UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

LEAD PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR FINAL APPROVAL OF SETTLEMENTS WITH THE THL AND AUDIT COMMITTEE DEFENDANTS AND WITH THE UNDERWRITER DEFENDANTS, FINAL APPROVAL OF PLAN OF ALLOCATION OF SETTLEMENT PROCEEDS AND FINAL CERTIFICATION OF A CLASS FOR SETTLEMENT PURPOSES

GRANT & EISENHOFER P.A.
Stuart M. Grant
James J. Sabella
Brenda F. Szydlo
485 Lexington Avenue, 29th Floor
New York, NY 10017
Telephone: (646) 722-8500
Facsimile: (646) 722-8501

- and -

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

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
Max W. Berger
Salvatore J. Graziano
John C. Browne
Jeremy P. Robinson
1285 Avenue of the Americas
New York, NY 10019
Telephone: (212) 554-1400
Facsimile: (212) 554-1444

Co-Lead Counsel for Lead Plaintiffs Pacific Investment Management Company, LLC and RH Capital Associates LLC and the Putative Class

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Pursuant to Rule 23(e) of the Federal Rules of Civil Procedure, Lead Plaintiffs RH Capital Associates LLC ("RH Capital") and Pacific Investment Management Company LLC ("PIMCO"), respectfully submit this memorandum of law in support of their motion for final approval of the proposed settlements with the THL Defendants[1] and Audit Committee Defendants, the Underwriter Group, and Sandler O'Neill (collectively, the "Settling Defendants"); final approval of the proposed Plan of Allocation of the settlement proceeds; and final certification of the Settlement Class for purposes of the proposed Settlements.[2]

PRELIMINARY STATEMENT

Lead Plaintiffs are pleased to present for the Court's consideration the following substantial settlements that have been achieved with certain defendants in the Action for the benefit of the Settlement Class: $140 million from the THL Defendants and Audit Committee Defendants; $49.5 million from the Underwriter Group; and $3.5 million from Sandler O'Neill, for an aggregate total of $193 million in cash (plus interest) (collectively, the "Settlements"). Lead Plaintiffs believe that each of the Settlements represents an excellent result and that, collectively, the Settlements create an outstanding recovery for the Settlement Class.

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[1] Unless otherwise noted, capitalized terms shall have the meanings set out in the Joint Declaration or in the Notices mailed to Settlement Class members.

[2] Lead Plaintiffs are simultaneously submitting herewith the Joint Declaration of Salvatore J. Graziano and Megan D. McIntyre in Support of (A) Lead Plaintiffs' Motion for Final Approval of Settlements with the THL and Audit Committee Defendants and with the Underwriter Defendants, Final Approval of Plan of Allocation of Settlement Proceeds and Final Certification of a Class for Settlement Purposes, and (B) Lead Counsel's Motion for an Award of Attorneys' Fees and Reimbursement of Expenses (the "Joint Declaration" or "Joint Decl."). The Joint Declaration is an integral part of this submission and, for the sake of brevity, the Court is respectfully referred to it for a detailed description of, *inter alia*: the history of the Action through the submission of the Settlements to the Court; the nature of the claims asserted in the Action; the negotiations leading to the Settlements; the value of the Settlements to the Class, as compared to the risks and uncertainties of continued litigation; the terms of the Plan of Allocation; and a description of the services Lead Counsel provided for the benefit of the Settlement Class.

As detailed in the accompanying Joint Declaration and below, the Settlements are the result of hard-fought, arm's-length negotiations by well-informed counsel and were achieved only after extensive discovery. The THL and Audit Committee Settlement was the product of lengthy negotiations, including a mediation session involving the Honorable Daniel Weinstein (Ret.) that included detailed submissions analyzing the merits of the claims and defenses relevant to these defendants. The Underwriter Group Settlement was also achieved only after discovery and strenuous negotiations and with the active assistance of another experienced mediator, the Honorable Layn R. Phillips (Ret.). The Sandler O'Neill Settlement, which was achieved in 2008, is the result of extensive arm's-length negotiations between Lead Counsel and counsel for Sandler O'Neill.[3]

Lead Plaintiffs negotiated each of the Settlements with a thorough understanding of the strengths and weaknesses of the claims asserted against each of the Settling Defendants. The THL and Audit Committee Settlement and the Underwriter Group Settlement were agreed to only after Lead Counsel had reviewed and analyzed tens of millions of pages of documents produced in discovery; had taken or participated in over 100 depositions of fact witnesses in the

[3] On November 5, 2008, Judge Lynch preliminarily approved the Sandler O'Neill Settlement and a class was preliminary certified for purposes of that settlement, but in the interests of conserving the resources of the Settlement Class, the Court approved deferral of the provision of notice and scheduling of a hearing for final approval. *See* Order Preliminarily Approving Proposed Settlement with Sandler O'Neill & Partners L.P. (Dkt. 536) ("Sandler O'Neill Prelim. Approval Order"), at 4-5. On July 30, 2010, this Court signed orders preliminarily approving the THL and Audit Committee Settlement and the Underwriter Group Settlement, approving notice of the Sandler O'Neill Settlement, and setting the final Settlement Hearing with respect to all three Settlements for October 27, 2010. *See* Order Preliminarily Approving Proposed Settlement with the Audit Committee and THL Defendants (Dkt. 728); Order Preliminarily Approving Proposed Settlement with the Settling Underwriter Defendants (Dkt. 729); and Order Approving Notice of Proposed Settlement with Sandler O'Neill & Partners L.P. and Settling Settlement Hearing (Dkt. 730) (collectively and, together with the Sandler O'Neill Prelim. Approval Order, the "Preliminary Approval Orders").

Action, including depositions of all Audit Committee Defendants and of multiple representatives of the THL Defendants and Underwriter Defendants; and had consulted extensively with experts in the fields of underwriters' due diligence, accounting, damages and market efficiency.

It is the well-informed opinion of Lead Counsel that the Settlements are excellent results in light of the potential risks of further litigation and the substantial expense of pursuing this Action against the Settling Defendants through summary judgment, trial, and the appeals that were sure to follow. Lead Plaintiffs, who are sophisticated institutional investors, reviewed and approved the Settlements before they were agreed to. Lead Counsel, who have significant experience in securities and other complex class action litigation and have negotiated numerous substantial class action settlements throughout the country, are of the opinion that the Settlements are fair, reasonable, adequate and in the best interest of the Settlement Class.

These Settlements are in addition to Lead Plaintiffs' 2007 settlement with BAWAG which was already approved and has produced a recovery exceeding $149 million. If the current Settlements are approved, they – together with the BAWAG settlement and certain restitution funds obtained by Lead Plaintiffs from the United States government – will create a fund of over $382 million, plus interest, for distribution to Settlement Class members. In addition to seeking final approval of the Settlements, Lead Plaintiffs respectfully ask the Court to approve the Plan of Allocation and to grant final certification of the Settlement Class for settlement purposes.

ARGUMENT

I. THE PROPOSED SETTLEMENTS WARRANT FINAL APPROVAL

Under Rule 23(e) of the Federal Rules of Civil Procedure, class action settlements must be approved by the Court, and should be approved if the Court finds them "fair, reasonable, and adequate." *See* Fed. R. Civ. P. 23(e)(2); *In re Marsh & McLennan Cos. Sec. Litig.*, No. 04 Civ. 8144 (CM), 2009 WL 5178546 (S.D.N.Y. Dec. 23, 2009); *In re Merrill Lynch Tyco Research*

Sec. Litig. ("*ML Tyco*"), 249 F.R.D. 124, 132 (S.D.N.Y. 2008); *In re Luxottica Group S.p.A. Sec. Litig.*, 233 F.R.D. 306, 310 (E.D.N.Y. 2006). The Court should also determine whether the negotiating process leading to the settlement was fair, reasonable and adequate. *See Wal-Mart Stores, Inc. v. Visa U.S.A, Inc.,*, 396 F.3d 96, 116 (2d Cir. 2005); *D'Amato v. Deutsche Bank*, 236 F.3d 78, 85 (2d Cir. 2001). Where, as here, a settlement is the product of "arm's length negotiations conducted by experienced counsel after adequate discovery," the settlement enjoys a strong presumption of fairness. *Marsh & McLennan*, 2009 WL 5178546, at *8; *see also In re Telik, Inc. Sec. Litig.*, 576 F. Supp. 2d 570, 575 (S.D.N.Y. 2008); *In re Veeco Instruments Inc. Sec. Litig.*, No. 05 MDL 01695 (CM), 2007 WL 4115809, at *5 (S.D.N.Y. Nov. 7, 2007).

In this Circuit, public policy favors the settlement of disputed claims, particularly in complex class actions. *See Wal-Mart*, 396 F.3d at 116 ("We are mindful of the 'strong judicial policy in favor of settlements, particularly in the class action context.'") (citation omitted); *In re WorldCom, Inc. Sec. Litig.*, 338 F. Supp. 2d 319, 337 (S.D.N.Y. 2005) ("public policy favors settlement, especially in the case of class actions").

A. <u>Application Of The *Grinnell* Factors Supports Approval Of The Settlements</u>

The standards governing approval of class action settlements in this Circuit are well established. In *City of Detroit v. Grinnell Corp.*, the Second Circuit held that the following factors should be considered:

> (1) the complexity, expense and likely duration of the litigation, (2) the reaction of the class to the settlement, (3) the stage of the proceedings and the amount of discovery completed, (4) the risks of establishing liability, (5) the risks of establishing damages, (6) the risks of maintaining the class action through the trial, (7) the ability of the defendants to withstand a greater judgment, (8) the range of reasonableness of the settlement fund in light of the best possible recovery, [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

495 F.2d 448, 463 (2d Cir. 1974) (citations omitted), *abrogated on other grounds by Goldberger v. Integrated Res., Inc.*, 209 F.3d 43 (2d Cir. 2000); *see also Wal-Mart*, 396 F.3d at 117; *Marsh & McLennan*, 2009 WL 5178546, at *4. "In finding that a settlement is fair, not every factor must weigh in favor of settlement, rather the court should consider the totality of these factors in light of the particular circumstances." *Marsh & McLennan*, 2009 WL 5178546, at *4 (internal quotations marks and citation omitted); *see also In re Global Crossing Sec. & ERISA Litig.*, 225 F.R.D. 436, 456 (S.D.N.Y. 2004) (same). In deciding whether to approve a settlement, a court "should not attempt to approximate a litigated determination of the merits of the case lest the process of determining whether to approve a settlement simply substitute one complex, time consuming and expensive litigation for another." *White v. First Am. Registry, Inc.*, No. 04 Civ. 1611 (LAK), 2007 WL 703926, at *2 (S.D.N.Y. Mar. 7, 2007).

The *Grinnell* factors favor approval of the Settlements, for the reasons discussed below.

1. The Complexity, Expense And Likely Duration Of The Litigation Support Approval Of The Settlements

Courts have acknowledged the "overriding public interest in favor of settlement" of class actions because it is "common knowledge that class action suits have a well deserved reputation as being most complex." *Strube v. Am. Equity Inv. Life Ins. Co.*, 226 F.R.D 688, 698 (M.D. Fla. 2005) (citation and internal quotations omitted). "Securities class actions are generally complex and expensive to prosecute." *In re Gilat Satellite Networks, Ltd.*, No. CV-02-1510, 2007 WL 1191048, at *10 (E.D.N.Y. Apr. 19, 2007). Due to this "notorious complexity," settlement is often appropriate in securities class actions because it "circumvents the difficulty and uncertainty inherent in long, costly trials." *In re AOL Time Warner, Inc. Sec. & ERISA Litig.*, No. MDL 1500, 02 Civ. 5575(SWK), 2006 WL 903236, at *8 (S.D.N.Y. Apr. 6, 2006); *see also Luxottica*,

233 F.R.D. at 310 ("[c]lass action suits readily lend themselves to compromise because of the difficulties of proof, the uncertainties of the outcome, and the typical length of the litigation").

As set forth in the Joint Declaration, this Action has been extensively and vigorously litigated by the parties and, at the time the Settlements were reached, the litigation had proceeded through the conclusion of a very extensive fact discovery process. *See* Joint Decl. ¶¶ 4, 21-53. Lead Plaintiffs would have had to overcome numerous additional hurdles in order to achieve litigated judgments against the Settling Defendants and there is no question that this continued litigation would be very expensive and time consuming. In the absence of the Settlements, there would need to be additional expert discovery, contested motions for summary judgment, and a lengthy and expensive trial involving extensive expert testimony. Even if Lead Plaintiffs succeeded at trial – which was far from certain, given the risks discussed below – post-trial motions and appeals from any verdict would inevitably result in substantial delays in recovery for the class, possibly for years.

In contrast, the Settlements avoid the costs and uncertainty of continued litigation and provide immediate and significant recoveries totaling $193 million for the Settlement Class.

2. <u>The Settlement Class's Reaction To The Settlements</u>

The reaction of the class to a proposed settlement is a significant factor in considering its adequacy. *See ML Tyco*, 249 F.R.D. at 134; *Strougo v. Bassini*, 258 F. Supp. 2d 254, 258 (S.D.N.Y. 2003); *Maley v. Del Global Techs. Corp.*, 186 F. Supp. 2d 358, 362 (S.D.N.Y. 2002).

On August 11, 2010, pursuant to the terms of the Preliminary Approval Orders, the Court-approved Claims Administrator, The Garden City Groups, Inc. ("GCG"), mailed 22,889 copies of the Notice Packet – consisting of a notice relating to the THL and Audit Committee Settlement (the "THL Notice"), a notice relating to the Underwriter Group Settlement and Sandler O'Neill Settlement (the "Underwriters Notice"), the Plan of Allocation, and the Proof of

Claim form – to potential Settlement Class members and nominees. *See* Joint Decl. ¶ 14. As of September 17, 2010, an additional 16,226 copies of the Notice Packet had been mailed to potential Settlement Class members and nominees. *See id*. The THL Notice and Underwriters Notice set out the essential terms of the Settlements and informed potential Settlement Class members of their rights to opt out of the Settlement Class or object to the Settlements. To date, Lead Counsel have received no objections to the Settlements or the Plan of Allocation and only one request for exclusion. The Court-ordered deadline for submitting objections and requesting exclusions from the Settlement Class is October 7, 2010. Should there be any objections they will be addressed by Lead Plaintiffs in a supplemental submission filed after that deadline. Lead Plaintiffs will also address requests for exclusion in their supplemental submission.

3. The Stage Of The Proceedings And The Amount Of Discovery Completed Support Approval Of The Settlements

The Settlements here were reached after years of hard fought litigation that included extensive motion practice, review and analysis of tens of millions of pages of documents, and depositions of over 100 fact witness. Accordingly, Lead Counsel and Lead Plaintiffs possessed a thorough understanding of the strengths and weaknesses the claims asserted against each of the Settling Defendants when negotiating and evaluating the merits of the proposed Settlements.

At the time that Lead Plaintiffs entered into agreements in principle to settle with the THL and Audit Committee Defendants in December 2009 and with the Underwriter Group Defendants in March 2010, the case had been thoroughly developed. As set forth in the greater detail in the Joint Declaration, Lead Counsel had extensively developed the claims against the Settling Defendants to that point by, among other things:

- conducting a detailed investigation and analysis of Refco's SEC filings, press releases, other public statements issued by defendants, media and news reports about the Company, publicly available trading data relating to the price and volume of Refco's securities, and other information regarding the criminal proceedings against

Refco's CEO Philip Bennett and other Refco insiders; and thoroughly researching the law pertinent to the claims against each Settling Defendant and the potential defenses available to these Settling Defendants (Joint Decl. ¶¶ 7, 31-33);

- drafting two detailed amended complaints as a result of this detailed investigation and legal research (*id*. ¶ 7);
- preparing extensive briefing in opposition to a dozen motions to dismiss, as well as several motions for reconsideration of the denial of such motions (*id*. ¶¶ 7, 23-29);
- reviewing and analyzing more than 31 million pages of document discovery obtained from Refco, the Settling Defendants, other defendants in the Actions, and multiple third parties (*id*. ¶¶ 36-37);
- taking or participating in depositions of more than one hundred (100) fact witnesses taken in more than one hundred fifty (150) days of testimony, which included fifty (50) depositions of representatives of the Settling Defendants over more than seventy-five (75) days of testimony (*id*. ¶ 40);[4]
- interviewing former Refco CEO Philip Bennett to obtain further insight regarding the roles of various defendants in the fraud at Refco (*id*. ¶ 41);
- retaining experts in the fields of underwriters' diligence, accounting practices, market efficiency and damages, who prepared detailed expert reports (*id*. ¶¶ 45-50); and
- drafting and exchanging multiple mediation statements for mediation sessions with the THL and Audit Committee Defendants and the Underwriter Group Defendants (*id*. ¶¶ 57, 59, 65).

Although the agreement-in-principle to settle with Sandler O'Neill occurred somewhat earlier – in August 2008 – even at that time the motions to dismiss had been resolved and fact discovery (including document discovery, which began in June 2007, and fact depositions, which commenced in February 2008) was already well underway. *See* Joint Decl. ¶¶ 35, 40. As a result of these efforts, Lead Plaintiffs and Lead Counsel were fully informed regarding the strengths and weaknesses of the claims against each of the Settling Defendants and they concluded that the Settlements provided highly favorable resolutions of those claims without the substantial risk, uncertainty, and delay of continued litigation.

[4] Lead Counsel deposed all of the Audit Committee Defendants, twelve (12) representatives of the THL Defendants and thirty-five (35) representatives of the Underwriter Defendants. *See* Joint Decl. ¶ 40. Lead Counsel also defended the depositions of representatives of each of the Lead Plaintiffs. *See id*.

The "advanced stage of the litigation and extensive amount of discovery completed" at the time the Settlements were reached "weigh heavily in favor of approval" of the Settlements. *Marsh & McLennan*, 2009 WL 5178546, at *6; *see also In re MetLife Demutualization Litig.*, 689 F. Supp. 2d 297, 333-34 (E.D.N.Y. 2010) ("Extensive discovery ensures that the parties have had access to sufficient material to evaluate their cases and assess the adequacy of the settlement proposal in light of the strengths and weaknesses of their positions."); *Maley*, 186 F. Supp. 2d at 364 ("Plaintiffs' Counsel possessed a record sufficient to permit evaluation of the merits of Plaintiffs' claims, the strengths of defenses asserted by Defendants, and the value of Plaintiffs' causes of action for purposes of settlement.").

4. The Risks Of Establishing Liability And Damages Support Approval Of The Settlements

Grinnell teaches that, in assessing the fairness, reasonableness and adequacy of a settlement, courts should consider such factors as the "risks of establishing liability," "the risks of establishing damages," and "the risks of maintaining the class action through the trial." 495 F.2d at 463 (citations omitted). These factors all support approval of the Settlements.

Risks of Establishing Liability. All of the Settling Defendants vigorously contested their liability in this Action and would have continued to do so in the absence of the Settlements. Lead Plaintiffs believe they had a strong case on the merits, but recovery against the Settling Defendants was by no means certain given the well-recognized hurdles to establishing liability under the federal securities laws. *See In re The Mills Corp. Sec. Litig.*, 265 F.R.D. 246, 256 (E.D. Va. 2009) (plaintiffs can never be confident of the outcome of securities fraud cases because "[e]lements such as scienter, materiality of misrepresentation and reliance by the class members often present significant barriers to recovery") (citation omitted); *AOL Time Warner*, 2006 WL 903236, at *9 ("the legal requirements for recovery under the securities laws present

considerable challenges, particularly with respect to loss causation and the calculation of damages").

As discussed in the Joint Declaration, Lead Plaintiffs faced substantial challenges in establishing the liability of the Settling Defendants. First, the Settling Defendants had serious arguments that other parties – Refco insiders who pled guilty or were convicted on criminal charges of securities fraud concerning Refco – were solely responsible for the fraud. *See* Joint Decl. ¶ 69. In addition, the fact that certain of these Refco insiders had been found guilty of lying to some of the Settling Defendants may have been used to support the view that the Settling Defendants lacked knowledge of the Refco fraud and did not act recklessly (or had performed adequate due diligence). *See id.*

With respect to the claims under the Securities Exchange Act of 1934 ("Exchange Act") against the THL Defendants and Audit Committee Defendants,[5] Lead Plaintiffs faced the substantial hurdle of establishing that the defendants acted with scienter or were "culpable participants" in the fraud. While establishing a defendant's culpable state of mind is always difficult,[6] there would have been particular difficulties in establishing this element against the THL Defendants and Audit Committee Defendants in this case. The THL Defendants asserted that they had no motive to commit fraud and, in fact, had invested millions of dollars of their own money in Refco during the time of the alleged fraud. *See* Joint Decl. ¶ 70. According to the THL Defendants, they were victims of the Refco fraud, rather than participants in it. Indeed, the THL Defendants commenced legal actions against some of the same defendants named by Lead

[5] Lead Plaintiffs asserted no Exchange Act claims against the Underwriter Defendants.

[6] *See, e.g.*, *Telik*, 576 F. Supp. 2d at 579 ("Scienter would also have been difficult to establish. Proving a defendant's state of mind is hard in any circumstances.").

Plaintiffs in this Action. *Id*. The Audit Committee Defendants were non-management directors of Refco who likewise took the position that they were not complicit in the fraud and were lied to by Refco management. While Lead Plaintiffs believe their Exchange Act claims against the THL Defendants and Audit Committee Defendants were meritorious, there was no certainty that a jury would agree.

Lead Plaintiffs also faced the risk that the Settling Defendants could successfully convince a jury that they had performed adequate due diligence in connection with Refco's offerings. *See* Joint Decl. ¶ 71. Such a finding would have precluded these Settling Defendants from being found liable under the Securities Act of 1933 ("Securities Act"). As evidence of their due diligence, the THL Defendants would be able to refer to the professionals and advisors they retained to assist with their investigation and the money they spent on due diligence. *See id*. The Underwriter Defendants would be able to point to, among other things, the numerous conference calls and meetings they conducted and documents they reviewed. *See id*. This too would have been a disputed issue for a jury. Moreover, resolution of this issue would have entailed use of competing expert testimony on the appropriate standards of due diligence and it is difficult to predict whose expert a jury might credit.

Risks of Establishing Damages. Even if Lead Plaintiffs were successful in establishing the liability of the Settling Defendants, they faced a number of serious arguments that could have greatly reduced (or eliminated) the damages that the class could recover from the Settling Defendants. For example, the Settling Defendants would argue that the class's damages should be limited to the drop in the price of Refco's securities that occurred immediately after the October 10, 2005 announcement that a multi-hundred million dollar related-party receivable had been discovered on Refco's books. *See* Joint Decl. ¶ 72. The Settling Defendants also would

each argue that their damages exposure was substantially reduced or even eliminated by the amounts that Lead Plaintiffs recovered from other defendants, because under the Private Securities Litigation Reform Act ("PSLRA"), a judgment against a non-settling defendant must be reduced by the greater of (i) the total amount recovered from any settling defendant; or (ii) the settling defendant's percentage of responsibility for any common damages. *See* 15 U.S.C. § 78u-4(f)(7)(B); *see also In re Refco, Inc. Sec. Litig.*, No. 05 Civ. 8626 (GEL), 2007 WL 57872, at **3-5 (S.D.N.Y. Jan. 9, 2007). These arguments could have resulted in no payment to the class by the Settling Defendants, even if Lead Plaintiffs were ultimately successful in establishing their liability at trial. *See* Joint Decl. ¶ 73.

Moreover, multiple complex issues in this case relating both to liability and to the calculation of damages would have required a significant amount of expert testimony from experts on both sides, thereby establishing the well-recognized risks attendant to a "battle of the experts." *See Hicks v. Morgan Stanley*, No. 01 Civ. 10071 (RJH), 2005 WL 2757792, at *6 (S.D.N.Y. Oct. 24, 2005) ("'battle of the experts' as to proper methods of valuation . . . creates a significant obstacle to plaintiffs in establishing liability"); *In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 127 F. Supp. 2d 418, 426-27 (S.D.N.Y. 2001) ("[i]n such a battle, Plaintiffs' Counsel recognize the possibility that a jury could be swayed by experts for Defendants, who could minimize or eliminate the amount of Plaintiffs' losses").

Risks Relating to Class Certification. At the time the Settlements were achieved, a class had not been certified and, if litigation had continued, the Settling Defendants would have vigorously contested class certification. Although Lead Plaintiffs believe that this Action is appropriate for class treatment, Lead Plaintiffs faced the risk that the class would not be certified in its entirety, based on the Settling Defendants' expected arguments that Refco's Bonds did not

trade on an efficient market and that Refco's common stock traded on an efficient market for, at most, only a short period of time. *See* Joint Decl. ¶ 72. Acceptance of these arguments would have substantially reduced the size of the class, which in turn would have substantially reduced the amount of class damages that could be proven. Indeed, if these arguments were successful, recoverable damages would have been *less than* the substantial recoveries to date.

* * *

Finally, even if Lead Plaintiffs achieved a favorable jury verdict, there is no doubt the Settling Defendants would have appealed. Any appeal would significantly delay the distribution of funds to the class even if the verdict were ultimately affirmed and, of course, Lead Plaintiffs would face the risk of reversal and having to relitigate the case in the trial court. Accordingly, while Lead Counsel believe that the Settlement Class's claims have merit, one or more arguments by the Settling Defendants may have ultimately prevailed and the Settlement Class may have ended up with little or no recovery from the Settling Defendants after years of costly litigation. In light of these risks, Lead Counsel believe that the immediate and certain recovery of $193 million provided by the Settlements is an excellent result for the Settlement Class.

5. The Ability Of Settling Defendants To Withstand A Greater Judgment

While some of the Settling Defendants may have been able to pay a judgment in excess of what they are paying in the Settlements, "defendants' ability to withstand a higher judgment . . . standing alone, does not suggest that the settlement is unfair." *D'Amato*, 236 F.3d at 86; *see also Parker v. Time Warner Entm't Co.*, 631 F. Supp. 2d 242, 261 (E.D.N.Y. 2009) ("The fact that a defendant is able to pay more than it offers in settlement does not, standing alone, indicate the settlement is unreasonable or inadequate."); *McBean v. City of New York*, 233 F.R.D. 377, 388 (S.D.N.Y. 2006) ("the ability of defendants to pay more, on its own, does not render the

settlement unfair, especially where the other *Grinnell* factors favor approval"). Here, the fact that some of the Settling Defendants may have had the ability to withstand a greater judgment is outweighed by the other strong considerations favoring the Settlements, most notably the risks to the class of establishing liability and damages and the reasonableness of the settlement amounts in light of these risks.

6. The Range Of Reasonableness Of The Settlement Amount In Light Of The Best Possible Recovery And All The Attendant Risks Of Litigation Supports Approval Of The Settlements

The last two substantive factors courts consider are the range of reasonableness of the settlement amount in light of: (i) the best possible recovery and (ii) litigation risks. In analyzing these last two factors, the issue is not whether a settlement represents the "best possible recovery," but how the settlement relates to the strengths and weaknesses of the case. *Grinnell*, 495 F.2d at 462-63 (a court should "consider and weigh the nature of the claim, the possible defenses, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable") (citation omitted). Courts agree that the determination of a "reasonable" settlement "is not susceptible of a mathematical equation yielding a particularized sum." *In re PaineWebber Ltd. P'ships Litig.*, 171 F.R.D. 104, 130 (S.D.N.Y. 1997), *aff'd*, 117 F.3d 721 (2d Cir. 1997). Instead, "in any case there is a range of reasonableness with respect to a settlement" that "recognizes the uncertainties of law and fact . . . and the concomitant risks and costs necessarily inherent in taking any litigation to completion." *Newman v. Stein*, 464 F.2d 689, 693 (2d Cir. 1972); *see also In re EVCI Career Colls. Holding Corp. Sec. Litig.*, No. 05 Civ. 10240, 2007 WL 2230177, at *5 (S.D.N.Y. July 27, 2007). Lead Plaintiffs submit that the Settlements are well within the range of reasonableness in light of the best possible recovery and all the attendant risks of litigation.

Lead Plaintiffs' damages expert has estimated that the maximum total damages in this case (assuming that Lead Plaintiffs prevailed on defendants' various challenges to damages summarized above) amount to approximately $989 million. *See* Joint Decl. ¶ 6. Accordingly, the Settlements, totaling $193 million, collectively represent a recovery of more than 19% of these maximum damages. *Id*. Together with (i) the $149 million received in the previously achieved BAWAG settlement; and (ii) the more than $40 million in government restitution funds being distributed to the Settlement Class, the total amount of recoveries for the benefit of the Settlement Class exceeds $382 million and represents a return of over 38% of the class's highest possible damage claim. *Id*. ¶ 6 n.5. This represents a truly excellent level of recovery for the Settlement Class.[7] If the Settling Defendants' various arguments seeking to limit the class's recoverable damages were to prevail, the current total recovery for the benefit of the Settlement Class would collectively *exceed* the maximum damages then available to the class. *See id.* ¶ 6.

Courts have frequently found recoveries representing much smaller percentages of maximum damages to be fair and reasonable in light of the numerous risks presented by securities litigation. *See, e.g.*, *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, No. 02 MDL 1484 (JFK), 2007 WL 313474, at *10 (S.D.N.Y. Feb. 1, 2007) (recovery of approximately 6.25% was "at the higher end of the range of reasonableness of recovery in class action[] securities litigations"); *Hicks*, 2005 WL 2757792, at *7 (settlement representing 3.8% of plaintiffs' damage calculation was "within the range of reasonableness"); *In re Blech Sec. Litig.*,

[7] Because the PSLRA's judgment reduction provision, discussed above, reduces the judgment exposure of a non-settling defendant by at least the dollar amount paid with respect to common damages by any Exchange Act defendants who settle before trial, it makes the most sense to consider the total size of past and present settlements together when judging their reasonableness in comparison to the best possible recovery.

No. 94 Civ. 7696 (RWS), 2000 WL 661680, at *4 (S.D.N.Y. May 19, 2000) (approving settlement representing 5% to 17% of plaintiffs' estimated damages).

Here, the $193 million cash recovery produced by these Settlements represents an excellent result for the Settlement Class in light of the range of possible recoveries and the risks and expense of continued litigation, particularly given that these Settlements represent only a portion of the overall recoveries that have been achieved for the Settlement Class.

B. The Fact That The Settlements Were The Product Of Arm's-Length Negotiations And That They Are Recommended By Lead Plaintiffs And Experienced Counsel Also Support The Fairness Of The Settlements

Each of the Settlements was the result of vigorously contested, arm's-length negotiations. "A 'presumption of fairness, adequacy, and reasonableness may attach to a class settlement reached in arm's-length negotiations between experienced, capable counsel after meaningful discovery.'" *Wal-Mart*, 396 F.3d at 116 (citation omitted); *Luxottica*, 233 F.R.D. at 315 ("An assumption of correctness attaches to a class settlement reached in arm's-length negotiations . . . ."); *In re Sterling Foster & Co., Inc. Sec. Litig.*, 238 F. Supp. 2d 480, 484 (E.D.N.Y. 2002) ("[a] strong presumption of fairness attaches to proposed settlements that have been negotiated at arm's-length").

The THL and Audit Committee Settlement and the Underwriter Group Settlement were reached following lengthy negotiations and sessions with experienced mediators. The THL and Audit Committee Settlement resulted from two separate mediation sessions held months apart, the first of which involved the active participation of the Honorable Daniel Weinstein, a retired judge and experienced mediator. *See* Joint Decl. ¶¶ 57-58. The agreement-in-principle was reached during the second session, which involved the exchange of detailed mediation submissions and a face-to-face meeting between a representative of Lead Plaintiff RH Capital and two individual defendants affiliated with the THL Defendants. *See id.* ¶¶ 59-60. The

Underwriter Group Settlement also involved the efforts of an experienced mediator and former federal judge, the Honorable Layn R. Phillips, and resulted from, among other things, the exchange of lengthy mediation submissions and a mediation session lasting for two intense days. *See id*. ¶¶ 65-66. Each of these mediators has submitted a declaration attesting to the arm's-length nature of the negotiations, and to his belief that the terms of the settlement in which he was involved are fair and reasonable. *See* Joint Decl. Ex. 1 (Declaration of Daniel Weinstein) and Ex. 2 (Declaration of Layn R. Phillips). The use of independent, experienced mediators supports a finding that Settlements are fair. *See D'Amato*, 236 F.3d at 85 (a "mediator's involvement in . . . settlement negotiations helps to ensure that the proceedings were free of collusion and undue pressure"); *Telik*, 576 F. Supp. 2d at 576 ("Judge Weinstein's role in the settlement negotiations strongly supports a finding that they were conducted at arm's-length and without collusion."); *In re Delphi Corp. Sec., Derivative & ERISA Litig.*, 248 F.R.D. 483, 498 (E.D. Mich. 2008) (approving settlement negotiated with the assistance of Judge Phillips and referring to him as "one of the most prominent and highly skilled mediators of complex actions").

The recommendations of Lead Plaintiffs and Lead Counsel also support the fairness of the Settlements. Lead Plaintiffs are sophisticated institutional investors who took an active role in overseeing the prosecution and resolution of the litigation against the Settling Defendants and strongly endorse the Settlements. *See* Joint Decl. Ex. 6 (Declaration of Robert Horowitz), at ¶¶ 3-4; Joint Decl. Ex. 7 (Declaration of Christian Stracke), at ¶¶ 3-4. A settlement reached "under the supervision and with the endorsement of a sophisticated institutional investor . . . is 'entitled to an even greater presumption of reasonableness." *Veeco*, 2007 WL 4115809, at *5; *see also EVCI*, 2007 WL 2230177, at *4 (same); *Global Crossing*, 225 F.R.D. at 462 (the

participation of a sophisticated institutional investor lead plaintiff in the settlement process supported approval of the settlement). "Absent fraud or collusion, the court should be hesitant to substitute its judgment for that of the parties who negotiated the settlement." *EVCI*, 2007 WL 2230177, at *4.

Moreover, Lead Counsel, who have extensive experience prosecuting complex securities class actions and are well informed about the facts of this case as result of the substantial discovery that has occurred, believe that the Settlements are not just fair and adequate, but excellent results for the Settlement Class. Joint Decl. ¶¶ 4, 9. The opinion of experienced and informed counsel is entitled to "great weight." *PaineWebber*, 171 F.R.D. at 125; *see also Veeco*, 2007 WL 4115809, at *12; *Am. Bank Note Holographics*, 127 F. Supp. 2d at 430.

In sum, an analysis of all the factors to be considered under *Grinnell* demonstrates that each of the Settlements is fair, reasonable and adequate and warrants approval by the Court.

II. THE PLAN OF ALLOCATION IS FAIR AND REASONABLE AND SHOULD BE APPROVED

Lead Counsel, in consultation with Lead Plaintiffs and their damages expert, have developed a proposed Plan of Allocation that, if approved, will determine how the net proceeds of all the settlements achieved in this Action are distributed to Settlement Class members. The Plan of Allocation is fair and reasonable and should be approved.

A. The General Standards For Approving A Plan Of Allocation

A plan of allocation must meet the same standards for approval to which the Settlements are subject – it must be fair, adequate and reasonable. *See ML Tyco*, 249 F.R.D. at 135; *EVCI*, 2007 WL 2230177, at *11; *WorldCom*, 388 F. Supp. 2d at 344.

The purpose of a plan of allocation is to equitably distribute settlement proceeds to eligible class members. *See Luxottica*, 233 F.R.D. at 316-17. Generally, a plan of allocation is

reasonable if it reimburses class members based on the type and extent of their injuries and the strength of their legal claims. *See, e.g.*, *Telik*, 576 F. Supp. 2d at 580 ("A reasonable plan may consider the relative strengths and values of different categories of claims."); *Luxottica*, 233 F.R.D. at 317 ("A plan of allocation should be based on the nature and extent of class members' provable damages."); *Am. Bank Note Holographics*, 127 F. Supp. 2d at 429 ("Allocation formulas . . . are recognized as an appropriate means to reflect the comparative strengths and values of different categories of the claim.").

A plan of allocation need not be perfect, and can never be tailored to each class member with "mathematical precision." *PaineWebber*, 171 F.R.D. at 133 ("To determine precisely 'the distribution of the settlement fund among the myriad claimants' in such a class would require counsel or the district court 'to weigh the strengths and weaknesses of the claims of each class member' and would be an 'almost impossible task.'") (citations omitted); *accord Silverblatt v. Morgan Stanley*, 524 F. Supp. 2d 425, 430 (S.D.N.Y. 2007) ("Exactitude is not required in allocating consideration to the class, providing that the overall result is fair, reasonable and adequate"); *Maley*. 186 F. Supp. 2d at 367 ("An allocation formula need only have a reasonable, rational basis….").

In assessing whether a proposed plan of allocation is fair and reasonable, courts have given great weight to the opinion of experienced counsel. *See Aramburu v. Healthcare Fin. Servs., Inc.*, No. 02-CV-6535 (MDG), 2009 WL 1086938, at *5 (E.D.N.Y. Apr. 22, 2009) ("In determining whether a plan of allocation is fair, courts look primarily to the opinion of counsel."); *PaineWebber*, 171 F.R.D. at 133 ("[T]he adequacy of an allocation plan turns on whether counsel has properly apprised itself of the merits of all claims, and whether the proposed apportionment is fair and reasonable in light of that information."). Indeed, courts have found

that a plan of allocation approved by experienced and competent counsel need only have a "reasonable, rational basis." *WorldCom*, 388 F. Supp. 2d at 344 (quoting *Maley*, 186 F. Supp. 2d at 367).

B. The Proposed Plan Of Allocation Is Fair And Reasonable And Warrants Approval By The Court

After the Settlements were reached, Lead Counsel consulted extensively with Lead Plaintiffs and their damages expert concerning the appropriate structure for the plan of allocation. The proposed Plan of Allocation applies not only to the proceeds of the Settlements that the Court will consider for approval at the October 27, 2010 Settlement Hearing, but also to the previously approved settlement with BAWAG and the restitution funds that Lead Plaintiffs have obtained from the government for the benefit of class members. If all the Settlements are approved, the fund created from all these sources will be in excess of $382 million, plus interest thereon (the "Total Settlement Fund"). The proposed Plan of Allocation sets out the method for distributing the Net Total Settlement Fund (*i.e.*, the Total Settlement Fund less all taxes and tax-related expenses, the costs and expenses of providing notice and administering the settlements, and any attorneys' fees and expenses awarded by the Court to Lead Counsel).

The Plan of Allocation was developed in consultation with Lead Plaintiffs' damages expert and was based on a damage study that he prepared during the course of the litigation. The Plan of Allocation also reflects Lead Counsel's informed assessment of ongoing litigation risks with respect to different categories of claims.

In general, the Plan of Allocation provides that class members whose claims are accepted for payment will receive a *pro rata* share of the Net Total Settlement Fund based on the value of their Recognized Loss Amounts. For each purchase of Refco securities during the Class Period, a Recognized Loss Amount is calculated based on a formula that considers the amount of

artificial inflation on the date of purchase and the amount of artificial inflation on the date of sale.[8] Because any losses suffered on sales of Refco securities before the first alleged corrective disclosure could not have been caused by the alleged wrongdoing, those losses are not compensated under the plan. *See In re Omnivision Techs., Inc.*, 559 F. Supp. 2d 1036, 1043 (N.D. Cal 2008) (approving a plan of allocation that excluded recovery for shares not held through the purportedly corrective disclosure). Thus, any Refco securities sold prior to the close of trading on October 9, 2005, the day before the first corrective disclosure, will have a Recognized Loss Amount of $0. *See* Plan of Allocation ¶¶ 17, 18, 21(a)(i).[9]

The Plan of Allocation also addresses the allocation of settlement funds between claims asserted under the Exchange Act as compared to the claims asserted under the Securities Act. Lead Plaintiffs' expert has estimated that the total damages in this case amount to approximately $989 million, of which about 79% represents Securities Act damages and about 21% represents non-overlapping Exchange Act damages (*i.e.*, damages to class members who do not possess Securities Act claims or whose Exchange Act damages exceed their Securities Act damages). *See* Joint Decl. ¶ 77. The Plan of Allocation does not allocate the settlement monies in these exact percentages, however, for several important reasons. First, the Plan recognizes differences among the claims applicable to the various Settling Defendants. For example, no Exchange Act claims were asserted against the Underwriter Defendants, and BAWAG's involvement with

[8] For Refco Bonds that were held as of the close of trading on December 15, 2006, the Plan reduces the Recognized Loss Amount by the amount that holders of Refco Bonds were expected to recover under the Refco bankruptcy plan.

[9] In addition, claimants' Recognized Claim will be capped by the amount of their actual market loss. *See* Plan of Allocation ¶ 29. If a claimant has an overall market gain from his, her or its transactions in Refco securities during the Class Period, he, she or it will not be eligible to recover under the Plan. *See id*.

Refco and the nature of the claims against it changed significantly prior to the IPO. *See id*. Second, in Lead Counsel's informed view, the relative risks of prevailing at trial on the fraud-based Exchange Act claims were greater than the risks of prevailing on the negligence-based Securities Act claims. Taking all of these and other factors into account, the Plan of Allocation allocates approximately 83% of the settlement funds to the Securities Act damages (the "Section 11 Fund") and approximately 17% of the settlement funds to the non-overlapping Exchange Act damages (the "Section 10(b) Fund"). *See id*.; Plan of Allocation ¶ 2.[10]

In the opinion of Lead Counsel, the Plan of Allocation reflects a reasonable and rational way to address "the relative strengths and values of different categories of claims," *Telik*, 576 F. Supp. 2d at 580, and "the nature and extent of class members' provable damages," *Luxottica*, 233 F.R.D. at 317, and the Plan as a whole is fair and reasonable. As noted above, as of September 17, 2010, 39,115 copies of the Notice Packet, which contains the Plan of Allocation and informs Settlement Class members of their right to object to the Plan, have been mailed to potential Settlement Class members and nominees. *See* Joint Decl. ¶ 14. To date, not a single objection to the Plan of Allocation has been received. Should any objections to the Plan be received they will be addressed in Lead Plaintiffs' supplemental submission.

In conclusion, the proposed Plan of Allocation has a reasonable and rational basis, is recommended by experienced counsel fully informed of the relevant legal and factual issues, and

[10] To allocate the funds from the Section 11 and Section 10(b) Funds to Claimants, the Plan of Allocation divides the calculated Recognized Loss Amounts into Section 11 Loss Amounts, which are based on formula that is consistent with the calculation of damages under Section 11 of the Securities Act, and Section 10(b) Loss Amounts, which represent any additional, non-overlapping damages as they would be calculated under Section 10(b) of the Exchange Act. Authorized Claimants will receive a *pro rata* distribution from the Section 11 Fund based on their Section 11 Loss Amounts and a *pro rata* distribution from the Section 10(b) Fund based on their Section 10(b) Loss Amounts.

warrants approval by the Court.

III. NOTICE TO THE SETTLEMENT CLASS SATISFIED THE REQUIREMENTS OF RULE 23 AND DUE PROCESS

The Notices provided to the Settlement Class satisfied the requirements of Rule 23(c)(2)(B), which requires "the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." Fed. R. Civ. P. 23(c)(2)(B); *see also Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 173-75 (1974). The Notices also satisfied Rule 23(e)(1), which requires that notice of a settlement be "reasonable" – *i.e.*, it must "fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with [the] proceedings." *Wal-Mart*, 396 F.3d at 114 (quoting *Weinberger v. Kendrick*, 698 F.2d 61, 70 (2d Cir. 1982)).

Both the substance of the Notices and the method of their dissemination to potential Settlement Class members satisfied these standards. The Court-approved Notice Packet included all the information required by Federal Rule of Civil Procedure 23(c)(2)(B) and the PSLRA, 15 U.S.C. §§ 77z-1(a)(7), 78u-4(a)(7), including: (a) an explanation of the nature of the action and the Settlement Class's claims; (b) a definition of the Settlement Class; (c) the amount of the Settlements; (d) a description of the Plan of Allocation; (e) an explanation of the reasons why the parties are proposing the Settlements; (e) a statement indicating the attorneys' fees and costs that will be sought; (f) a description of Settlement Class members' rights to opt-out of the Settlement Class or object to the Settlements, the Plan of Allocation, or the requested attorneys' fees or expenses; and (g) notice of the binding effect of a judgment on Settlement Class members.

In accordance with the Court's Preliminary Approval Orders, beginning on August 11, 2010, the Claims Administrator caused 39,115 copies of the Notice Packet to be mailed by first-class mail to potential Settlement Class members and nominees. *See* Joint Decl. ¶ 14. On

August 18, 2010, the Summary Notice concerning the THL and Audit Committee Settlement was published in *Investor's Business Daily* and on August 23, 2010, the Summary Notice concerning the Underwriters Settlement was published in *Investor's Business Daily*. *See id.* This combination of individual first-class mail to all Settlement Class members who could be identified with reasonable effort, supplemented by notice in a widely-circulated publication, was "the best notice . . . practicable under the circumstances." Fed. R. Civ. P. 23(c)(2)(B).

IV. THE SETTLEMENT CLASS SHOULD BE FINALLY CERTIFIED FOR SETTLEMENT PURPOSES

In its Preliminary Approval Orders, the Court preliminarily certified a Settlement Class consisting of "all persons and entities who purchased or otherwise acquired Refco Group Ltd., LLC/Refco Finance Inc. 9% Senior Subordinated Notes due 2012 (CUSIP Nos. 75866HAA5 and/or 75866HAC1) and/or common stock of Refco (CUSIP No. 75866G109) during the period July 1, 2004 through and including October 17, 2005, and who were damaged thereby."[11] Judge Lynch previously certified an essentially identical settlement class in connection with the BAWAG Settlement. For the reasons set forth in detail in Lead Plaintiffs' memoranda in support of preliminary approval of the Settlements (Dkt. 672, at 8-16; & Dkt. 682, at 9-17), certification is appropriate here because the Settlement Class meets all the requirements of Rule 23(a) and

[11] Excluded from the Settlement Class are "(a) Refco; (b) the Defendants; (c) any person or entity who was a partner, executive officer, director, controlling person, subsidiary, or affiliate of Refco or of any Defendant during the Class Period; (d) members of the Defendants' immediate families; (e) entities in which Refco or any Defendant has a controlling interest; and (f) the legal representatives, heirs, estates, administrators, predecessors, successors or assigns of any of the foregoing excluded persons and entities; provided however that any Investment Vehicle shall not be deemed an excluded person or entity by definition." Also excluded from the Settlement Class is any person and/or entity who or which properly excludes himself, herself or itself by filing a valid and timely request for exclusion.

Rule 23(b)(3). Accordingly, Lead Plaintiffs request that the Court grant final certification of the Settlement Class.

CONCLUSION

For all the foregoing reasons, Lead Plaintiffs respectfully request that the Court approve the proposed Settlements as fair, reasonable and adequate, approve the proposed Plan of Allocation, and finally certify the Settlement Class for purposes of the proposed Settlements.

Dated: New York, New York
September 22, 2010

Respectfully submitted,

GRANT & EISENHOFER P.A.

/s/ Stuart M. Grant
Stuart M. Grant
James J. Sabella
Brenda F. Szydlo
485 Lexington Avenue, 29th Floor
New York, NY 10017
Telephone: (646) 722-8500
Facsimile: (646) 722-8501

- and -

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

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP

/s/ Salvatore J. Graziano
Max W. Berger
Salvatore J. Graziano
John C. Browne
Jeremy P. Robinson
1285 Avenue of the Americas
New York, NY 10019
Telephone: (212) 554-1400
Facsimile: (212) 554-1444

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