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Refco Wins Dismissal, But Not Safe Yet

By **Marc Tracy**

Law360 (September 14, 2007, 12:00 AM EDT) -- Defunct brokerage Refco Capital Markets Ltd.'s woes were lessened Thursday when a federal judge dismissed a putative class action brought by customers accusing it, auditor Grant Thornton LLP, and several individual defendants associated with Thomas H. Lee Partners LP of securities fraud.

Gerard E. Lynch of the U.S. District Court for the Southern District of New York granted the defendants' motion to dismiss, though he also granted the plaintiffs leave to replead against most defendants, including Refco.

Lynch found that the complaint did not sufficiently point to deceptive conduct on the part of the defendants for their alleged role in loans of customers' money made to Refco Capital Management Ltd., a Bermuda-based Refco subsidiary.

“Plaintiffs make various allegations of wrongdoing or mishandling of assets, but they fail to explain how defendants created a false impression concerning their handling of plaintiffs’ assets. The apparent basis of plaintiffs’ claim is deceptive conduct, rather than market manipulation. But it is not clear how plaintiffs believe they were deceived,” Lynch argued.

The plaintiffs needed to establish deceptive conduct in order to file their claims under federal securities laws, according to Lynch.

Lynch acknowledged that much of Refco's alleged conduct may seem potentially fraudulent, and therefore granted the plaintiffs leave to replead against all defendants except for four former Refco officers.

“Several different potential fraudulent schemes could be hypothesized within the vague contours of plaintiffs’ allegations. Given the opportunity to explain what conduct by defendants was deceptive, plaintiffs may be able to point to some specific duty or action on defendants’ part that created the requisite false impression,” Lynch said.

“We are reviewing the decision, and it's likely that we'll replead,” said Mark Strauss, an attorney at Kirby McInerney LLP, which is representing lead plaintiff Global Management Worldwide Ltd., on Friday.

An attorney at Shapiro Mitchell Forman Allen & Miller LLP, which is representing the defendants, did not return a request for comment Friday.

Refco schemed to conceal its massive financial losses through a series of fraudulent loans that temporarily transferred the company's debts to Refco Group Holdings Inc., an entity owned by Refco CEO Phillip Bennett and President Tone Grant, plaintiffs have alleged.

In the year leading up to Refco’s bankruptcy filing, executives took $1.124 billion from the firm, much of it coming from the sale of a large stake in the company to Thomas H. Lee Partners.

The deal was completed in August 2004, at which time $1.057 billion of the $2.2 billion payment was given in large part to Bennett and Tone Grant, who served as CEO of the company before Bennett.

According to Refco's financial statements, Bennett and Grant split $550 million in cash received as part of the Thomas H. Lee payment. Bennett later received an additional $507 million.

Four other Refco executives also received a total of $22 million in cash payments just before the firm completed the deal with Thomas H. Lee. The payments were in relation to a profit-sharing pact made by the insiders.

Refco executives did not explain the adjustment.

Just two months before declaring bankruptcy in 2005, Refco's initial public offering resulted in the sale of 26.5 million shares of stock, which flooded Refco's coffers with $583 million.

The U.S. Securities and Exchange Commission initiated an investigation into the alleged securities fraud at Refco, and the New York Stock Exchange and the Commodity Futures Trading Commission have also conducted probes.

Refco also faces numerous class action lawsuits that name not only the company and its executives as defendants, but also the company's auditors and the banks that underwrote its initial public offering.

In June, investors of the collapsed broker scored a huge victory after a judge signed off on a $140 million settlement with the Austrian bank that allegedly helped sink Refco.

The plaintiffs are represented by Kirby McInerney LLP.

The defendants are represented by Shapiro Mitchell Forman Allen & Miller LLP, Paul, Weiss, Rifkind, Wharton & Garrison LLP, Weil, Gotshal & Manges LLP, Friedman & Wittenstein PC, Hunton & Williams LLP, Baker & Hostetler LLP, Nathan Law Office, Winston & Strawn LLP, Bingham McCutchen LLP, Zuckerman, Spaeder, Goldstein, Taylor & Kolker LLP, Hannafan & Hannafan Ltd., Heller Ehrman, White & McAuliffe LLP, Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer PC, and Golenbock Eiseman Assor Bell & Peskoe LLP.

The case is In re Refco Capital Markets, Ltd. Brokerage Customer Securities Litigation, case number 1:06-cv-00643, in the U.S. District Court for the Southern District of New York.

--Additional reporting by Anne Urda