SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION : FIRST DEPARTMENT

CAMELOT EVENT DRIVEN FUND, a Series of Frank Funds Trust, et al., Plaintiffs-Respondents-Appellants, v. MORGAN STANLEY & CO. LLC, et al., Defendants-Appellants-Respondents, VIACOMCBS, INC., et al., Defendants-Respondents.	Appellate Case No.: 2023-00983 New York County Supreme Court Index No.: 654959/21

NOTICE OF MOTION FOR LEAVE TO FILE AMICUS BRIEF IN SUPPORT OF DEFENDANTS-APPELLANTS-RESPONDENTS

PLEASE TAKE NOTICE, that upon the annexed affirmation of Robert Stern sworn to on September 15, 2023, and all exhibits attached thereto, including a copy of the proposed brief of *amicus curiae*, the undersigned will move this Court at 27 Madison Avenue, New York, New York, at 10:00 AM on September 25, 2023, or as soon thereafter as is practicable, for an order granting leave to the American Bankers

Association to file with this Court an *amicus* brief in support of Defendants-Appellants-Respondents.

Defendants-Appellants-Respondents consent to the filing of the brief. Plaintiffs-Respondents-Appellants take no position.

PLEASE TAKE FURTHER NOTICE, that pursuant to CPLR 2214(b), answering affidavits and cross-motions, if any, are to be served at least two (2) days prior to the return date of this motion.

Dated: September 15, 2023

By: ________________________

Robert Stern
WEIL, GOTSHAL & MANGES LLP
2001 M Street NW, Suite 600
Washington, DC 20036
(202) 682-7190
robert.stern@weil.com

Attorney for Amicus Curiae the American Bankers Association

To: Counsel of record (by NYSCEF)

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION : FIRST DEPARTMENT

CAMELOT EVENT DRIVEN FUND, a Series of Frank Funds Trust, et al., Plaintiffs-Respondents-Appellants, v. MORGAN STANLEY & CO. LLC, et al., Defendants-Appellants-Respondents, VIACOMCBS, INC., et al., Defendants-Respondents.	Appellate Case No.: 2023-00983 New York County Supreme Court Index No.: 654959/21

AFFIRMATION OF ROBERT STERN IN SUPPORT OF MOTION FOR LEAVE TO FILE AMICUS BRIEF IN SUPPORT OF DEFENDANTS-APPELLANTS-RESPONDENTS

Robert Stern, an attorney duly admitted to the practice of law in the courts of this State, affirms under the penalties of perjury:

1. I am counsel for proposed *amicus curiae* the American Bankers Association ("ABA"). I submit this affirmation in support of the motion for leave to file the attached brief as *amicus curiae* in support of Defendants-Appellants-Respondents.

2. The ABA is the principal national trade association and voice of the banking industry in the United States. Its members, located in each of the fifty States and the District of Columbia, include banks, savings associations, and nondepository trust companies of all sizes.

3. ABA frequently appears in litigation as *amicus curiae* where the issues raised are vital to the banking industry.

5. This case raises important issues regarding the duties banks face when they act as underwriters for a securities offering. Many of ABA's members could be affected by this ruling, particularly insofar as it imposes new duties on underwriters that other courts have not recognized.

6. The proposed brief of *amicus curiae* is attached to this affirmation as **Exhibit A**. The proposed brief should be allowed because it provides additional information regarding how the market and the securities laws account for potential conflicts of interests at underwriters and explains the unworkability of the lower court's decision.

7. For these reasons, *amicus* respectfully request the Court's permission to file the attached brief.

Dated: September 15, 2023

By: ______________________________
Robert Stern

Attorney for Amicus Curiae the American Bankers Association

EXHIBIT A

New York Supreme Court

Appellate Division—First Department

CAMELOT EVENT DRIVEN FUND, a Series of Frank Funds Trust,

Plaintiffs-Respondents-Appellants,

Appellate Case No.: 2023-00983

– against –

MORGAN STANLEY & CO. LLC, J.P. MORGAN SECURITIES, LLC, CITIGROUP GLOBAL MARKETS INC., GOLDMAN SACHS & CO. LLC, MIZUHO SECURITIES USA LLC, SIEBERT WILLIAMS SHANK & CO., LLC, BNP PARIBAS SECURITIES CORP., RBC CAPITAL MARKETS, LLC, U.S. BANCORP INVESTMENTS, INC., SMBC NIKKO SECURITIES AMERICA, INC., TD SECURITIES (USA) LLC, SG AMERICAS SECURITIES, LLC, MUFG SECURITIES AMERICAS INC., CASTLEOAK SECURITIES, L.P., SAMUEL A. RAMIREZ & COMPANY, INC., ACADEMY SECURITIES, INC., R. SEELAUS & CO. LLC, WELLS FARGO SECURITIES, LLC, BNY MELLON CAPITAL MARKETS, LLC, INTESA SANPAOLO S.P.A. and ICBC STANDARD BANK PLC,

Defendants-Appellants-Respondents,

(For Continuation of Caption See Inside Cover)

BRIEF FOR *AMICUS CURIAE* THE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF DEFENDANTS-APPELLANTS-RESPONDENTS

AMERICAN BANKERS ASSOCIATION
1333 New Hampshire Avenue NW
Washington, DC 20036
(202) 663-5035
adoersam@aba.com

WEIL, GOTSHAL & MANGES LLP
2001 M Street NW, Suite 600
Washington, DC 20036
(202) 682-7000
robert.stern@weil.com

Attorneys for Amicus Curiae

New York County Clerk's Index No. 654959/21

– and –

VIACOMCBS, INC., ROBERT M. BAKISH, KATHERINE GILL-CHAREST, SHARI E. REDSTONE, CANDACE K. BEINECKE, BARBARA M. BYRNE, LINDA M. GRIEGO, ROBERT N. KLIEGER, JUDITH A. MCHALE, RONALD L. NELSON, CHARLES E. PHILLIPS JR, SUSAN SCHUMAN, NICOLE SELIGMAN and FREDERICK O. TERRELL,

Defendants-Respondents.

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INTEREST OF *AMICUS CURIAE*

The American Bankers Association ("ABA") is the principal national trade association and voice of the banking industry in the United States. Its members, located in each of the fifty States and the District of Columbia, include banks, savings associations, and nondepository trust companies of all sizes. ABA frequently appears in litigation as *amicus curiae* where the issues raised are vital to the banking industry. This is such a case.

ARGUMENT

In the Order under review, the lower court erred in imposing two novel duties on underwriters under the securities laws. First, it erroneously held that underwriters must disclose all positions they have in the issuer and any transactions they are contemplating that may affect the value of the issuer's securities, even if the investment banking division of the institution is unaware of such positions or transactions because of the presence of required ethical walls. Second, it imposed an unprecedented obligation that underwriters must investigate *other* underwriters within the same syndicate to determine whether those other underwriters have fulfilled their disclosure obligations. Both these duties, if affirmed by this Court, would work a sea change in the role of

banks in underwriting and their ability to protect client confidences. The ABA respectfully submits the decision should not be allowed to stand.

For decades, investment banks have offered a suite of services to their clients, including, but not limited to, underwriting, brokerage, prime brokerage, investment research, and other advisory services. And since a change in the law in 1999, those services have been offered in tandem with depository banking services, allowing banks to now provide clients a one-stop shop for all of their banking needs. This arrangement benefits both issuers and investors, because it lowers costs, increases the quality of services, and promotes capital formation.

The tradeoff is that full-service banks simultaneously represent many different clients with many different interests across many different industries, which may give rise to conflicts of interest. To counter that risk, Congress and the banking regulators have endorsed (and in some cases required) the use of ethical walls between groups, divisions, and even individual traders to prevent the unauthorized sharing or use of nonpublic information.

The Order below disregards and upends this entire framework. Rather than recognize that modern banks operate in discrete divisions

that often have little to no contact with one another—and certainly do not engage in the cross-proliferation of confidential customer information imagined by the lower court—the Order obligates banks to *breach* their duties to clients and share confidential information freely within the firm. Under the Order, banks would be unable to both satisfy their duties of confidentiality to their clients and perform underwriting services. If left undisturbed, the ruling would sow widespread disruption in the banking sector while robbing issuers and investors of the benefits that full-service banks offer. This Court should not sanction such a result.

The lower court also erred in holding that underwriters have a duty under the securities laws to investigate *each other* for potential conflicts of interest. The lower court did not explain the source of this supposed duty, instead citing an inapposite regulation that simply confirms that underwriters' principal concern is with the financial condition of the *issuer*, not other underwriters within a syndicate. If taken seriously, the Order would require financial institutions engaged in underwriting to share confidential information about their clients *with their competitors*, all in service of providing a slightly more detailed disclosure on a perceived conflict of interest of which the market is already aware

through underwriters' ordinary disclosures. That result should not stand either.

I. The Order on Review Misunderstands How Financial Institutions Operate

The central error in the lower court's first holding—that those underwriters who were counterparties in total return swap agreements with non-party Archegos (the "Trading Underwriters") had a duty to investigate and disclose alleged conflicts of interest arising out of their prime brokerage and/or other trading practices—is that it ignores how banks operate in the modern era. Today, commercial banks are complex, diversified financial institutions that do not offer *just* underwriting services. In fact, it would be bad for issuers, investors, and other market participants if they did. Any bank that underwrites offerings thus employs ethical walls to prevent the dissemination of confidential client information across departments and divisions. Viewed in that light, the lower court's imposition of a novel duty to breach those ethical walls—and in doing so threaten client confidences—clashes with any informed view of practical market realities.

A. Modern Financial Institutions Are Full-Service Firms

1. This case principally involves two kinds of investment-banking services: underwriting and prime brokerage.

Underwriting is a service whereby an investment bank agrees to pre-purchase a set number of securities a firm intends to issue and then resell those securities to the open market. Giuliano Iannotta, *Investment Banking: A Guide to Underwriting and Advisory Services* 4 (Springer-Verlag Berlin Heidelberg, eds. 2010). The underwriter is responsible for pricing the securities, performing due diligence on the transaction, and soliciting buyers of the securities ahead of the offering. *Id.* The underwriter assumes the risk that the market will have less interest in the securities than anticipated, but if it is able to offload its allocation of the securities at a competitive price, the underwriter will recognize a gain. *Id.*

In modern practice, a single firm rarely underwrites any significantly sized offering by itself. Iannotta, *supra*, at 61; Rajesh P. Narayanan et al., *The Role of Syndicate Structure in Bank Underwriting*, 72 J. Fin. Econ. 555, 558 (2004). Instead, to distribute risk, underwriters will form a syndicate for an offering, with one or two underwriters leading

as the "book-runners," principally responsible for due diligence and organizing the overall offering. Iannotta, *supra*, at 62. Other underwriters in the syndicate do not manage the offering, but simply assume the obligation to purchase a certain amount of the securities and resell them to the market to the best of their abilities. *Id.*

Prime brokerage, broadly speaking, is a group within a bank that provides a range of services to sophisticated investing clients (e.g., hedge funds). *See* Christian M. McNamara & Andrew Metrick, *Basel III E: Synthetic Financing by Prime Brokers*, 1 J. Fin. Crises 91, 92–93 (2019). Some such services allow clients to enhance their returns through various investing approaches that involve some kind of borrowing from the bank, thus allowing the client to recognize a higher return (and assume more risk) than if it had invested only its own capital. *See id.* at 94–95.

One such approach—and the kind that is relevant here—is the "total return swap." In a total return swap, the bank agrees to pay the client any gains on an agreed-upon position (e.g., 100 shares in Company A), and then typically buys that stock for itself to hedge its position. *See id.* at 95. In exchange, the client pays the bank for any losses in that

position (thereby assuming the risk) and also pays a regular fee. *See id.* The result is that the client has an exposure to the market and the bank receives fees for financing that leverage.

For decades, investment banks have provided both these services. In fact, a review of the relevant literature on potential conflicts of interest in investment banking reveals no widespread (or even isolated) concern about the kind of conflict alleged here. *Cf.* Norman S. Poser, *Chinese Wall or Emperor's New Clothes? Regulating Conflicts of Interest of Securities Firms in the U.S. and the U.K.*, 9 Mich. J. Int'l L. 91, 96–97 (1988) (cataloguing potential conflicts of interests at securities firms). And while banking services in the United States previously were divided between commercial banks and securities firms, *see* George J. Papaioannou, *Commercial Banks in Underwriters and the Decline of the Independent Investment Bank Model*, 9 J. Int'l Bus. & L. 79, 80 (2010), that is no longer the case after the repeal of the Glass-Steagall Act in 1999, *see* Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338. Thus, today, banks offer underwriting, prime brokerage, depository, and many other investment banking and commercial banking services to clients, all under one roof.

Federal law expressly contemplates that banks will offer this full range of services. For example, the Anti-Tying Statute prohibits banks from conditioning an extension of credit on a customer's purchase of other, unrelated services from the bank (such as underwriting services). *See* 12 U.S.C. § 1972. But the statute does not prohibit banks from *offering* such services, and the law would be superfluous if banks did not in fact do so. *Cf. Corley v. United States*, 556 U.S. 303, 314 (2009) (statutes should be interpreted to avoid superfluity). Likewise, Sections 23A and 23B of the Federal Reserve Act define the circumstances in which a depository institution may engage in certain transactions with an affiliate investment bank, *see* 12 U.S.C. §§ 371c–371c-1—a regulatory scheme that again would be meaningless if banks were not *expected* to offer various financial services.

This full-service bank model is beneficial to both issuers and investors. Commercial banks are in some ways better situated to act as underwriters in view of their longer-term relationships with clients and their correspondingly greater insight into the value of the firm (and its securities). *See* Iannotta, *supra*, at 6–7; Narayanan, *supra*, at 559. Additionally, because banks offer many services, they have an increased

incentive to offer unbiased and high-quality underwriting services to encourage underwriting clients to purchase other financial services from them too. *See* Hamid Mehran & René M. Stulz, *The Economics of Conflicts of Interest in Financial Institutions*, 85 J. Fin. Econ. 267, 273 (2007). And finally, large commercial banks can draw on the expertise of different individuals within the firm to assist with underwriting (as appropriate and consistent with ethical limitations), reducing the cost and increasing the quality of underwriting. *See id.* at 275.

2. The tradeoff in this model is that full-service banks—with the diversity of services they offer and clients they service—are likely to be exposed to a wider range of potential conflicts of interests. But the market is both well aware of this risk and capable of accounting for it when retaining underwriters or purchasing securities. *See* Iannotta, *supra*, at 8; Mehran, *supra*, at 272–73. Indeed, "conflicts of interest are omnipresent in economic transactions" because of the information asymmetry between the buyer and seller, but the buyer can appropriately discount the price it is willing to pay based on the knowledge that such conflicts exist, and therefore "will only enter into the transaction at a price that is advantageous enough to cover the costs associated with

conflicts of interest." Mehran, *supra*, at 269. And because underwriters rely on repeat business and depend on their credibility, they have an incentive to provide accurate valuations and perform comprehensive diligence regardless of any alleged conflicts of interest. *See id.*

Beyond the market dynamics that account for and manage the risks arising from potential conflicts of interest, Congress, regulators, and financial institutions themselves have long used ethical walls to minimize the impact of any potential conflicts of interest arising out of the exchange of nonpublic, material information. These walls stand between the various groups, departments, and affiliates of a bank, preventing the exchange of sensitive information (e.g., customer information, proprietary trading information, nonpublic information about a borrower or issuer) among such groups. By doing so, financial institutions segregate themselves into discrete divisions, each of which can focus on providing the best services to the clients for which it is responsible.

The SEC first endorsed the use of such ethical walls in *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 1968 WL 86072 (S.E.C. Nov. 25, 1968). There, Merrill Lynch obtained confidential

information in its role as an underwriter, which it then disclosed to certain of its institutional investing clients. *Id.* at *2. In settling an enforcement action by the SEC, Merrill Lynch agreed to implement policies and procedures protecting against "disclosure by any member of the Underwriting Division of material information obtained from a corporation" to others in the firm, with exceptions for certain specified categories (e.g., executive officers, legal department, etc.). *Id.* at *4. The SEC understood and intended this ethical wall to be prophylactic, that is, it was intended to *prevent* the dissemination of confidential information to other departments within the firm, and not simply to provide a legal defense for the firm if such dissemination occurred. *Id.*

Since *Merrill Lynch*, the requirement that banks and broker-dealers erect formal barriers to information sharing has been codified in several places. In 1980, the SEC promulgated Rule 14e-3, which prohibits insider trading regarding tender offers, but provides a safe harbor for firms that erect ethical walls to prevent the dissemination of nonpublic, material information among departments. *See* 17 C.F.R. § 240.14e-3. In 1988, Congress passed the Insider Trading and Securities Fraud Enforcement Act of 1988, which amended both the Securities

Exchange Act of 1934 and the Investment Advisers Act of 1940 to require broker-dealers and financial advisers subject to those statutes to establish "written policies and procedures reasonably designed . . . to prevent the misuse . . . of material, nonpublic information." 15 U.S.C. § 78o(g); *id.* § 80b-4a; *see also* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677. And in 1996, the Office of the Comptroller of the Currency promulgated a rule requiring national banks to implement "[m]ethods for ensuring that fiduciary officers and employees do not use material inside information in connection with any decision or recommendation to purchase or sell any security." 12 C.F.R. § 95.

Such ethical walls are now ubiquitous at large financial institutions. *See* Thomas Lee Hazen, *Treatise on the Law of Securities Regulation,* 5 Law. Sec. Reg. § 14:123 (June 2023 update). They stand as an important bulwark against the undisciplined flow of nonpublic information about clients between discrete groups within a bank. They also offer a legal defense for the firm (in some circumstances) if one of its employees nonetheless misuses such information. *See id.*

B. The Order Below Disregards This Framework and Context

There is no dispute that the Trading Underwriters disclosed to investors that they may own stock in Viacom and may trade in that stock. JA-342–JA-343. Prospective investors were thus aware of the potential for a supposed conflict of interest and could discount the price they would pay for the offered securities accordingly. *See* Mehran, *supra*, at 269, 272–73. The Order holds, however, that the Trading Underwriters were required to disclose "that they held massive stock positions (10X the size of the offering) pursuant to certain 'total return swap agreements' and that if their swap-counter parties failed to make margin calls, they would sell the stock." JA-79. Thus, in the lower court's view, the Trading Underwriters needed to disclose the specific terms of their positions in Viacom securities (via their swap agreements with Archegos) and the possibility that movement in those positions could affect the value of the securities. The lower court cited no case imposing this duty, and several courts have held in analogous circumstances that no such duty exists. *See In re Morgan Stanley Tech. Fund Sec. Litig.*, 643 F. Supp. 2d 366, 377 (S.D.N.Y. 2009) (no duty to disclose alleged conflict of interest arising out of analyst reports), *aff'd*, 592 F.3d 347 (2d Cir. 2010); *In re Merrill Lynch*

& Co., Rsch. Reps. Sec. Litig., 289 F. Supp. 2d 429, 435 (S.D.N.Y. 2003) (same).

As made apparent by the above discussion, a requirement that banks exchange such confidential information between discrete divisions or affiliates—here, the underwriting group and the trading groups—flouts the statutory, regulatory, and industry-standard provisions that are designed to protect against that very exchange of information. The purpose of those ethical walls is to prevent the dissemination of confidential information throughout a firm in the first place, *Merrill Lynch*, 43 S.E.C. at *4, yet the Order *mandates* such dissemination upon threat of liability under the securities laws. Such an obligation would erode decades of practice and progress regarding how banks can maximize the services they offer to clients, as well as run headlong into a host of laws and regulations that *require* the erection and observance of ethical walls between banking divisions. *See* 15 U.S.C. §§ 78o(g), 80b-4a; 12 C.F.R. § 95; 17 C.F.R. § 240.14e-3.

It bears noting in this respect that the Order's novel rule does not appear to be limited to the provision of prime brokerage services. Instead, the duty imposed by the Order would apply to *any* of a bank's

brokerage services, including the thousands of relationships banks have with retail investors. The Order thus does not contemplate tearing down just one ethical wall, but in fact demands dismantling the entire system, leaving commercial banks unable to provide clients the full suite of services they have come to expect.

There is no countervailing benefit to consumers: Investors—especially sophisticated investors—already know about the potential for such conflicts in large banks and can account for that when deciding whether to purchase a security. *See In re Lehman Bros. Sec. & ERISA Litig.*, 684 F. Supp. 2d 485, 492 (S.D.N.Y. 2010) (no obligation to "disclose the potential for a conflict of interest" where such potential "had been known publicly for years"), *aff'd*, *In re Lehman Bros. Mortgage-Backed Sec. Litig.*, 650 F3d 167 (2d Cir. 2011). In the limited areas in which more specific disclosure is necessary, the SEC has stepped in to define issuers' and underwriters' responsibilities. *See, e.g.*, 17 C.F.R. § 229.403(a), (b) (requiring disclosure of ownership of certain beneficial owners and management). The Order's imposition of a novel legal duty thus does nothing to solve any actual problems, and instead just proliferates securities litigation.

In several places, the Order's reasoning reflects a fundamental misunderstanding of how banks operate. For example, the Order asserts that "[i]n underwriting both the 'total return swap agreements' and Viacom[,] . . . the Conflicted Defendants knew and understood the volatility of Archegos highly leveraged position." JA-79. To begin, the Trading Underwriters did not "underwrit[e]" the total return swap agreements with Archegos—they were counterparties to those agreements through their prime brokerage business. More critically, though, asserting what the Trading Underwriters "knew"—without differentiating between the underwriting and prime brokerage groups—ignores how information is shared (or not shared) within financial services institutions. Elsewhere, the Order accuses the Trading Underwriters of setting a "trap" for investors through the securities offering, JA-80, a characterization that again erroneously assumes that a bank acts as a single entity with a unified purpose.

For these reasons, it is not even accurate to say there was a "conflict of interest" here. The Trading Underwriters faced no conflict, because, as described above, underwriting groups are not privy to the confidential investment positions of the banks' other clients and therefore have no

ability to, let alone motivation to, misrepresent the fair price of the securities or the financial health of the issuer. If, however, as the Order contemplates, the Trading Underwriters needed to share information among discrete groups and affiliates to detect and disclose possible financial interests in the offering, that would have the perverse effect of *creating* a conflict of interest where none currently exists. Under such a regime, the underwriting division *would* know about the bank's positional interest and may therefore have incentives that are not aligned with investors'. In other words, the Order creates the very problem it purports to be addressing.

The Order's mandated breach of ethical walls poses another problem for banks, which is that banks owe duties to several different clients and may face irreconcilable competing obligations if information about one client is shared with a department servicing another. One of the reasons banks began erecting ethical walls was to avoid a situation in which an agent of a client (e.g., a financial adviser) receives confidential information about another, unrelated client (e.g., an underwriting client) that is relevant to the advice being given to the first client. *See* Poser, *supra*, at 104–05 (citing *Black v. Shearson, Hammill &*

Co., 266 Cal. App. 2d 362, 368 (1968); *In re Van Alstyne, Noel & Co.*, 33 S.E.C. 311, 1952 WL 44153, at *6 (S.E.C. Apr. 8, 1952)). The problem is that the financial adviser must tell its clients about information material to their investment decisions—including, potentially, confidential financial information about the bank's underwriting client—but the underwriter is obliged to keep that information confidential. For the bank to fulfill one duty, it must breach the other. *See id.* By keeping information segregated among a bank's departments, ethical walls mitigate against that risk. The Order, by contrast, exacerbates that risk.

Although the Trading Underwriters raised many of these arguments below, the Supreme Court derided them as "nonsense," asserting that "[s]omeone working at some senior risk management level within the Conflicted Defendants (presumably at least the Chief Compliance Officer) had not only the ability to look over the walls but an obligation to do so as to prevent exactly this scenario from happening." JA-82. The sole case it cited for this characterization—arising out of the historic Enron fraud—did not denigrate the efficacy or need for ethical walls, and instead dismissed the conflict-of-interest charges, acknowledging that "[t]he SEC has long recommended the use of [ethical]

[w]alls." *In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 2016 WL 4095973, at *21 n.29 (S.D. Tex. Aug. 2, 2016), *aff'd sub nom. Giancarlo v. UBS Fin. Servs., Inc.*, 725 F. App'x 279 (5th Cir. 2018).

The information-sharing hypothesized by the court below is the exact kind of circumstance against which ethical walls are designed to protect. If higher-level compliance executives were required to facilitate the exchange of information over ethical walls as a matter of course, the entire purpose of those walls would be undermined. A breach of information-sharing protections committed by a compliance officer is no less a breach than any other kind of impermissible sharing. And it is unclear exactly *when* these compliance executives would be required to look over ethical walls: Any time the bank underwrites an offering in an entity in which any of its clients hold a position? Any time the bank is anticipating executing a transaction that may affect the price of the securities in an offering it is underwriting? If the latter, how is the compliance officer to know *ex ante* whether such circumstances exist and, thus, whether breach of the ethical wall is necessary under the Order's rule? The Order does not say.

The Order thus puts banks in an untenable position. Either they disregard their legal and ethical responsibilities by sharing nonpublic, material information across divisions and affiliates to avoid liability for the failure to disclose an alleged conflict of interest, or they honor those ethical walls but assume the risk of massive liability under the securities laws. The only other option, it seems, is for banks simply to cease conducting any combination of businesses that could theoretically give rise to a perceived conflict of interest. But as described above, *see supra* pp. 8–9, banks' ability to offer a complete suite of services to their clients is a benefit to investors and issuers alike. Eliminating that benefit to mitigate against an illusory conflict of interest of which investors are already aware harms the markets and is without any legal basis.

II. The Order on Review Misunderstands the Role of Underwriters

Even if underwriters must investigate and disclose their own specific, contemplated transactions relevant to the issuer (they are not), that does not mean underwriters must investigate and disclose transactions contemplated by their co-underwriters. There is no basis in law or reason for such a requirement, and the Supreme Court cited none.

A. There Is No Duty to Investigate Co-Underwriters

The fundamental legal error in the Order's approach is that it *assumes* a duty of an underwriter to investigate other underwriters in the same syndicate, rather than searching for support for the existence of that duty to begin with. The "securities laws do not create an affirmative duty to disclose any and all material information" to investors. *In re Pretium Res. Inc. Sec. Litig.*, 2020 WL 953609, at *5 (S.D.N.Y. Feb. 27, 2020) (quotation marks omitted). Instead, a plaintiff must plead "that the defendant had a duty to disclose the omitted fact." *Constr. Laborers Pension Tr. for S. Cal. v. CBS Corp.*, 433 F. Supp. 3d 515, 531 (S.D.N.Y. 2020). And as the Order below acknowledges, "liability under Section 11 can not be imposed for the failure to disclose what was not known where there was no duty to know or for the lack of clairvoyance." JA-60 (citing *In re NIO Inc. Sec. Litig.*, 211 A.D.3d 464, 466 (1st Dep't 2022)); *see also In re HEXO Corp. Sec. Litig.*, 524 F. Supp. 3d 283, 300 (S.D.N.Y. 2021) (quotation marks omitted) (plaintiff must "plead facts to demonstrate that allegedly omitted facts both existed, and were known or knowable, at the time of the offering"); *In re JP Morgan Chase*, 363 F. Supp. 2d 595, 635 (S.D.N.Y. 2005) (plaintiff must allege

"the defendant possessed the omitted information at the time the registration statement became effective").

There is no freestanding duty for underwriters to investigate one another for hypothetical conflicts of interest. No statute or regulation imposes such a duty, and the lower court cited no case recognizing one either. That is unsurprising: The role of an underwriter is to create a market for the securities and to perform due diligence on the *issuer*, *see* Iannotta, *supra*, at 4, not to validate or vouch for the work of its fellow (and competing) underwriters. The lower court observed that "[n]owhere does [Section 11] provide that an underwriter need not ask relevant questions of each other to ensure that conflicts do not exist." JA-86. But, of course, the fact that the securities laws do not expressly *absolve* underwriters of such a duty is not sufficient to *establish* the existence of the duty at all, as is required to impose liability. *See Constr. Laborers Pension Tr.*, 433 F. Supp. 3d at 531.

Rather than first identifying an affirmative duty to investigate, the Supreme Court focused on whether the allegations established a *defense* to liability, that is, whether the underwriters conducted a "reasonable investigation" and were thus insulated from liability pursuant to 15

U.S.C. § 77k(b)(3). JA-86. But the determination of whether a duty exists at all is antecedent to examining whether some affirmative defense to liability is available. The lower court thus skipped an essential threshold step in the analysis—one that, as noted above, should have been dispositive.

Even looking at the regulatory definition of a "reasonable investigation," though, it is clear the regulation does not contemplate an investigation into other underwriters. The reasonableness of an underwriter's investigation must be assessed in view of "the type of underwriting arrangement, the role of the particular person as an underwriter and the availability of information *with respect to the registrant*." 17 C.F.R. § 230.176(g) (emphasis added). The focus is therefore on the underwriter's access to information about the issuer, not about its fellow underwriters. Moreover, the regulation accounts for the "type of underwriting arrangement" and the "role of the particular person as an underwriter," thus reflecting the reality (described above) that underwriters typically work together in a syndicate, each performing different roles.

It is not the role of the judiciary to devise and enforce new disclosure obligations based on its subjective views of public policy or general welfare. The securities laws delineate the disclosures issuers and underwriters must make, and the absence of an express *exemption* for a particular disclosure does not establish its necessity as a statutory matter.

B. Imposing a Duty to Investigate Co-Underwriters Is Irrational

Not only is imposing a duty to investigate other underwriters unsupported by any legal precedent, it also makes no sense as a practical matter.

As described above, large securities offerings (like the one at issue) are underwritten by a syndicate of underwriters. *See* Iannotta, *supra*, at 61. Responsibility for the offering is not evenly divided among the underwriters; instead, the lead underwriter (or co-lead underwriters) oversees “the origination function[,] which includes acting as an advisor in the early stages of formulating a financing plan, conducting a due-diligence assessment of business prospects, preparing and filing the registration statement with the Securities Exchange Commission, and negotiating the basic underwriting terms.” Narayanan, *supra*, at 559.

Other underwriters in the syndicate may merely help spread risk by agreeing to underwrite a portion of the securities offering. *See* Iannotta, *supra*, at 62.

It therefore cannot be the case that underwriters—some of whom do not even conduct due diligence *on the issuer*—must investigate *each other* for potential conflicts of interest. Such diligence is not remotely within the scope of underwriters' responsibilities. Indeed, it is not even clear what power an underwriter has to conduct due diligence on others within the syndicate—an underwriter who has agreed to pre-purchase 5% of an offering cannot coerce underwriters with a larger share or greater responsibility to turn over their entire client files to their competitors.

In fact, syndicates are a necessary feature of underwriting in part *because* investors sometimes discount the price of securities based on an underwriter's perceived potential for a conflict of interest, and thus bringing in additional underwriters can lend credibility to the diligence of the underwriters. Naraynan, *supra*, at 559–60. Investors know that a large bank underwriter may face some inherent, perceived conflicts of interest, and they therefore generally are willing to pay more for

securities underwritten by a syndicate co-managed by several banks. *Id.* at 557. That is because a syndicate of underwriters can provide multiple perspectives on the value of the offering and how it should be marketed. *See id.*

The lower court failed entirely to consider the sheer scope of the obligation it has imposed on underwriters. Here, the supposed conflict of interest arose due to interests held by the Trading Underwriters' prime brokerage and trading groups. But as the plaintiffs themselves describe, those prime brokerage and trading groups were situated in entirely different divisions from the underwriter groups, and in some cases, were managed by a different corporate entity. *See* JA-348–JA-352. The Order thus would require underwriters to probe not just the integrity of the underwriting services of their colleagues, but also the inner workings of financial groups and even separate companies not even remotely involved in the offering. And of course, if conducted, that inquiry would expose clients' confidential information to financial institutions with whom they have *no* dealing. In effect, the lower court held that clients' personal, confidential, financial information must be shared among *all* financial institutions that engage in underwriting—a substantial portion of

banks—so that each institution can determine whether *other* institutions may have underwriting conflicts. To even articulate this proposed regime is to expose its absurdity.

CONCLUSION

For the foregoing reasons, this Court should reverse the Order in relevant part and direct dismissal of the claims against all underwriters.

Dated: September 15, 2023

Andrew Doersam
(*of the bar of the District of Columbia) pending permission of the Court*
AMERICAN BANKERS ASSOCIATION
1333 New Hampshire Ave NW
Washington, DC 20036
(202) 663-5035
adoersam@aba.com

By:
Mark A. Perry
(*of the bars of the State of California and the District of Columbia) pending permission of the Court*
Robert Stern
Joshua M. Wesneski
WEIL, GOTSHAL & MANGES LLP
2001 M Street NW, Suite 600
Washington, DC 20036
(202) 682-7190
robert.stern@weil.com

Attorneys for Amicus Curiae the American Bankers Association

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By ______________________
Robert Stern