significant stake in their fraud-ridden Company to outside investors.

Collins and Mayer Brown knew by 2002 that Bennett's ultimate goal was to sell his interests in Refco. ¶ 99. Bennett's plan to sell Refco began to come to fruition in 2004, when Refco issued \$600 million in bonds (the "Bonds") to public investors in connection with a leveraged buy-out ("LBO") that yielded tens of millions of dollars in cash payouts to Bennett and other Company executives. Mayer Brown was deeply involved in the LBO and Bond

⁵ Mayer Brown was aware of these guarantees because it drafted them, despite the fact that such guarantees were *expressly prohibited* by covenants in other loan documents Mayer Brown had previously prepared for Refco. ¶ 631.

⁶ In each fiscal year from 2002 through 2005, Refco reported positive pre-tax income between \$100 million and \$200 million, whereas if the uncollectible receivables had been disclosed and written off in any of those years,

(Cont'd)

offering, representing Refco and RGHI in the LBO and – *as publicly disclosed to Bond investors in the Offering Memorandum* – Refco in connection with the Bond offering. ¶¶ 101, 116.

As alleged in the Complaint and confirmed by the Collins Indictment, Mayer Brown was heavily involved in drafting materially false portions of the documents that were filed with the SEC in order to induce investors to purchase Refco’s Bonds (and, later, in order to effectuate Refco’s IPO). *See* Collins Indictment at ¶¶ 45-49, 55-57. For example, Collins and other Mayer Brown attorneys personally drafted the Management’s Discussion & Analysis (“MD&A”) section of the Offering Memorandum for the Bonds (¶ 116), and Collins was involved in drafting the Risk Factors and other portions of the offering documents for both the Bond offering and the IPO. Collins Indictment ¶¶ 45-49, 57. Collins and other Mayer Brown attorneys also reviewed and revised successive drafts of the Offering Memorandum, and at least two Mayer Brown partners attended numerous drafting sessions for the Offering Memorandum. *Id.*

The Company sold \$600 million in Bonds pursuant to the Offering Memorandum, which was later revealed to be materially false and misleading. Among other things, the 15-page MD&A section – written by Mayer Brown – contained statements regarding Refco’s business and financial condition that were materially false as a result of the fraud, and failed to disclose the existence of hundreds of millions of dollars of uncollectible receivables, related-party transactions, and guarantees. ¶¶ 116, 127-28, 133, 135, 149-50, 152-53. The Risk Factors section was also materially false and misleading because it failed to disclose the uncollectible RGHI receivable. Collins Indictment ¶¶ 45-47. Collins and Mayer Brown knew or recklessly disregarded the false and misleading nature of the Offering Memorandum, given their direct involvement in the round-trip loan transactions through which the fraud was occurring. Indeed,

Refco would have reported a multi-hundred million dollar loss. ¶¶ 579-80.

at the same time Mayer Brown's attorneys were working on the Offering Memorandum, Mayer Brown (through Collins) was billing Refco for legal services pertaining to round trip loans which rendered the Offering Memorandum materially false and misleading. ¶ 117.

With the LBO and the Bond offering completed, Refco's insiders turned their sights toward a \$670 million initial public offering of Refco stock (the "IPO"), so that they could sell additional ownership interests to innocent public investors. Mayer Brown represented Refco in the IPO, and played a significant role in preparing the IPO Registration Statement, *which again publicly identified Mayer Brown as counsel to Refco*. ¶¶ 201, 221-22. The IPO Registration Statement and the Bond Registration Statement (whereby the Bonds issued in 2004 were exchanged for registered securities) were prepared at the same time and Collins and Mayer Brown participated in drafting both of them. ¶ 170; *see also* Collins Indictment ¶¶ 56-57 (charging Collins drafted false sections of the IPO Registration Statement in order to deceive investors).

The Offering Memorandum served as the foundation for the Bond Registration Statement, and therefore the two documents were substantially similar in content. Unlike the Offering Memorandum, however, the Bond Registration Statement and the IPO Registration Statement required SEC review before they could become effective. Collins and Mayer Brown received and reviewed several comment letters from the SEC and also participated in drafting sessions for amendments of both documents. ¶¶ 170-71, 177, 180, 201. Among the SEC comment letters that Collins and Mayer Brown received was a November 10, 2004 letter questioning why the Bond Registration Statement characterized amounts due from equity members (including RGHI) as receivables from customers. ¶ 185. Collins and Mayer Brown knew well before the SEC reviewed the Bond Registration Statement that these were not

customer receivables, yet they reviewed and approved the Offering Memorandum, which mischaracterized them as such. *Id.*

Both the IPO and Bond Registration Statements were materially false and misleading for the same reasons as the Offering Memorandum – *i.e.*, they misrepresented Refco’s financial condition and failed to disclose hundreds of millions of dollars in uncollectible receivables that should have been written off, but instead were deliberately concealed through transactions conceived and implemented by Collins and Mayer Brown. ¶¶ 181, 186, 203.

E. Collins Is Indicted by a Federal Grand Jury on Eleven Felony Counts, Including Violations of Rule 10b-5(a), (b) & (c)

On December 18, 2007, Collins was indicted for eleven felonies, including two counts of violating Rule 10b-5(a), (b) and (c) (one count relating to the Refco Bonds and one to Refco common stock) and one count of conspiracy to commit securities fraud. Consistent with Lead Plaintiffs’ Complaint, the indictment charges that Collins knowingly participated in the fraud and made false statements to Refco’s investors. Among other things, the indictment charges that:

- “Refco was the most significant client of Joseph P. Collins . . . and [Collins] billed more time to matters for Refco than he did to matters for any other client and generated more fees for [Mayer Brown] through his work for Refco than he did through any other client.” Collins Indictment ¶ 4.
- Collins and others “made and caused to be made false public filings with the United States Securities and Exchange Commission.” *Id.* ¶ 9.
- “Acting hand-in-hand with Bennett, Collins made affirmative misrepresentations, material omissions, and told deceptive half-truths, all to assist Bennett’s scheme to steal more than \$2.4 billion from potential investors and lenders. These misrepresentations, omissions, and half-truths ... *were believed by Refco’s investors and lenders in part because Collins’ status as a partner with a well-known law firm and as Refco’s long-time counsel gave them confidence that such representations were truthful, accurate, and complete.*” *Id.* ¶10 (emphasis added).
- “Collins also knowingly *negotiated and drafted* fraudulent agreements and public filings that resulted in the investment of more than \$2.4 billion in Refco by banks, investors and the public.” *Id.* (emphasis added).

- Collins’ “lies” enabled Refco to sell approximately \$600 million in Bonds in the Bond Offering and approximately \$583 million in common stock in the IPO. *Id.*
- Collins knew that Refco’s publicly filed financial statements were false and misleading. *Id.* ¶ 35.

Moreover, the indictment charges that Collins was directly involved in drafting materially false portions of the documents investors relied upon when deciding whether to purchase Refco securities in the Bond Offering and the IPO. For instance, it charges that Collins “participated in drafting two sections of the offering circular [for the Bonds] entitled ‘Risk Factors’ and ‘Certain Relationships and Related Transactions,’ among other sections” and “participated in the drafting of [the IPO] registration statement . . . [including] the section entitled ‘Risk Factors,’” all of which Collins “well knew . . . contained material misstatements and omissions.” Collins Indictment ¶¶ 45, 47, 49, 57. It further charges that Collins knew that the portions of the IPO Registration Statement he helped draft were materially false and misleading because they:

failed to disclose risks posed to Refco’s business by (1) Refco being owed hundreds of millions of dollars by a related party, RGHI, that was solely owned and operated by Bennett; and (2) Refco periodically incurring hundreds of millions of dollars in obligations guaranteeing and indemnifying the performance of a related party, RGHI, that was solely owned and operated by Bennett.

Id. ¶ 47; *see also id.* ¶ 48.

Similarly, the indictment charges that Collins “at all times” knew that “Bennett and others intended to sell a portion of Refco to the public through an IPO of stock sometime after the LBO transaction closed.” *Id.* ¶ 51. The IPO Registration Statement was “based on the offering circular that Joseph P. Collins . . . helped draft” and contained the same material misstatements and omissions. *Id.* ¶ 56. Based on this and other conduct, it charges Collins with violating Rule 10b-5(a), (b) and (c) in connection with the sale of Refco Bonds and common stock. *Id.* ¶¶ 75, 77. The indictment also charges that Collins “did make and cause to be made” false and misleading statements in documents filed with the SEC. *Id.* ¶ 66; *see also* ¶ 67.

In announcing the Collins Indictment, United States Attorney Michael J. Garcia stated:

[Collins] is charged with *intentionally furthering* the fraud at Refco by telling lies and deceptive half-truths and omitting material information. *He was not merely a lawyer whose client was committing fraud and who should have caught on – Collins instead played an active and crucial part in perpetrating the Refco fraud.*

* * * *

Collins’s role in the fraud was vital because the people he lied to believed him as a result of his long-standing relationship with the company and his stature within the legal community.

. . . Today’s charges should be no cause for concern for the vast majority of outside counsel who conduct themselves lawfully. It is not a crime to have a client who commits a crime. *No lawyer will be prosecuted unless that lawyer knows about the client’s fraud and agrees to join in it understanding the unlawful nature, or understanding its unlawful nature, takes steps intending to help the fraud succeed. That is what Joseph Collins is alleged to have done: That is why he is being charged today.*

Declaration of James J. Sabella, dated Jan. 31, 2008 (“Sabella Decl.”) Ex. 2 (emphasis added).

ARGUMENT

I. THE COMPLAINT ALLEGES THAT DEFENDANTS MADE FALSE AND MISLEADING STATEMENTS, THEREBY SATISFYING RULE 10b-5(b)

The Complaint alleges, and the Collins Indictment confirms, that: (i) Defendants drafted portions of the Offering Memorandum and the IPO Registration Statement; (ii) they were identified in such documents as Refco’s counsel; and (iii) sections of those documents that Collins and Mayer Brown prepared were false and misleading. These facts are sufficient to demonstrate under Rule 10b-5(b) that Defendants made false and misleading statements.

A. The Statements Made by Collins and Mayer Brown

The Complaint alleges that Defendants “drafted” and “revised” the Offering Memorandum and drafted materially misleading portions of Refco’s offering documents for the Bond Offering and the IPO. ¶¶ 116, 201. Collins and other Mayer Brown attorneys personally drafted sections of the Offering Memorandum, including the MD&A section, which contained

materially false and misleading statements and omissions. ¶¶ 116, 119-55, 127-28, 149-50, 204-31. Collins and other Mayer Brown attorneys also reviewed and revised successive drafts of the Offering Memorandum. *Id.* The Complaint also alleges that Collins and Mayer Brown were “directly involved” in “drafting the IPO Registration Statement” which contained similar materially false and misleading statements. ¶¶ 170, 201.⁷ Furthermore, the Complaint alleges that both the Offering Memorandum and the IPO Registration Statement specifically identified Mayer Brown to investors as counsel to Refco in connection with those documents. ¶¶ 116, 201. As discussed above, the Collins Indictment confirms that Collins and Mayer Brown drafted materially misleading portions of Refco’s offering documents for the Bond Offering and the IPO.

B. The Complaint Adequately Alleges That the Mayer Brown Defendants Made False and Misleading Statements

Defendants assert that they cannot be held liable under Rule 10b-5(b) for the false and misleading statements contained in the Offering Memorandum and the IPO Registration Statement because those documents do not specifically attribute the statements therein to Collins and Mayer Brown. Defendants argue that the Second Circuit has adopted a “bright-line” test under which Rule 10b-5(b) liability requires the subject document to specifically attribute false statements to the defendant. As this Court and numerous other courts in this Circuit have held, however, the line is neither bright nor is it drawn where Defendants assert it is. Ample authority demonstrates that Defendants can be held liable under Rule 10b-5(b) for the false and misleading statements in the Offering Memorandum and the IPO Registration Statement.

Defendants’ so-called “bright-line” test stems from *Wright v. Ernst & Young, LLP*, 152 F.3d 169 (2d Cir. 1998), which the court based on “*Central Bank* and [its] recent decision in

⁷ Citing allegations in the Complaint regarding other actors’ drafting roles, Defendants argue that their drafting role was limited. *See* MB Mem. at 12. This merely raises a factual issue for discovery and trial, not a basis for a motion
(*Cont’d*)

Shapiro v. Cantor, 123 F.3d 717 (2d Cir. 1997).” 152 F.3d at 173. Citing *Central Bank*, the court in *Wright* noted that a secondary actor may be held liable for making material misstatements “on which a purchaser or seller of securities relies.” *Id.* at 174. Quoting *Shapiro*, the Court also observed that “[t]here is no requirement that the alleged violator directly communicate misrepresentations to [investors] for primary liability to attach,” as long as the statements are “attributed” to the secondary actor. *Id.* at 175 (internal citation omitted).

Defendants assert that the Complaint fails to allege sufficient facts to satisfy the test articulated in *Wright* — namely, that the statements Mayer Brown drafted and reviewed were “attributed” to Mayer Brown — because Mayer Brown was supposedly not identified as the author of the false statements at the time they were disseminated. MB Mem. at 7-15.

Defendants are wrong. As an initial matter, the Complaint alleges that Mayer Brown was identified in the offering documents as Refco’s counsel, which, when coupled with the detailed allegations of Mayer Brown’s involvement in the drafting process, provides more than sufficient basis for “attributing” the false statements therein to Mayer Brown. ¶¶ 116, 201.

Moreover, Second Circuit case law makes clear that statements may be “attributed” to secondary actors, like Defendants, who are heavily involved in drafting the statements on behalf of the issuer.⁸ For instance, in *In re Scholastic Corp. Securities Litigation*, 252 F.3d 63 (2d Cir. 2001), the Second Circuit upheld a Rule 10b-5(b) claim against a corporate officer who “was involved in drafting, producing, reviewing and/or disseminating of the false and misleading

to dismiss.

⁸ See, e.g., Collins Indictment ¶¶ 66-67 (charging Collins with making false statements in documents filed with the SEC).

statements” issued by the corporation, even though that officer was not identified as having written them.⁹ *Id.* at 76.

As this Court noted in *In re Global Crossing, Ltd. Securities Litigation*, 322 F. Supp. 2d 319 (S.D.N.Y. 2004), the Second Circuit “relaxed” the view of *Wright* such that statements may be “attributed” to an actor who was involved in preparing the statements and on whose involvement sophisticated investors may have relied. *Id.* at 333-35.¹⁰

In *Suez Equity Investors v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001), the Second Circuit similarly interpreted both *Central Bank* and *Wright* as limited by their facts:

The distinction between the case at bar and those cited is that in *Central Bank* and *Wright* there was no allegation that the defendants were agents of the alleged defrauder, acting for the defrauder. Rather, the *Central Bank* and *Wright* plaintiffs only alleged that the defendants knew of the purported fraud through transactions with the defrauders, but failed to expose the deception. *See Cent. Bank*, 511 U.S. at 167-69, 114 S. Ct. 1439 (plaintiff alleged that defendant-petitioner, indenture trustee for the alleged defrauder, was aware appraisal might not be accurate but delayed review until bonds were issued); *Wright*, 152 F.3d at 171-72 (plaintiff alleged that defendant-appellee, outside auditor for alleged defrauder, knew of problems with financial statements distributed as “unaudited” and without mention of auditor’s name).

While Defendants place great weight on the Second Circuit’s recent decision in *Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147 (2d Cir. 2007), *Lattanzio* is entirely consistent with *Suez*

⁹ Although not an officer of Refco, Collins was a *de facto* insider who owed comparable fiduciary duties to investors in Refco securities. *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983).

¹⁰ Indeed, this flows directly from careful analysis of *Wright*. For instance, *Wright* cited a district court decision in a case where, as in *Wright*, the plaintiff alleged only that an issuer’s accountants had reviewed and approved interim financial statements, not that they had played any role in drafting them. *Id.* (citing *In re Kendall Square Research Group Corp. Sec. Litig.*, 868 F. Supp. 26, 28 (D. Mass. 1994)). Thus, both *Wright* and *Kendall Square* are best understood as holding that a secondary actor cannot be held liable for a misstatement that he or she has neither uttered nor authored. Put differently, just as *Central Bank* held that a secondary actor can be held liable if he makes a material misstatement on which a purchaser or seller relies, *Wright* should be read as holding that a secondary actor can be held liable if he causes – *i.e.*, creates, authors or issues – a misrepresentation on which a purchaser or seller relies. In *Stoneridge*, the Supreme Court reaffirmed that a secondary actor can be held liable if he makes a misrepresentation on which investors rely. 2008 WL 123801, at * 6. Furthermore, the Court held that “under the fraud-on-the-market doctrine, reliance is presumed when the statements at issue become public.” *Id.* at * 6. The identity of the person who published the statement is irrelevant for this purpose.

Equity Investors' reading of *Wright* and in no respect purports to overrule *Scholastic*. Plaintiffs there argued that an auditor had a duty to correct its pre-class period audit opinion in connection with a corporation's subsequently issued Forms 10-Q which it did not audit. *Id.* at 154. The Second Circuit rejected this argument *and* found no loss causation for the auditor's subsequent audit opinion issued during the class period. *Id.* at 157.¹¹ *Lattanzio* stands only for the long-standing proposition that a company's quarterly unaudited financial statements cannot be "attributed" to an auditor simply because the auditor reviewed and approved the unaudited quarterly financials. *See id.* at 155. *Lattanzio* provides no guidance where, as here, a law firm closely associated with an issuer allegedly (i) *devised and perpetrated a fraudulent scheme* to falsify the issuer's financial statements, (ii) *directly participated in drafting* false and misleading public statements about that fraudulent scheme for the express purpose of marketing the issuer's securities, and (iii) the law firm was *specifically identified* by name to investors. In these circumstances, *Lattanzio* provides no bar to finding that those statements may be "attributed" to the drafters.

This Court's opinion in *Global Crossing* and subsequent decisions which rely upon it demonstrate that the statements drafted by Defendants in these circumstances may be "attributed" to them. *Global Crossing* involved financial information, released by the company, which was not specifically attributed to the company's auditor. To the contrary, some of the information was explicitly stated to be *unaudited*. 322 F. Supp. 2d at 331. Nevertheless, this Court held that the complaint stated a Rule 10b-5(b) claim against the auditor with respect to

¹¹ Defendants suggest that *Scholastic* may create an exception applicable only to corporate officers. *See* MB Mem. at 9-10. Nothing in any Second Circuit case suggests that that is so. Moreover, as discussed below, *Scholastic* has been applied not only to corporate officers but also to claims against lawyers, *see Seippel v. Sidley, Austin, Brown & Wood, LLP*, 399 F. Supp. 2d 283 (S.D.N.Y. 2005), and corporate subsidiaries, *see In re LaBranche Sec. Litig.*, 405 F. Supp. 2d 333, 350 (S.D.N.Y. 2005).

these statements, holding:

[A] plaintiff may state a claim for primary liability under section 10(b) for a false statement (or omission), even where the statement is not publicly attributed to the defendant, where the defendant's participation is substantial enough that s/he may be deemed to have *made* the statement, and where investors are sufficiently aware of defendant's participation that they may be found to have *relied* on it as if the statement had been attributed to the defendant.

Id. at 332-33 (emphasis in original). Applying this test, the Court held that allegations that the auditor "prepared" and "helped create" the company's false statements, along with the allegation that its role as the company's auditor was well known, were sufficient to enable assertion of a Rule 10b-5(b) claim against it. *Id.* at 334. As the Court stated: "These allegations are sufficient to raise a reasonable inference not only that [the auditor] was one of the 'makers' of the statements, but also that investors viewed it as such." *Id.*

This Court's holding in *Global Crossing* is well-rooted in both § 10(b) and Rule 10b-5 as well as the policies underlying those provisions. Both § 10(b) and Rule 10b-5 forbid engaging "directly or indirectly" in the prohibited conduct. "There is no requirement that the alleged violator *directly* communicate misrepresentations to [investors] for primary liability to attach." *Wright*, 152 F.3d at 175 (emphasis added) (citation omitted). A defendant who creates a false statement but provides it to another to release into the marketplace falls squarely within § 10(b) and Rule 10b-5's prohibition against violating those provisions "indirectly." Moreover, allowing a defendant to evade liability in such circumstances "would allow those primarily responsible for making false statements to avoid liability by remaining anonymous, and thus 'would place a premium on concealment and subterfuge rather than on compliance with the federal securities laws.'" *Global Crossing*, 322 F. Supp. 2d at 333 (quoting *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 587 (S.D. Tex. 2003)).

Numerous courts in this Circuit have followed *Global Crossing*. When a defendant

subsidiary asserted that it could not be held liable for statements made by its corporate parent in *In re LaBranche Securities Litigation*, 405 F. Supp. 2d 333 (S.D.N.Y. 2005), Judge Sweet stated that “even though [the parent] failed to explicitly identify [the subsidiary] as the source of the information concerning revenue and earnings of its specialist operations, the misrepresentations may be constructively attributed to [the subsidiary].” *Id.* at 352. The court reasoned that “investors may be deemed to have been ‘sufficiently aware of [the subsidiary’s] participation that they may be found to have relied on it as if the statement[s] had been publicly attributed to [it].” *Id.* at 351 (quoting *Global Crossing*). See also *In re Alstom SA Securities Litigation*, 406 F. Supp. 2d 433, 466 (S.D.N.Y. 2005) (same).

This same approach was applied to claims against lawyers in *Seippel v. Sidley, Austin, Brown & Wood, LLP*, 399 F. Supp. 2d 283 (S.D.N.Y. 2005), where a law firm allegedly prepared false statements that were provided to investors. The law firm argued that, under *Wright*, it could not be held liable since an accounting firm, not the law firm, communicated the misrepresentations to the investors. *Id.* at 289, 293. The court disagreed, noting that the lawyers allegedly “engineered and were key members of the conspiracy to defraud,” *id.* at 294, the misrepresentations “were caused” by them, *id.*, and the plaintiffs were aware of the lawyers’ role in the transaction. *Id.* at 294 n.57. Denying the law firm’s motion to dismiss, the court held that, “[i]n essence, [plaintiffs] allege that defendants made misrepresentations to them, albeit indirectly, using [the accountants] as their agent and mouthpiece.” *Id.* at 294.

In *Teachers’ Retirement System of Louisiana v. ACLN, Ltd.*, No. 01 Civ. 11814 (LAP), 2004 U.S. Dist. LEXIS 25927 (S.D.N.Y. Dec. 20, 2004), the court held that *Wright* did not preclude Rule 10b-5(b) claims against a U.S. audit firm for a misleading audit report signed by its international affiliate. Addressing *Wright*’s “attribution” rule, Judge Preska stated:

Attribution can be “indirect” in some cases. A plaintiff may state a claim for primary liability under Section 10(b) for a false statement (or omission), even where the statement is not directly attributed to the defendant, where the defendant’s participation is substantial enough that it may be deemed to have made the statement and where investors are sufficiently aware of the defendant’s participation that they can be found to have relied on it as if the statement had been directly attributed to the defendant.

Id. at *19. *See also Menkes v. Stolt-Neilsen S.A.*, No. 03 Civ 409 (DJS), 2006 U.S. Dist. LEXIS 42644, at *20 (D. Conn. June 19, 2006) (“Despite the apparent bright-line rule regarding primary liability, . . . courts bound to follow [*Wright*] have permitted claims against persons who did not actually utter the false or misleading statements but nevertheless may be deemed to have caused the statements to be uttered.”); *Pension Comm. of Univ. of Montreal Pension Plan v. Banc of America Sec., LLC*, 446 F. Supp. 2d 163, 182-83 (S.D.N.Y. 2006) (upholding claims against corporate directors for statements the corporation did not specifically identify as made by them); *In re Vivendi Universal S.A. Sec. Litig.*, No. 02 Civ. 5571 (HB), 2003 WL 22489764, at *25 (S.D.N.Y. Nov. 3, 2003) (upholding claim against CFO for company’s public statement not specifically attributed to him).

Under this authority, the Complaint’s allegations that Defendants drafted and revised the Offering Memorandum and IPO Registration Statement, that those documents identified Mayer Brown as counsel for Refco, and that investors reasonably understood Mayer Brown to have drafted those documents, adequately allege that Defendants made false and misleading statements and omissions in violation of Rule 10b-5(b).¹²

¹² Defendants argue that reasonable investors would not have attributed the offering documents to Mayer Brown because they disclosed that Weil, Gotshal & Manges “passed on the validity” of the Refco securities. MB Mem. at 14-15. However, Weil Gotshal’s validity opinions addressed only the narrow question of whether the issuance of the securities was valid under corporate law. The offering documents specifically disclosed that Mayer Brown represented Refco in the offerings, and the Complaint alleges that investors knew that Mayer Brown, not Weil Gotshal, was Refco’s longtime primary counsel with a much broader role in its business, such that investors reasonably attributed the offering documents to Mayer Brown. ¶¶ 116, 201, 749, 766.

Indeed, during oral argument in the Supreme Court in *Stoneridge*, Justice Kennedy, who authored the *Stoneridge* opinion, appeared to draw a distinction between outside attorneys “who deliberately and directly participate in negotiating or in drafting” false documents, and outside vendors or suppliers who are not involved in that way. Sabella Decl. Ex. 3, at **37-39.

II. THE COMPLAINT STATES A CLAIM AGAINST THE MAYER BROWN DEFENDANTS UNDER RULE 10b-5(a) AND (c)

As discussed above, the Complaint alleges in detail that Collins and Mayer Brown conceived and implemented both the transfer of worthless customer receivables from Refco to RGHI and the sham round-trip loans straddling the ends of Refco’s financial reporting periods, which enabled Refco to avoid disclosing the worthless, related-party RGHI receivable. The Complaint also alleges that Collins and Mayer Brown knew or were reckless in not knowing that the transactions lacked economic substance and would be falsely reported in Refco’s public disclosures, which Collins and Mayer Brown themselves drafted for the purpose of allowing Refco to issue securities to public investors. Together, these allegations adequately plead that Collins and Mayer Brown “employed [a] device, scheme, or artifice to defraud” and “engage[d] in [an] act, practice, or course of business which operate[d] or would operate as a fraud or deceit upon any person,” in violation of § 10(b) and Rule 10b-5(a) and (c).

A. Plaintiffs’ Scheme Liability Claims Against the Mayer Brown Defendants Comport With *Stoneridge*

Citing *In re Charter Communications, Inc.*, 443 F.3d 987, 992 (8th Cir. 2006), Defendants argued in their moving brief that private claims under § 10(b) and Rule 10b-5 that are based deceptive conduct other than false statements are “merely disguised claims for aiding

and abetting and are barred under *Central Bank*.” MB Mem. at 18 & n.7.¹³ The Supreme Court, however, unequivocally rejected *Charter*’s narrow reading of the statute and rule, holding that there need not be “a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5,” and that “[c]onduct itself can be deceptive” *Stoneridge*, 2008 WL 123801, at *6. The Court also held that “the implied right of action in §10(b) continues to cover secondary actors who commit primary violations.” *Id.* at *11. While *Stoneridge* rejected the Rule 10b-5(a) and (c) claims asserted in that case, the decision demonstrates the continued viability of Lead Plaintiffs’ claims against Defendants here.¹⁴

The Supreme Court rejected the Rule 10b-5(a) and (c) claims in *Stoneridge* because (1) the fraud occurred in the marketplace for goods and services, not the investment sphere (*id.* at *11); (2) the defendants’ conduct was remote from the issuer’s decision to record the transactions as it did in its financial statements (*id.* at **4, 7); and (3) the plaintiffs could not demonstrate reliance. *Id.* at *6. None of these considerations applies here.

1. **The Fraud Here Occurred in the Investment Sphere**

Stoneridge was premised largely on the defendants’ status as outside “suppliers” and “customers” of the issuer, who were acting “in the marketplace for goods and services, not in the investment sphere.” 2008 WL 123801, at *11.¹⁵ By contrast, Collins and Mayer Brown acted

¹³ The Eighth Circuit had held that “any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5.” *Charter*, 443 F.3d at 992 (citations omitted).

¹⁴ Defendants argued that Plaintiffs’ claims would fail if the Supreme Court found a private right of action for scheme liability to be inconsistent with the fact that the Private Securities Litigation Reform Act of 1995 permits the SEC, but not private plaintiffs, to bring aiding and abetting claims. MB Mem. at 19 n.8. In fact, the Supreme Court did *not* hold that there is no private right of action for scheme liability. Rather, it held that secondary actors on whose deceptive conduct investors rely *may* be primarily liable. *Stoneridge*, 2008 WL 123801, at *6.

¹⁵ Defendants concede that *Stoneridge* (which had been argued before they filed their motion) addresses the question “whether scheme liability is a viable theory to hold *a counterparty* liable for knowingly engaging in transactions that enable an issuer to misrepresent its financial statements.” MB Mem. at 15 n.6 (emphasis added).

squarely within the investment sphere. They were Refco's primary counsel, not unrelated suppliers or customers. Collins and Mayer Brown worked closely with Refco, functioning as *de facto* insiders of the Company in devising and implementing the sham transactions. Those transactions had the express purpose of allowing Refco to raise over a billion dollars from unsuspecting investors through fraudulent bond and stock offerings. Indeed, Collins and Mayer Brown drafted false and misleading sections of the very documents that Refco used to sell securities to investors, and those documents identified Mayer Brown by name. As *Stoneridge* recognized, deceptive conduct in connection with fraudulent securities offerings is at the heart of the securities laws' prohibitions.¹⁶

2. Defendants Had Direct Control Over the Company's Misleading Communications to Investors

In *Stoneridge*, a second important reason why the Court rejected the Rule 10b-5(a) and (c) claims was that the defendants "had no role in preparing or disseminating" the issuer's false statements, and had no control over how the issuer's financial statements would report their transactions with the issuer. 2008 WL 123801, at *4. The Court stated:

It was [the issuer], not respondents, that misled its auditor and filed fraudulent financial statements; nothing respondents did made it necessary or inevitable for [the issuer] to record the transactions as it did.

Id. at *7.

In contrast, not only were Defendants instrumental in effectuating the sham transactions, but the *only* purpose of those transactions was to enable Refco to present false and misleading

¹⁶ A recent commentator explains that the Court's decision that the chain of reliance was "too remote for liability" (2008 WL 123801, at *6) was dependent on the distinction between commercial conduct and the investment sphere:

The terms "indirect" and "remote" refer to the difference between the "realm of financing business," which includes transactions in securities markets, and the "realm of ordinary business operations," in which the sales contracts at issue took place.

David W. Wiltenburg, *Stoneridge: Supreme Setback for the "Scheme" Theory?*, N.Y.L.J., Jan. 25, 2008, at 6, col. 5.

financial information to investors, and Defendants were directly involved in drafting the Offering Memorandum and IPO Registration Statement through which the false and misleading information was conveyed to the securities marketplace. In the words of *Stoneridge*, the “necessary” and “inevitable” result of Defendants’ conduct was that Refco’s offering documents were materially misleading, because the entire purpose of that conduct was to conceal uncollectible related-party receivables from investors.

3. Investors Relied on Defendants’ Fraudulent Conduct

Because the defendant suppliers’ and customers’ conduct in *Stoneridge* was too remote from investors in the issuer, the Supreme Court held that “[i]n these circumstances the investors cannot be said to have relied upon any of respondents’ deceptive acts in the decision to purchase or sell securities” 2008 WL 123801, at *11 (emphasis added). In this case, however, Defendants were not “remote” from investors in Refco; rather, they were directly involved in creating and executing the fraudulent scheme; drafted materially misleading communications to Refco investors; were heavily involved in due diligence and negotiations relating to Refco’s securities offerings; and were identified by name as counsel to Refco in the false statements provided to investors.

Unlike *Stoneridge*, where the outside customers’ and vendors’ “deceptive acts were not communicated to the public,” 2008 WL 123801, at *6, Defendants’ fraudulent conduct consisted of creating and orchestrating sham transactions that removed significant uncollectible related-party receivables from Refco’s books, and then preparing the false and misleading securities offering documents by which Refco’s statements were communicated to, and relied on by, investors. As charged in the Collins Indictment, Collins acted as the “public face” of Refco in implementing the fraudulent scheme and made numerous misrepresentations in an attempt to conceal the fraud. For instance, he caused “false and misleading information to be provided”

directly to the purchasers of the 144A Bonds. Collins Indictment ¶ 41. In short, Defendants' own conduct "made it necessary [and] inevitable" for Refco to make false and misleading disclosures to investors in its offering documents, satisfying the reliance prong of Lead Plaintiffs' Rule 10b-5 claim.

In *Stoneridge*, the Supreme Court also noted that reliance could be presumed if there was "an omission of a material fact by one with a duty to disclose." 2008 WL 123801, at *6. Defendants had such a duty by virtue of Rule 4.1 of the Illinois Supreme Court Rules of Professional Conduct,¹⁷ which provides that in the course of representing a client, "a lawyer shall not ... fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6." Under Rule 1.6, a lawyer has permission to reveal "(1) confidences or secrets when permitted under these Rules or required by law or court order; [or] (2) the intention of a client to commit a crime in circumstances other than those enumerated in Rule 1.6(b)." Defendants knew that in seeking to sell securities to the public, Refco intended to commit fraudulent and criminal acts. In these circumstances, Rule 1.6 did not prohibit disclosure, and therefore Defendants had a duty under Rule 4.1 to disclose the facts to avoid assisting their client's fraudulent and criminal acts. There was, therefore, "an omission of a material fact by one with a duty to disclose," 2008 WL 123801, at *6, and reliance is presumed.

B. Plaintiffs Allege Conduct by Defendants That Violates Rule 10b-5(a) and (c)

The Complaint alleges with specificity that Collins and Mayer Brown conceived, negotiated, and implemented both the transformation of uncollectible customer debts into the purportedly collectible, but actually worthless RGHI receivable, and the repeated concealment of

this sham related-party receivable by means of round-trip loans that lacked any economic substance. ¶¶ 440-42; 451-519; 549-58; 564-72. The Complaint further alleges that Collins and Mayer Brown directly participated in concealing these secret transactions from investors. ¶¶ 715-21. Collins has been indicted for securities fraud and other crimes for his role in these transactions. Collins Indictment ¶¶ 74-85. The Collins Indictment explicitly quotes Rule 10b-5(a) and (c), indicating that the United States Attorney’s Office intends to prove beyond a reasonable doubt that Collins engaged in a criminal scheme to defraud and a course of business which operated as a fraud on purchasers of Refco publicly traded securities. *Id.* ¶¶ 37, 47-49. Together, these facts demonstrate that Defendants’ conduct was inherently deceitful and therefore satisfies the first and second elements of a claim under Rule 10b-5(a) and (c). These Defendants “conceived and engineered” the fraudulent scheme and are primarily liable. *In re Salomon Analyst AT&T Litig.*, 350 F. Supp. 2d 455, 474 (S.D.N.Y. 2004) (Lynch, J.).

The Complaint’s Rule 10b-5(a) and (c) claims against Collins and Mayer Brown are not, as they assert, contrary to *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), which held that there is no private cause of action for “aiding and abetting” a Rule 10b-5 violation. MB Mem. at 8, 18. Nor are these claims contrary to *Stoneridge*’s admonition against allowing scheme liability claims to “revive in substance the implied cause of action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud” 2008 WL 123801, at *8. The Complaint seeks to hold Collins and Mayer Brown liable for their *own* deceptive conduct in devising and implementing the improper transactions and preparing the false offering documents upon which investors relied.

¹⁷ Mayer Brown is an Illinois limited liability partnership, ¶ 76, and much of the deceptive conduct alleged in the Complaint emanated from its Chicago office.

The Supreme Court's affirmation in *Stoneridge* that secondary actors who engage in deceptive conduct may incur primary liability under Rule 10b-5(a) and (c) confirms this Court's reading of *Central Bank* in *Global Crossing*:

[T]he Supreme Court's ruling in *Central Bank* does not amount to a categorical prohibition on claims against secondary actors such as accountants. To the contrary, the Court explicitly emphasized that secondary actors such as accountants and lawyers may still be held liable where they commit a primary violation of securities laws: "Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met In any complex securities fraud . . . there are likely to be multiple violators." *Central Bank*, 511 U.S. at 191, 114 S. Ct. 1439 (emphasis in original).

322 F. Supp. 2d at 330. Similarly, Judge Kaplan has held:

This analysis is not an end run around *Central Bank*. If a defendant has committed no act within the scope of Section 10(b) and Rule 10b-5 – as in fact was the case in *Central Bank* – then liability will not arise on the theory that that defendant assisted another in violating the statute and rule. But where, as alleged here, a [defendant] enters into deceptive transactions as part of a scheme in violation of Rule 10b-5(a) and (c) that causes foreseeable losses in the securities markets, that [defendant] is subject to private liability under Section 10(b) and Rule 10b-5.

In re Parmalat Sec. Litig., 376 F. Supp. 2d 472, 509-10 (S.D.N.Y. 2005).¹⁸

Second Circuit law validates Rule 10b-5(a) and (c) claims against defendants, including professionals, who participate in a scheme to defraud investors while artfully avoiding making public misrepresentations. *See SEC v. U.S. Environmental, Inc.*, 155 F.3d 107, 112 (2d Cir. 1998) (upholding claims against stock trader who did not make false statements, but participated in his company's manipulative trading); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1471-72

¹⁸ The Supreme Court in *Stoneridge* arguably rejected *Parmalat* only with respect to the way in which reliance must be pleaded and established under Rule 10b-5(a) and (c). *See Stoneridge*, 2008 WL 123801, at *7. Nothing in *Stoneridge* undermines *Parmalat's* (or *Global Crossing's*) analysis of the other elements of a claim under Rule 10b-5(a) and (c). As discussed herein, the Complaint fully satisfies *Stoneridge's* holding with respect to reliance.

(2d Cir. 1996) (upholding claims against corporate insider who did not make false statements, but planned and orchestrated his company’s program of fraudulent securities trading); *SEC v. PIMCO Advisors Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004) (“If the SEC were able to charge [insider defendants] with knowledge of the inherently fraudulent selective disclosures, [defendants’] activities would fit squarely into the rule articulated in *U.S. Environmental* . . . in which ‘participat[ion] in a fraudulent scheme or other activity proscribed by the securities laws,’ 155 F.3d at 111, gives rise to primary 10b-5 liability.”);¹⁹ *Rich v. Maidstone Fin., Inc.*, No. 98 Civ. 2569 (DAB), 2002 WL 31867724, at *9 (S.D.N.Y. Dec. 20, 2002) (upholding claim against brokerage insider who made no misstatement but carried out fraudulent scheme); *Mishkin v. Ageloff*, No. 97 Civ. 2690 (LAP), 1998 WL 651065, at *18-19 (S.D.N.Y. Sept. 23, 1998) (same).²⁰

Defendants’ argument that the Complaint alleges “nothing more than typical lawyer work assisting a client with corporate transactions,” MB Mem. at 19, is remarkable. As the United States Attorney has stated, it is by no means typical for corporate lawyers to engage in seventeen sham transactions which conceal hundreds of millions of dollars worth of bad debts, to deliberately fail properly to disclose such transactions in securities offering documents, and to be indicted for their misconduct.²¹ Nor is Defendants’ reliance on *In re Refco Capital Markets, Ltd.*

¹⁹ *U.S. Environmental*, *First Jersey*, and *PIMCO* were SEC enforcement actions, but the cited sections of those opinions address primary Rule 10b-5 liability, not aiding and abetting. Thus, these cases’ reasoning and holdings apply to private Rule 10b-5 actions.

²⁰ The complaints in *Rich* and *Mishkin* were dismissed for failure to plead defendants’ participation in the fraudulent schemes with sufficient particularity under Rule 9(b). *Rich*, 2002 WL 31867724, at *10; *Mishkin*, 1998 WL 651065, at *21. This in no way weakens these decisions’ reasoning regarding the ability to state scheme liability claims under Rule 10b-5(a) and (c) and Fed. R. Civ. P. 12(b)(6).

²¹ Defendants also argue that the Complaint does not adequately allege that they knew about the “third leg” of the round-trip loans in which RGHI temporarily paid down its debt to Refco. MB Mem. at 21. However, the Complaint alleges that these Defendants were fully aware of this part of the transaction, because they designed the entire transaction structure and drafted the guaranty and indemnity by Refco for the benefit of the third party participant,

(Cont’d)

Brokerage Customer Securities Litigation, No. 06 Civ. 643 (GEL), 2007 WL 2694469 (S.D.N.Y. Sept. 13, 2007), well placed, because the plaintiffs there failed to allege how Refco Capital Markets operated normally, how it diverted their assets, and what false impression it conveyed. *Id.* at **2, 8. The detailed allegations about Defendants’ role in the sham transactions here clearly distinguish this complaint from the one in *Refco Capital Markets*.

In re Parmalat Securities Litigation, 383 F. Supp. 2d 616 (S.D.N.Y. 2005), also cited by Defendants, actually supports Plaintiffs, because in that case Judge Kaplan upheld scheme liability claims against an attorney and law firm who “created and controlled” shell companies with which Parmalat engaged in fraudulent transactions. *Id.* at 625-26. Mayer Brown attorneys created all the documentation for seventeen sham transactions and even cancelled the third parties’ notes while unwinding some of the round-trip loans. ¶¶ 554, 564, 574. As in the claims sustained in *Parmalat*, Collins and Mayer Brown “allegedly designed and helped perpetrate transactions intended to misrepresent a client's financial situation” and did far more than merely provide legal opinions and similar services, as in the claims dismissed in *Parmalat*.

On similar facts, in *Global Crossing*, this Court held that an accounting firm could be liable under Rule 10b-5(a) and (c) where it “essentially created the accounting schemes used to inflate the Companies’ financials at the outset,” “masterminded the misleading accounting,” and “actively participated in structuring each [sham transaction].” 322 F. Supp. 2d at 335-36.²² Of

which clearly indicated that the transactions were for the benefit of Refco, not RGHI. ¶¶ 467, 474, 479, 485, 492, 497, 503, 509, 512, 517, 553, 567, 569, 571, 631.

²² Defendants mischaracterize *Global Crossing* as holding that “claims based on alleged misrepresentations and omissions cannot state a claim under Rule 10b-5(a) or (c).” MB Mem. at 16 (citing *Global Crossing*, 322 F. Supp. at 337 n.17). This Court actually held in *Global Crossing* that Rule 10b-5(a) and (c) “may only be used against [a defendant] for the underlying deceptive devices or frauds themselves,” not to impose liability for false statements that neither relate to the defendants’ underlying deceptive conduct nor are attributable to the defendant. 322 F. Supp. 2d at 337 n.17. This Court did *not* hold that scheme liability is unavailable where a defendant both engages in deceptive conduct and makes false statements, as Collins and Mayer Brown did.

course, Collins and Mayer Brown were as central to the Refco fraud as Arthur Andersen LLP was to the Global Crossing fraud. *See also Stoneridge*, 2008 WL 123801, at *7 (round-trip transactions cycling cash between issuer and its customers and vendors constituted deceptive conduct under Rule 10b-5(a) and (c)); *Parmalat*, 376 F. Supp. 2d at 504 (banks' "factoring and securitization of worthless invoices were deceptive devices or contrivances for purposes of Section 10(b)" and were actionable under 10b-5(a) and (c) because "[t]he transactions in which the defendants engaged were by nature deceptive").²³

III. THE COMPLAINT GIVES RISE TO A STRONG INFERENCE OF DEFENDANTS' SCIENTER

Plaintiffs may "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," 15 U.S.C. § 78u-4(b)(2), in two ways: "(a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 168-69 (2d Cir. 2000); *see also Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000); *In re Carter-Wallace Sec. Litig.*, 220 F.3d 36, 39 (2d Cir. 2000). The Complaint here does both.

When ruling on a motion to dismiss under Rule 12(b)(6), a court must accept the complaint's factual allegations as true, *see, e.g., Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co.*, 32 F.3d 697, 699-700 (2d Cir. 1994), and determine whether the allegations, viewed *as a*

²³ The Complaint also satisfies the "in connection with the purchase or sale of any security" and "loss causation" elements of Rule 10b-5 (and Defendants do not suggest otherwise). "A plaintiff makes out a sufficient nexus with the purchase or sale of securities when the defendants' deceptive conduct affects a market for securities." *Parmalat*, 376 F. Supp. 2d at 505-06. By conceiving and implementing the transfer of worthless customer receivables to RGHI and the sham round-trip loans that allowed Refco to conceal the RGHI receivable, and by concealing these transactions from the market in the materially false and incomplete documents they drafted for Refco, Collins and Mayer Brown misled investors about Refco's financial condition. The market's swift adverse reaction when the truth was revealed confirms that Defendants' deceptive conduct artificially inflated the market prices of Refco securities, and that its disclosure caused losses to investors.

whole, adequately state a claim. See *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 658 (S.D.N.Y. 2007); *SEC v. Collins & Aikman Corp.*, No. 07 Civ. 2419 (SAS), 2007 WL 4480025, at *13 (S.D.N.Y. Dec. 21, 2007). In clarifying the scienter pleading standard in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007), the Supreme Court reaffirmed these principles.

First, faced with a Rule 12(b)(6) motion to dismiss a § 10(b) action, courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true Second, courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice. The inquiry . . . is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.

127 S. Ct. at 2509 (internal citation omitted) (emphasis omitted).

In addition, under *Tellabs*, a district court ruling on a motion to dismiss must consider plausible opposing inferences that could reasonably be drawn from the facts alleged in the complaint. Thus, the relevant inquiry is whether the alleged facts – accepted as true and viewed as a whole – create an inference of scienter that is “cogent and *at least as compelling as any* opposing inference one could draw *from the facts alleged.*” *Id.* at 2510 (emphasis added). Notably, the Supreme Court made clear that the inference of scienter “need not be irrefutable, *i.e.*, of the ‘smoking gun’ genre, *or even the ‘most plausible of competing inferences.’*” *Id.* (quotation omitted) (emphasis added).

As the Seventh Circuit recently held on remand in *Tellabs*, the scienter pleading standard is satisfied by the same concepts of recklessness that governed before passage of the PSLRA. Thus, “when the facts known to a person place him on notice of a risk, he cannot ignore the facts and plead ignorance of the risk.” *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, No. 04-1687, 2008

U.S. App. LEXIS 975, at *4 (7th Cir. Jan. 17, 2008). Under this formulation, a securities fraud complaint must be sustained unless “on its face, and without reference to the defendant’s case, [it] creates only a weak or bare inference of scienter, suggesting that the plaintiff would prevail only if there were no defense case at all.” *Id.* at *7. As Judge Posner stated: “[T]he critical question . . . is how likely it is that the allegedly false statements . . . were the result of merely careless mistakes . . . rather than of an intent to deceive or a reckless indifference.” *Id.* at *17. Holding that this was “exceedingly unlikely” and “no plausible story has yet been told by the defendants that might dispel our incredulity,” the Seventh Circuit reversed the District Court’s dismissal of the complaint. *Id.*

Defendants erroneously contend that Plaintiffs must plead that at least *one particular individual* affiliated with Mayer Brown acted with scienter. MB Mem. at 25. To the contrary, and as Defendants acknowledge, courts in this District have held that this is not required. *See, e.g., In re Worldcom, Inc. Sec. Litig.*, 352 F. Supp. 2d 472, 497 (S.D.N.Y. 2005) (“To carry their burden of showing that a corporate defendant acted with scienter, plaintiffs in securities fraud cases need not prove that any one individual employee of a corporate defendant also acted with scienter. Proof of a corporation’s collective knowledge and intent is sufficient.”); *In re Oxford Health Plans, Inc. Sec. Litig.*, 51 F. Supp. 2d 290, 294-96 (S.D.N.Y. 1999) (finding that plaintiffs had sufficiently alleged auditing firm’s scienter without reference to acts or omissions of any particular employees or agents of the firm); *see also Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 2008 U.S. App. LEXIS 975, at *21 (“it is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud”). Even if the test were as Defendants contend, Lead Plaintiffs have plainly established Collins’ scienter.

A. Plaintiffs’ Well-Pleaded Factual Allegations of Conscious Misbehavior and Recklessness Create an Inference of Scienter That Is Cogent and at Least as Compelling as Any Competing Inference

Plaintiffs’ well-pleaded allegations give rise to an inference of scienter that is cogent and at least as compelling as any competing inference that could be drawn from the Complaint’s allegations. The Complaint contains extensive factual allegations demonstrating that Defendants were, at best, reckless in participating in Refco’s fraudulent scheme. As set forth above in detail, Defendants played a vital role in the fraudulent scheme and plainly knew that the scheme was being conducted for a fraudulent purpose. *See supra* at 4-8; ¶¶ 452-519; 549-58; 563-72.

Despite the suspicious nature of the round-trip loans – *i.e.*, repeated short-term loans in the exact same amount between Refco Capital and a third party, on one hand, and between the same third party and RGHI, on the other hand, in amounts dwarfing Refco’s net income and timed to straddle the close of its financial reporting periods – Defendants drafted *all* of the documents needed to effectuate these shams a staggering *seventeen times*. The Complaint contains many other detailed allegations of these Defendants’ scienter, including:

- Defendants participated in drafting the Offering Memorandum and IPO Registration Statement and knew that their descriptions of Refco’s related-party transactions and customer receivables were inaccurate (¶¶ 136, 201, 221);
- Defendants participated in a transaction, which they knew lacked any legitimate business purpose, to transfer an uncollectible \$71 million receivable from Refco customer Niederhoffer off the Company’s books and convert it to a receivable purportedly owed to Refco by RGHI (¶¶ 440-42);
- Other outside professionals reviewing the Niederhoffer receivable, who were far less familiar with Refco than Defendants, recognized that they could be viewed as “somehow being an accessory to some type of fraud” if they advised Refco that it could continue to recognize the Niederhoffer receivable, demonstrating that Defendants knew (or recklessly disregarded) that Refco’s treatment of the Niederhoffer losses was improper (¶ 444); and
- Defendants knew that Refco had a long history of regulatory violations, some of which involved the same type of transactions that Refco used to hide the fraud in this case (*i.e.*, improperly shifting funds between related party accounts) (¶ 647).

Refco's court-appointed bankruptcy Examiner, after reviewing over a million pages of documents about Mayer Brown's representation of Refco and interviewing Mayer Brown employees, concluded that "there is evidence showing that Mayer Brown *knew* that the Round Trip Loans were a scheme to avoid disclosure of the RGHI Receivable on Refco's audited financial statements in order to fraudulently bolster Refco's financial appearance to lenders and investors." ¶ 721 (quoting Examiner's Report (emphasis added)). Further, as discussed above, in announcing the Collins Indictment, the U.S. Attorney made clear that his office concluded that Collins intentionally participated in Refco's fraud. *See Sabella Decl. Ex. 2.*

Plaintiffs' allegations, viewed in their totality, create a cogent and compelling inference of scienter based on conscious misbehavior or recklessness. *See, e.g., In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d at 648-50 (size, timing, recurrent nature, and obvious lack of business purpose of sham loan transactions and Refco's history of regulatory violations were sufficient to establish scienter as to defendants who had reason to be aware of these facts).

Faced with these formidable allegations, Defendants attempt to construct a competing inference of non-scienter by selectively attacking isolated portions of the Complaint. *See MB Mem.* at 24-33. These assaults on Plaintiffs' well-pleaded allegations do not dispel the cogent and compelling inference of scienter created by the Complaint.

1. Defendants' Involvement in the Round-Trip Loan Transactions Gives Rise to an Inference of Scienter That Is at Least as Plausible as Any Other Inference

Defendants attempt to downplay the significance of their involvement in drafting the round-trip loan documents by arguing that (1) they did not know that RGHI used the loan proceeds to pay down its receivable to Refco; (2) "[b]ack-to-back loans are commonly used in financing transactions" and, accordingly, "there is nothing inherently suspicious about them"; and (3) they understood that "the purpose of the back-to-back loans was obvious from the face of

the documents—to provide RGHI with short-term liquidity.” MB Mem. at 28. These arguments are unavailing for two reasons.

First, Defendants’ claim that they did not know the proceeds of these “loans” were used to pay down the RGHI receivable (or that they were not reckless in failing to discover this) strains credulity given that (1) many of the loan documents contained a “use of proceeds” clause expressly requiring the money to be used only to make a loan to RGHI; (2) Defendants knew that RGHI (which they also represented) had no operations or liquid assets, making it highly unlikely that it would need to repeatedly borrow hundreds of millions of dollars for a few days at the end of Refco’s financial reporting periods *or* that it would be able to repay these loans;²⁴ (3) the loans straddled the end of Refco’s financial reporting periods and were always designed to be repaid within a few days; and (4) Refco guaranteed repayment of the loans by third parties and indemnified the third parties against any loss or liability arising from the transactions, demonstrating that the loans were for the benefit of Refco, not RGHI. These facts create an inference of scienter that is at least as compelling as any opposing inference.

Second, Defendants’ arguments based on (1) the purportedly “common[] use[] in financing transactions” of back-to-back loans and (2) the supposedly “obvious” purpose of the round-trip loans fly in the face of the Complaints’ allegations. Accordingly, the Court cannot consider any inferences drawn from these supposed “facts.” *See Tellabs*, 127 S. Ct. at 2504 (court should consider “competing inferences *rationaly drawn from the facts alleged*”)

²⁴ Defendants’ claim that “[a]s the owner of Refco, RGHI was presumably worth hundreds of millions of dollars, giving Mayer Brown lawyers every reason to believe that RGHI had the economic means to take on debt and handle it responsibly” (MB Mem. at 28 n.12) directly contradicts the Complaint’s allegations, which must be assumed to be true. *See* ¶ 638 (“Mayer Brown [and] Collins . . . knew that RGHI . . . was simply an off balance-sheet holding company that Bennett and Grant used to ‘park’ their significant personal holdings of Refco stock. These Defendants also knew that RGHI had no liquid assets and no operational functions, thereby making it highly suspicious that RGHI would repeatedly need to ‘borrow’ hundreds of millions of dollars (at each of Refco’s financial period ends) for any legitimate purpose.”).

(emphasis added); *In re Openwave Sys. Sec. Litig.*, No. 07 Civ. 1309 (DLC), 2007 WL 3224584, at *10 (S.D.N.Y. Oct. 31, 2007) (refusing to consider an “argument [that] does not arise from the face of the Complaint, and depends on the weighing of evidence of intent which, even after *Tellabs*, is reserved for trial”).²⁵

2. Defendants’ Role in Concealing Niederhoffer’s Losses Gives Rise to an Inference of Scienter at Least as Plausible as Any Other Inference

Lead Plaintiffs allege that Defendants participated in a scheme to convert \$71 million in uncollectible trading losses sustained by a customer into “receivables” purportedly owed to Refco by RGHI. ¶¶ 439-42. Defendants contend that these allegations negate, rather than support, an inference of scienter because they suggest that “Mayer Brown would not have known that Refco executives had created a massive, hidden receivable.” MB Mem. at 30. To support this *non sequitur*, Defendants sidestep significant portions of the Complaint’s allegations and analyze these allegations as if they deal only with “*hidden* inter-company receivables,” asserting that “Plaintiffs have failed to allege any facts demonstrating [Defendants’] knowledge that the alleged \$71 million RGHI Receivable was hidden.” *Id.* This argument misses the mark. Defendants’ speculation that this receivable was included in the \$252 million in related-party receivables disclosed in Refco’s 1998 financial statements is of no moment, because those financial statements did *not* disclose the uncollectibility of the receivable, which was well known to Defendants.²⁶ Moreover, the Complaint alleges that by 2004 and 2005 – when the false

²⁵ For the same reason, the Court cannot consider any inferences flowing from the purportedly “ministerial” nature of Defendants’ role in the roundtrip loan scheme. MB Mem. at 29. This “fact” is flatly refuted by the Complaint, which alleges that Defendants were intimately involved in every facet of these transactions. *See, e.g.*, ¶ 452 (Defendants were involved in “negotiating the terms of the loans, drafting and revising the documents relating to the loans, transmitting the documents to the participants, and retaining custody of and distributing the executed copies of the documents. In at least one instance, Mayer Brown even represented the counterparty to the loans, in addition to representing Refco and RGHI.”).

²⁶ Defendants’ assertions concerning the DF Capital documents falter for the same reason. Plaintiffs do not, as Defendants erroneously contend, “fail to make the distinction between inter-company receivables and *secret* inter-

(Cont’d)

statements at issue in this case were made – the uncollectible related party receivables were not being disclosed, but rather were being passed off as third party receivables.²⁷ Lead Plaintiffs allege that Refco used a structure similar to the Niederhoffer transaction to transfer other uncollectible receivables to RGHI, and that by 2002 Mayer Brown knew the RGHI receivable had grown to hundreds of millions of dollars. ¶¶ 717-19. Given Defendants’ close relationship to Refco and their involvement in the Niederhoffer transaction and in other transactions designed to conceal the related party receivables, there is a compelling inference that they knew the RGHI receivable consisted of other uncollectible customer receivables. The purported “disclosure” of related party receivables in 1998 simply does not negate Defendants’ scienter with respect to the concealment of such receivables *through transactions they orchestrated* in later years.

Finally, Defendants’ arguments about the Assignment Agreement do not defeat the inference of scienter. That the Assignment Agreement purportedly bound RGHI to provide Refco \$71 million in “immediately available funds” in exchange for the right to collect on the \$71 million debt – from which Niederhoffer had previously been released *in a settlement agreement drafted by Defendants* (¶ 440) – does not change the analysis. In fact, Lead Plaintiffs specifically allege that Defendants knew that (1) there was no legitimate reason for RGHI to agree to pay \$71 million to Refco in return for the “right” to collect an unenforceable debt, and

company receivables.” MB Mem. at 32. To the contrary, it is Defendants who fail to make the relevant distinction — between legitimate, *collectible* receivables and sham *uncollectible* receivables. The RGHI receivable itself was a fraud, as it was nothing more than disguised uncollectible customer receivables. That this receivable – but not its nature as an *uncollectible* receivable – may have been disclosed in pre-IPO financial statements, before the Company saw the need to expand the scheme to replace the RGHI receivable itself with phony third-party receivables, does nothing to dispel the cogent and compelling inference of scienter.

²⁷ Defendants’ contention that a handwritten note referring to “Loans to RGH[I]” is not probative of scienter also fails. MB Mem. at 30 n.13. First, Defendants’ factual argument that the Examiner never asked Collins about this note and that Collins did not make it, goes beyond the scope of the Complaint and should not be considered on this motion. Second, the 1998 financial statements’ disclosure of \$252 million in related-party receivables is of no consequence, because Plaintiffs allege that this “related party receivable” actually consisted of uncollectible customer trading losses masquerading as collectible receivables from RGHI.

(2) RGHI had no conceivable means of paying \$71 million to Refco. ¶¶ 441-42.

B. Plaintiffs' Well-Pleaded Factual Allegations of Motive and Opportunity Create an Inference of Scienter That Is Cogent and at Least as Compelling as Any Competing Inference

The Complaint alleges that Defendants had the motive and opportunity to commit fraud. Specifically, Plaintiffs allege that Refco was an extremely lucrative client for Mayer Brown, paying approximately \$5 million in legal fees every year (or approximately \$40 million in total). ¶ 78. Moreover, Plaintiffs allege that Refco was vitally important to Collins, accounting for more than half of his total billings. Collins knew that if Refco went out of business or took its business elsewhere, his own salary, bonus, and position of influence within the firm would suffer. ¶ 714. These allegations support an inference of scienter. *See, e.g., In re Qwest Commc'ns Int'l, Inc.*, 396 F. Supp. 2d 1178, 1208 (D. Colo. 2004) (allegations that auditors had motive to commit fraud due to importance of telephone company as client, contributing in excess of \$8 million in fees, supported inference of scienter); *In re Rospatch Sec. Litig.*, 760 F. Supp. 1239, 1253 (W.D. Mich. 1991) (fact that Rospatch was one of law firm's "major clients," in conjunction with fact that firm had handled transactions leading to writeoffs, supported inference of scienter). Moreover, because Refco's fraud was essential to the Company's continued existence, Mayer Brown and Collins "stood to profit in a direct, personal and concrete way from the alleged fraud." *Refco*, 503 F. Supp. 2d at 647. If the fraud was revealed, the Company could not survive, and Defendants would lose the benefits flowing from its continued existence. These allegations of motive and opportunity support a cogent and strong inference of scienter.

To refute this inference, Defendants contend that their "motive to commit fraud to further the sale of Refco is belied by the fact that the LBO could have been expected to (and did) result in the loss of most of Mayer Brown's Refco work to THL Partners' outside counsel." MB Mem. at 26. The Court should not consider this speculative argument. Nothing in the Complaint or in

any document which may properly be considered in ruling on this motion suggests that Defendants expected to (or did) lose the Refco account after the LBO.

IV. THE COMPLAINT ADEQUATELY ALLEGES RELIANCE

Defendants' arguments as to reliance (MB Mem. at 34-42) ignore the Complaint's allegations, distort the applicable pleading standard, and ask the Court to make factual determinations inappropriate until a more complete factual record is developed.

A. The Complaint's Detailed Allegations of Reliance

Contrary to Defendants' arguments, the Complaint contains numerous detailed allegations of reliance that are plainly sufficient at this stage. As discussed above, the Complaint alleges — and the Collins Indictment confirms — that Defendants drafted significant portions of the materially false offering documents used to sell Refco Bonds and common stock to investors. ¶¶ 170, 201. These documents were drafted by Collins and Mayer Brown and others for the *sole purpose* of soliciting investors' purchases of Refco securities, and Refco and Defendants intended for investors to rely on these documents when making investment decisions. For instance, the Offering Memorandum and the IPO Registration Statement both expressly instructed investors to rely on the information they contained. ¶ 729; Sabella Decl. Ex. 4 at i.

Moreover, the offering documents specifically identified Mayer Brown as Refco's counsel. ¶¶ 79, 116, 201. This public acknowledgement of Mayer Brown's role was consistent with public statements made during the Class Period about Mayer Brown's close involvement with Refco. For instance, a profile of Collins on the Mayer Brown website, which was published during the Class Period (but has since been deleted), described Collins as the "Lead attorney for Refco," and press reports demonstrate that the market was aware of Collins' involvement with

the Company by describing him as the “go-to-guy at Refco.” ¶¶ 245, 710.²⁸

As noted above, Defendants also played a central role in devising and implementing the fraudulent transactions on behalf of Refco. ¶¶ 439-448, 451-52, 457-60, 471, 476, 482, 488, 494, 500, 506, 512, 514, 550-58, 564-65, 567, 569-72, 574. They did this, among other reasons, in order to present false information to investors in the offering documents on which investors relied in purchasing Refco securities. Indeed, the Collins Indictment charges that Collins “caused . . . false and misleading information to be provided to the . . . purchasers of [Refco’s Bonds] and their advisers” (Collins Indictment ¶ 41), and “[a]s a result of Collins’ lies on behalf of Refco, Collins and Bennett were able to achieve the ultimate objective of the scheme [including] the sale of approximately . . . \$600 million of [Bonds] to private investors in 2004 . . . and the August 2005 IPO of stock in Refco.” *Id.* ¶ 10.

The Complaint also alleges in detail that Refco’s 144A Bonds, Registered Bonds, and common stock all traded on efficient markets based on analyst and rating agency coverage, market structure, trading volumes, bid-ask spreads, and other relevant factors. ¶¶ 737-43. The Complaint alleges that Refco’s stock price reacted promptly and in a statistically significant way to disclosures of new information, that Refco was followed by several securities analysts who published research reports regarding the Company, that Refco’s average weekly trading volume and market capitalization support an inference that the market for Refco’s stock was efficient, and that Refco’s securities were owned by large sophisticated institutional investors, with “over 60% of the IPO shares having been allocated to the top 50 institutional shareholders in the United States.” ¶ 742. The Complaint contains similar detailed allegations regarding the market for Refco’s Bonds. ¶¶ 737-40. These are the very factors that courts evaluate when determining

²⁸ Indeed, an article on October 18, 2005 (shortly after the end of the Class Period) noted that Mayer Brown drafted
(*Cont’d*)

whether the fraud-on-the-market presumption applies. *See, e.g., Cammer v. Bloom*, 711 F. Supp. 1264, 1276 n.17 (D.N.J. 1989).

As discussed below, in light of the Complaint's detailed allegations of reliance, Defendants' contention that the Complaint does not adequately allege *any* theory by which reliance may be presumed at this stage must be rejected.

B. The Applicable Pleading Standards

Defendants argue that Plaintiffs face “extremely demanding pleading standards” in alleging reliance. MB Mem. at 37. They are wrong. As discussed above, the PSLRA established heightened pleading standards in 10b-5 cases with respect to defendants' scienter. But neither the PSLRA's heightened pleading standards nor Rule 9(b) apply to the Complaint's allegations of reliance, which need only satisfy the notice pleading standard of Rule 8(a). *Cromer Fin. Ltd. v. Berger*, No. 00 Civ. 2284 (DLC), 2001 U.S. Dist. LEXIS 14744, at *7 (S.D.N.Y. Sept. 20, 2001). The Supreme Court recently addressed Rule 8(a) in *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007). As construed by the Second Circuit, *Twombly* imposes “a flexible ‘plausibility standard,’ which obliges a pleader to amplify a claim with some factual allegations in those contexts where such amplification is needed to render the claim plausible.” *Iqbal v. Hasty*, 490 F.3d 143, 157-58 (2d Cir. 2007). However, the rule remains that “[t]he court is to draw all reasonable inferences in favor of the plaintiff.” *Kassner v. 2nd Avenue Delicatessen, Inc.*, 496 F.3d 229, 237 (2d Cir. 2007). And, “[a]s always, the court must ‘accept[] all factual allegations in the complaint.’” *In re Refco Capital Mkts.*, No. 06 Civ. 643 (GEL), 2007 WL 2694469, at *6 (S.D.N.Y. Sept. 13, 2007) (quoting *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007)). The Complaint's reliance allegations amply satisfy

the sham round-trip loan documents and “worked for Refco in the broker's \$583 million IPO in August.” ¶ 245.

this standard. ¶¶ 729-44.

C. Plaintiffs Are Entitled to a Presumption of Reliance at This Stage of the Litigation

Ignoring the allegations of the Complaint and distorting the applicable pleading standard, Defendants contend that the facts alleged do not provide a basis for presuming reliance under any legal theory. MB Mem. at 34. This argument is not only wrong, it asks the Court to make factual determinations that cannot be made until summary judgment or class certification (at the earliest), after the parties have had the opportunity to develop a full factual record. Indeed, many of the arguments raised by Defendants implicate precisely the type of “merits issues” and “factual disputes” that the Second Circuit has acknowledged require discovery. *See In re Initial Pub. Offering Sec. Litig.*, 471 F.3d 24, 41 (2d Cir. 2006). As discussed below, none of these arguments provides a basis for dismissing the Complaint at the pleading stage.

First, Defendants assert that the presumption of reliance on material omissions recognized by the Supreme Court in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), does not apply to them because they purportedly had no “duty to disclose” their participation in the fraud at Refco. MB Mem. at 35. But, as discussed above, Mayer Brown was required by Rule 4.1 of the Illinois Supreme Court to “disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client.” Moreover, as Refco’s primary outside counsel, Mayer Brown certainly had a duty to disclose to Refco’s board of directors Mayer Brown’s knowledge of (and participation in) the fraud at Refco. *See, e.g.*, 17 C.F.R. § 205.3. While certain members of Refco’s Board are themselves culpable for their reckless failure to uncover the fraud, there is no allegation in the Complaint that Collins or Mayer Brown ever disclosed the fraud to Refco’s board, as they plainly had a duty to do. And Defendants repeatedly failed to disclose material facts in numerous telephone calls,

meetings, emails and other correspondence with, among others, “Refco’s banks, investors, potential investors, and their advisers.” Collins Indictment ¶ 10. Thus, the Complaint adequately alleges that Defendants had a duty to disclose the fraud and breached that duty.²⁹

Second, Defendants argue that Plaintiffs are not entitled, as a matter of law, to the “fraud created the market” presumption. Specifically, Defendants argue that the Complaint does not adequately allege that “Refco stock could not have been sold at any price and Refco bonds could not have been offered at any combination of price and interest rate” had the fraud been disclosed. MB Mem. at 37. This argument fails.

The Fifth and Eleventh Circuits adopted a “fraud-created-the-market” presumption of reliance in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981), and *Ross v. Bank South, N.A.*, 885 F.2d 723 (11th Cir. 1989). The Tenth Circuit similarly adopted the fraud-created-the-market presumption in *T.J. Raney & Sons, Inc. v. Fort Cobb, Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330 (10th Cir. 1983), and *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000).³⁰ While the Second Circuit has not ruled on this doctrine, this case presents a compelling instance of why

²⁹ Defendants also contend that the *Affiliated Ute* presumption does not apply to them because the “gist” of the Complaint is that they made false statements, not that they failed to disclose material facts. MB Mem. at 34-35. But Defendants argue extensively elsewhere in their brief that they *did not* make any false statements attributable to them. MB Mem. at 7-15. If they are correct about that (which they are not), then the remaining “gist” of the Complaint will focus on their liability for their material omissions. If they are not correct, then the *Affiliated Ute* presumption will operate in parallel with the other theories of reliance alleged by Plaintiffs. In any event, *Starr ex rel. Estate of Sampson v. Georgeson Shareholder, Inc.*, 412 F.3d 103 (2d Cir. 2005), cited by Defendants, does not weigh against applying the *Affiliated Ute* presumption in this case, because in *Starr*, the allegedly omitted information had actually been fully disclosed in prior communications to the investors. *Id.* at 110.

³⁰ Only one Circuit has rejected the fraud-created-the-market presumption. *Eckstein v. Balcors Film Investors*, 8 F.3d 1121, 1130-31 (7th Cir. 1993). *Eckstein*’s reasoning is inapposite, because it relies on the trading of securities of bankrupt companies as proof that any company, no matter how pervasively fraudulent, can sell securities to the public market. *Id.* at 1131. However, no company could successfully market an IPO or bond offering if it disclosed that it was already insolvent, as Refco was at the time of its IPO and Bond Offering. Only bankrupt companies that went public *before* falling into bankruptcy have publicly traded securities. And contrary to Defendants’ claim that the Sixth Circuit has “strongly criticized” the fraud-created-the-market presumption (MB Mem. at 36), that Circuit expressly declined to reject or adopt this doctrine because it was not properly presented on the facts of the cases before that court. *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1161 (6th Cir. 1994); *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 200 (6th Cir. 1990).

investors' reliance should be presumed where a fraud was so massive that the securities could not economically or legally have been marketed at all, absent the fraud.

The Complaint alleges that had investors known about the Refco fraud “there would have been no market for the Bonds.” ¶ 733. The Complaint also alleges that if the truth had been disclosed, “Refco would have been in violation of the restrictive covenants of its loan agreements.” *Id.* Valid issuance of the Bonds in violation of prior covenants would not have been possible as a matter of corporate law. The Complaint further alleges that Refco and/or its regulated subsidiaries were “in violation of the CFTC’s minimum net capital requirements and/or other regulatory capital requirements, thereby precluding Refco from conducting a primary line of business and threatening the Company’s very existence.”³¹ *Id.* Thus, the Complaint alleges sufficient facts, if proven, to satisfy the fraud-created-the-market presumption.³²

Third, Defendants assert that there is no presumption of reliance because there was not an efficient market in Refco Bonds “prior to May 11, 2005” nor in Refco common stock “at least to the extent [shares] were [purchased] in the IPO.” MB Mem. at 40. As discussed above, however, the Complaint alleges numerous facts sufficient to establish the presumption of fraud-on-the-market at this stage of the litigation. These include allegations that the 144A Bonds,

³¹ *Wiley v. Hughes Capital Corp.*, 746 F. Supp. 1264 (D.N.J. 1990), is closely analogous. In that case, Hughes was a pervasively fraudulent enterprise, and the court held that investors in its IPO were entitled to a presumption of reliance because the securities would have been “factually unmarketable” if the truth had been revealed. *Id.* at 1289-93. After a careful analysis of the various Circuits’ decisions addressing the fraud-created-the-market presumption, Judge Lechner concluded that “the *Shores* doctrine applies to cases in which the security, although it may have had some economic worth, was subject to fraud which was so pervasive as to undermine its genuineness and render it unworthy of trading in a regulated securities market.” *Id.* at 1293. The Refco fraud, which led to the Company’s implosion within weeks of its IPO and to Collins’ and Bennett’s indictments for securities fraud, is a clear case in which the securities could not economically or legally have been sold to the public absent the fraud.

³² Importantly, economic unmarketability does not require that the securities have absolutely no value, but only that they be “worthless” because the underlying business is a sham, even if it has some real assets. *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1122 (5th Cir. 1988). Thus, the presumption is not defeated because Refco had some genuine assets and business. What matters is that the Bond Offering, the Exchange Offer, and the IPO would all have been economically and legally impossible absent the fraud. *See also* ¶ 735.

Registered Bonds, and Refco common stock all traded on efficient markets based on analyst and rating agency coverage, had “statistically significant” price movements in response to new information, were issued and traded in a well-developed market structure, had substantial trading volumes and narrow bid-ask spreads, and other relevant factors. ¶¶ 737-43. These alleged facts are more than sufficient to give rise to the presumption of reliance set forth in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

To the extent Defendants contend that these factors do not establish the market’s efficiency, they raise factual disputes which cannot be resolved without reference to expert opinions and other evidence — including evidence in the defendants’ exclusive possession. For instance, the Complaint alleges — and Plaintiffs will prove—that sophisticated investors and market makers were involved in the market for Refco securities and that Refco’s securities experienced statistically significant price movements during the Class Period – key benchmarks of an efficient market. *See Cammer v. Bloom*, 711 F. Supp. at 1276 n.17 (identifying factors useful in establishing market efficiency). Furthermore, Plaintiffs will show, after discovery, that the trading of Refco Bonds in the PORTAL and OTC markets was driven by sophisticated institutional investors who employed professional securities analysts to read and analyze all relevant publicly available information about Refco and the Bonds, leading to heavy trading volume and narrow bid-ask spreads indicative of market efficiency. ¶ 738. Finally, much of the evidence regarding market efficiency is in the defendants’ exclusive possession, including the process by which the Underwriters (in conjunction with securities analysts employed by them) set the initial offering prices of Refco’s Bonds and common stock. Plaintiffs will demonstrate that these sophisticated entities evaluated all available information regarding Refco and set the

prices of Refco securities accordingly.³³

Thus, Defendants' arguments cannot be assessed by the Court without the benefit of a developed factual record that will not be available until the class certification and summary judgment stages. This is particularly true given the Second Circuit's guidance in *In re Initial Public Offering Securities Litigation*, 471 F.3d at 41-42, which requires a district court to "make determinations" regarding "factual disputes" arising at the class certification stage even if those disputes overlap with "merits issues." Especially in this case, where the Complaint specifically alleges that fraud created the market for securities such that they could not have been issued absent the fraud, it would be inappropriate to reject a presumption of reliance at this early stage of the proceedings.

In sum, the Complaint adequately alleges facts from which reliance may be presumed. Defendants are free to challenge these facts — or develop others — at the class certification and summary judgment stages, but their motion to dismiss on these points should be denied.

V. THE COMPLAINT STATES A CLAIM AGAINST MAYER BROWN FOR CONTROL PERSON LIABILITY

Mayer Brown's motion does not challenge that Lead Plaintiffs' control person claim under § 20(a) of the Exchange Act sufficiently alleges Mayer Brown's control of Collins. MB Mem. at 42. Mayer Brown does dispute, however, that the Complaint sufficiently alleges culpable participation by Mayer Brown. Assuming that such an allegation is necessary in a

³³ While Plaintiffs are plainly entitled to a presumption of reliance in this case, Plaintiffs would in any event be able to establish, at the proper stage of the proceedings, that Class members who purchased Refco securities in initial offerings directly relied on the materially false offering documents prepared and disseminated by Defendants. Indeed, the notion that sophisticated investors would have purchased Refco's securities in the Bond Offering or IPO *without* relying on the offering documents is simply not plausible. Thus, any arguments that Plaintiffs are not entitled to a presumption of reliance will not ultimately have any impact on Defendants' liability in this case.

complaint,³⁴ the allegations at bar are sufficient.

Mayer Brown's argument that Lead Plaintiffs are engaging in "circular pleading," *i.e.*, attempting to use the same knowledge and conduct by Collins that constitutes the primary violation as the basis for the allegation of culpable participation by Mayer Brown (MB Mem. at 42-44), mischaracterizes the Complaint. The Complaint alleges that Mayer Brown had knowledge of the activities of Collins, Koury, Monk, Lang, Best, and other Mayer Brown attorneys who participated for years in the fraudulent scheme. ¶¶ 116-17, 714-20, 822. This allegation is *not* based on the notion that Collins knew about his own wrongful conduct. Rather, as the Complaint explains, numerous Mayer Brown lawyers participated in the fraudulent transactions and drafting of the misleading disclosure documents, and Mayer Brown's knowledge was based on its possession of copies of the documents used in furtherance of the scheme and discussions at departmental meetings and periodic review sessions. *Id.* These particularized allegations satisfy the culpable participation test.

Culpable participation is shown by allegations that "the controlling person *knew or should have known* that the primary violator, over whom that person had control, was engaging in fraudulent conduct." *Global Crossing*, 322 F. Supp. 2d at 349 (emphasis added).³⁵ As Judge Sweet stated in *Dietrich v. Bauer*, 126 F. Supp. 2d 759 (S.D.N.Y. 2001):

³⁴ While Lead Plaintiffs recognize that this Court has held that a complaint asserting a § 20(a) claim must allege culpable participation, Lead Plaintiffs note that numerous other judges in this District have held that culpable participation is an affirmative defense under § 20(a) and, therefore, it need not be pled. *See Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am, Sec., LLC*, 446 F. Supp. 2d 163, 191 (S.D.N.Y. 2006) (Scheidlin, J.); *In re Van Der Moolen Holding N.V. Sec. Litig.*, 405 F. Supp. 2d 388, 413 (S.D.N.Y. 2005) (Sweet, J.); *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 307-10 (S.D.N.Y. 2005) (Kaplan, J.); *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 392, 414-16 (S.D.N.Y. 2003) (Cote, J.); *In re Quintel Entm't Inc. Sec. Litig.*, 72 F. Supp. 2d 283, 297-98 (S.D.N.Y. 1999) (Conner, J.).

³⁵ *See also Compudyne Corp. v. Shane*, 453 F. Supp. 2d 807, 830 (S.D.N.Y. 2006); *Liberty Media Corp. v. Vivendi Universal, S.A. Sec. Litig.*, No. 02 Civ. 5571 (RJH), 2004 U.S. Dist. LEXIS 7015, at *34 (S.D.N.Y. Apr. 22, 2004); *In re Flag Telecom Holdings, Ltd.*, 308 F. Supp. 2d 249, 273 (S.D.N.Y. 2004).

[T]here is persuasive authority for the proposition that a willful blindness standard applies, that is, that where the control person knew or should have known that [the] primary violator, over whom the person had control, was engaged in fraudulent conduct, but . . . did not take steps to prevent the primary violation, there is culpability in the sense required by [*SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1472 (2d Cir. 1996)].

126 F. Supp. 2d at 765 (internal quotation marks omitted).³⁶ The Complaint plainly contains adequate allegations that Mayer Brown knew or should have known about Collins' improper conduct for an extensive period of time, but failed to take steps to prevent the violation.

Furthermore, "a controlling person's receipt of financial benefits can demonstrate culpable participation." *In re Blech Sec. Litig.*, No. 94 Civ. 7696 (RWS), 2002 U.S. Dist. LEXIS 19835, at *59 (S.D.N.Y. Oct. 22, 2002); *see also In re Oxford Health Plans, Inc.*, 187 F.R.D. 133, 143 (S.D.N.Y. 1999) (sustaining § 20(a) allegations where plaintiffs alleged that defendants "participated in the fraud at least by reaping benefits of insider trading"). Facts sufficient to establish motive and opportunity suffice to establish culpable participation. *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d at 662; *see also Flag Telecom*, 308 F. Supp. 2d at 273. The Complaint adequately alleges Mayer Brown's culpable participation under this approach, since "Mayer Brown collected approximately \$5 million in legal fees annually from Refco." ¶ 78.

Finally, where there is a duty to supervise, "the failure to supervise satisfies the culpable participation element." *Compudyne*, 453 F. Supp. 2d at 830; *see also Metzner v. D.H. Blair & Co.*, 689 F. Supp. 262, 266 (S.D.N.Y. 1988). Under the Illinois Supreme Court Rules of Professional Conduct, "[e]ach partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the conduct of all lawyers in the firm conforms to these Rules," Rule 5.1(a), and "[e]ach lawyer having direct supervisory

³⁶ *See also Cromer Fin. Ltd. v. Berger*, 245 F. Supp. 2d 552, 563 (S.D.N.Y. 2003); *Gabriel Capital, L.P. v. NatWest Fin., Inc.*, 122 F. Supp. 2d 407, 428-29 (S.D.N.Y. 2000).

authority over another lawyer shall make reasonable efforts to ensure that the other lawyer's conduct conforms to these Rules." Rule 5.1(b).³⁷ If the other partners and department heads at Mayer Brown had fulfilled these responsibilities, they would have and should have known about the unlawful conduct of Collins and the other Mayer Brown lawyers who were participating in the fraud. ¶ 769. The failure to discharge this supervisory responsibility satisfies the culpable participation requirement.

CONCLUSION

For all these reasons, Lead Plaintiffs respectfully submit that Defendants' motion to dismiss should be denied in all respects.

Dated: January 31, 2008

Respectfully submitted,

GRANT & EISENHOFER P.A.

**BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP**

By: /s/ James J. Sabella
James J. Sabella (JS-5454)
485 Lexington Avenue, 29th Floor
New York, NY 10017
Telephone: (646) 722-8500

By: /s/ John P. Coffey
John P. Coffey (JC-3832)
1285 Avenue of the Americas
New York, NY 10019
Telephone: (212) 554-1400

*Attorneys for Lead Plaintiff Pacific Investment
Management Company LLC and Co-Lead
Counsel for the Putative Class*

*Attorneys for Lead Plaintiff RH Capital
Associates LLC and Co-Lead Counsel for the
Putative Class*

³⁷ To the extent that some of the work constituting the deceptive conduct alleged in the Complaint was performed by lawyers in Mayer Brown's New York office, DR 1-104 of the New York Lawyer's Code of Professional Responsibility imposes substantially similar requirements for law firms and lawyers with management responsibility in law firms to make reasonable efforts to ensure that their lawyers conform to the disciplinary rules.

CERTIFICATE OF SERVICE

I hereby certify that on January 31, 2008 the attached **Lead Plaintiffs' Memorandum of Law in Opposition to the Motion to Dismiss of Joseph P. Collins and Mayer Brown LLP and Declaration of James J. Sabella in Opposition to the Motion to Dismiss Filed by Mayer Brown LLP and Joseph P. Collins** were filed electronically. Notice of this filing will be electronically mailed to all parties registered with the Court's electronic filing system.

/s/ James Sabella
James Sabella