08-2899-cv(L)

08-3016-cv(XAP)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

CSX CORPORATION,

Plaintiff-Appellant-Cross-Appellee,

MICHAEL WARD,

Third-Party-Defendant,

—against—

THE CHILDREN'S INVESTMENT FUND MANAGEMENT (UK) LLP, THE CHILDREN'S INVESTMENT FUND MANAGEMENT (CAYMAN) LTD., THE CHILDREN'S INVESTMENT MASTER FUND, 3G CAPITAL PARTNERS LTD., 3G CAPITAL PARTNERS, L.P., 3G FUND, L.P., CHRISTOPHER HOHN, SNEHAL AMIN, and ALEXANDRE BEHRING, also known as Alexandre Behring Costa,

Defendants-Third-Party-Plaintiffs-Counter-Claimants-Appellees-Cross-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR PLAINTIFF-APPELLANT-CROSS-APPELLEE CSX CORPORATION

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Reference Conventions

"Exchange Act": Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.*

"Williams Act": Sections 13(d), 14(d) and 14(e) of the Exchange Act

Additional Citation Conventions

Record Below:

"CSX Post-Trial Reply": Corrected Memorandum of CSX Corporation and Michael Ward in Response to Defendants' Post-Trial Brief

"Defs. Post-Trial Br.": Defendants' Corrected Post-Trial Reply Brief Relating to the Claims of CSX Corporation

Briefs on Appeal:

"CSX Br.": July 3, 2008 Brief for Plaintiff-Appellant-Cross-Appellee CSX Corporation

"CSX Resp. Br.": July 18, 2008 Responding Brief for Plaintiff-Appellant-Cross-Appellee CSX Corporation

"Defs. Resp. Br.": July 18, 2008 Responding Brief of Defendants-Appellees-Cross-Appellants

"CPIC Br.": July 18, 2008 Brief of Amicus Curiae Coalition of Private Investment Companies ("CPIC") in Support in Part of Defendants-Appellees-Cross-Appellants and Reversal in Part of the Judgment of the District Court

"ISDA Br.": July 18, 2008 Brief of *Amici Curiae* International Swaps and Derivatives Association, Inc. and Securities Industry and Financial Markets Association (collectively, "ISDA")

"MFA Br.": July 18, 2008 Brief of *Amicus Curiae* Managed Funds Association ("MFA") in Support of Neither Party

"Defendants' *amici*": CPIC, ISDA and MFA

"Levitt Br.": July 18, 2008 Brief of Former SEC Commissioners and Officials and Professors as Amici Curiae in Support of Appellant CSX Corporation and Affirmance

Preliminary Statement

Defendants set out to steal an election by violating the law.

Our appeal—a serious one—addresses whether this Court can grant a meaningful remedy against defendants' egregious violations of the securities laws. Instead of making jokes about "old adages",[1] we analyze the power of a court of equity to remedy defendants' all-out attack on the rules that make "[f]air corporate suffrage" possible.

Unlike defendants, we do not believe that this Court is powerless to stop unscrupulous, well-funded shareholders from stealing elections by tilting the playing field. *Rondeau*, *Treadway* and all the other cases that the parties have cited do not prevent the Court from fashioning a remedy to deal with new violators

[1] Inexplicably, defendants start their brief with a joke, about an "old adage that if the law is against you, argue the facts". (Defs. Resp. Br. 1.) We say "inexplicably", not because we are surprised at defendants' avoiding responsibility (A-5673), but because not a single true word has been spoken in this jest. *First*, we do have "the facts", but defendants use wiggle words—"supposed facts", somehow even "larded with distortions". (Defs. Resp. Br. 1.) Let us be clear. Defendants *are* "bad actors", but we have no need to "smear" them (Defs. Resp. Br. 1). They daubed themselves in dishonesty, including their persistent false testimony before the district court. They have spurned "honesty alone", let alone "the punctilio of an honor the most sensitive". *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928). *Second*, defendants' assertion that "the law is against [us]" (Defs. Resp. Br. 1) is false. The district court described their egregious violations of "the law" in great detail.

with new methods. We do not believe the law is "a ass" or "a idiot".[2] The "life of the law . . . has been experience"; "[i]t is forever adopting new principles from life". Oliver Wendell Holmes, Jr., *The Common Law* 1, 36 (1881). This case has opened the "eye of the law" through the "experience" of novel schemes (which will become routine if defendants are right). To "know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict". Oliver Wendell Holmes Jr., *The Path of the Law*, 10 Harv. L. Rev. 457, 462 (1897). Thus, "[s]ome people deliberately go close to the line dividing legal from illegal if they see a sufficient opportunity for profit in doing so" and "[a] few cross that line and, if caught, seek to justify their actions on the basis of formalistic arguments even when it is apparent that they have defeated the purpose of the law". (A-5561.)

Since "[f]lexibility rather than rigidity has distinguished" the "power of the Chancellor to do equity and to mould each decree to the necessities of the particular case", *Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944), the Court is not powerless to deal with these new violators with new methods. We believe that this Court should use its broad equitable powers to remedy the irreparable harm to

[2] Coverture, in which "the eye of the law . . . supposes that your wife acts under your direction" was the subject of Mr. Bumble's wrath: "If the law supposes that, . . . the law is a ass—a idiot. If that's the eye of the law, the law is a bachelor; and the worst I wish the law is, that his eye may be opened by experience—by experience". Charles Dickens, *Oliver Twist*, 714-15 (1838).

shareholders and the interests that the Williams Act seeks to protect. *See infra* Part I.A.

Before we address that legal issue, we deal with some fundamental points that defendants ignore or misstate.

First, democracy, the least "worst form of government", allows the CSX shareholders to vote the CSX directors out of office for any reason. The "price" of democracy against "all those other forms that have been tried from time to time" is that the electorate is free to make the "wrong" choice. CSX shareholders can vote for Pinocchio rather than probity,[3] provided that defendants have not violated the rules that establish "[f]air corporate suffrage".

Second, CSX here proved that defendants illegally undermined these rules by tilting the playing field and "disclos[ing] only when convenient to their strategy". (A-5673.) This conduct undermined the goal of the Williams Act because "Congress meant to promote the 'free exercise' of stockholders' voting rights . . . and protect '[f]air corporate suffrage'" (*Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1103 (1991)), which is "an important right that should

[3] Contrary to defendants' assertion that "CSX has taken the unusual step of announcing that the final results of the June 25 election might not be available until July 25" (Defs. Resp. Br. 11), the review and challenge period commenced at the earliest possible date and was completed today and the inspector's report is expected tomorrow. Even before the inspector issued its final report, CSX invited two of the Group's nominees to join the board, and they have accepted that offer.

attach to every equity security bought on a public exchange", *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964).

Third, the Williams Act requires full disclosure as a necessary condition for "[f]air corporate suffrage". "Sunlight" is the "best of disinfectants"; "electric light" is the "most efficient policeman"; and "publicity [is required] in aid of fair dealing". Louis D. Brandeis, *Other People's Money* 92, 103 (1914). Therefore, disclosure is the typical remedy in a Section 13(d) case.

Fourth, disclosure must occur within a system of rules. Without such rules, each person has a claim to everything and there is a "war of all against all".[4] Here, defendants, in order to steal the election, illegally evaded the rules that the Williams Act established to maintain a fair playing field. *See ICN Pharms. Inc. v. Kahn*, 2 F.3d 484, 490-91 (2d Cir. 1993). Disclosure does not cure this manipulation of the electorate.

Fifth, courts "have not hesitated to recognize the power . . . to fashion private remedies for securities laws violations when to do so is consistent with the legislative scheme and necessary for the protection of investors as a supplement to

[4] "[T]he state of men without civill [sic] society (which state we may properly call the state of nature) is nothing else but a meere warre [sic] of all against all; and in that warre [sic] all men have equall [sic] right unto all things". Thomas Hobbes, *De Cive*, Praefatio (Preface), 9 (1651 ed.). In such a state, life is "solitary, poore [sic], nasty, brutish, and short". Thomas Hobbes, *Leviathan*, 84 (1651, reprinted in 1904).

enforcement by the Securities and Exchange Commission ['SEC']". *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 62 (1975). Courts have therefore issued a wide range of relief to avoid irreparable harm to shareholders' "[f]air corporate suffrage". For example:

- postponing the annual meeting coupled with "clearing the air and disseminating the information necessary to eradicate false impressions", *Edelman v. Salomon*, 559 F. Supp. 1178, 1189 (D. Del. 1983);
- enjoining the stockholder meeting, voiding proxies and ordering resolicitation of proxies in order to furnish shareholders with "the opportunity to make an informed decision", *Kaufman v. Cooper Cos., Inc.*, 719 F. Supp. 174, 185-86 (S.D.N.Y. 1989); and
- voiding an election that has already taken place and ordering a new election after resolicitation of proxies, *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1202 (2d Cir. 1978); *see also United Paperworkers Int'l Union v. Int'l Paper Co.*, 985 F.2d 1190, 1197-1202 (2d Cir. 1993).

A court of equity "has the power to grant full relief, taking into account . . . the goals of the Williams Act". (6/9/08 Hr'g 3:18-21.) Even defendants' counsel conceded this:

- "There is no question, your Honor, that the Court has the authority, sitting in equity, to render the appropriate relief, the relief deemed appropriate, guided by what the cases teach us, particularly in a Williams Act case" (6/9/08 Hr'g 41:25-42:4); and
- "I will concede the point that this Court sitting in equity has the power to issue in a remedy deemed appropriate based on the learning and guidance of the Courts of this district, of this circuit, and of the Supreme Court" (6/9/08 Hr'g 42:25-45:3).

Sixth, defendants' misconduct is *highly* relevant to "the narrow legal question presented by CSX's appeal" (Defs. Resp. Br. 1). The issue on appeal is whether, in the *extraordinary* situation of lying and deceit to steal an election, this Court has the power to grant relief. Here, defendants evaded the law before trial, testified falsely at trial, and tried to evade responsibility after trial. One of defendants' nominees "insist[ed] the funds acted properly and 'did it all according to the book.' . . . 'So the question is, what's the big deal? We didn't do anything wrong'".[5] *Funds Faulted in CSX Row*, Wall St. J., June 12, 2008. But defendants' cover-up is not just "what's the big deal?". In its brief to this Court, defendants urge that "there is nothing remotely 'egregious' about the alleged violations of § 13(d) at issue here". (Defs. Resp. Br. 3.) In support of this attention-getting assertion, defendants cite Institutional Shareholder Services ("ISS"), the "respected independent shareholder advisory firm . . . , which examined the parties' positions in detail and issued its analysis of the contest *after* the ruling below, [and] recommended that shareholders elect four of defendants' five nominees". (Defs. Resp. Br. 34-35.) In fact, ISS represents the "new" market

[5] This nominee adopted a strategy at his deposition of not remembering anything. (*See* CSX Post-Trial Reply Addendum A.) CSX has seated him, as well as Behring, on whose credibility the district court commented at length.

players,[6] and in this very election put forward a dismal view of integrity in corporate America:[7]

- "[t]o date, no law enforcement agency has brought perjury charges against the dissidents";
- a credibility determination by a judge "is subject to a much lower evidentiary burden than is a criminal charge of perjury";
- "[w]ith respect to the court's finding that TCI and 3G formed a 'group,' we note the court's ruling is based on circumstantial evidence" and that, despite the court's finding to the contrary, "we find little evidence that TCI/3G has sought control of CSX"; and
- "the behavior of TCI and 3G has [not] been particularly egregious", *available at* http://www.issproxy.com/governance_weekly/2008/131.html.

A brave new world that has such people. Defendants and defendants' *amici*[8] spell out the morals of the "new man" in the marketplace—the "respected [not so]

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[6] "[A]lternative investment managers" or hedge funds accounted for 22 percent of the company's annualized contract value. *See* RiskMetrics Inc., Annual Report (Form 10-K), at 14 (Mar. 31, 2008), *available at* http://www.sec.gov/Archives/edgar/data/1295172/000104746908003858/a2184315z10-k.htm. The "eye of the law" has focused on "not so independent" analysts, but not yet on hedge funds' influence on ISS.

[7] TCI adopted ISS's "Orwellian" (Defs. Resp. Br. 3) view. *See* Press Release, TCI and 3G Capital Send Letter to CSX Shareholders (June 20, 2008), *available at* http://www.sec.gov/Archives/edgar/data/277948/000110465908041211/a08-12469_16ex99d1.htm.

[8] Defendants' *amici* describe defendants' conduct as not extraordinary and consistent with the morals of the marketplace (*e.g.*, CPIC Br. 14-20, ISDA Br. 21-25, MFA Br. 1-2, 7, 10), praising defendants' "role [as] activist shareholder[s] in improving corporate governance and maximizing shareholder value" (CPIC Br.

independent shareholder advisory firm" ISS advises that lying is not "particularly egregious" because the district court's credibility findings do not require proof beyond a reasonable doubt, and these gentlemen have not yet been indicted.

Seventh, defendants' lack of honesty—even if supported by "friends and family"—defeats their argument that CSX knew the true facts and that, in any event, the disclosure is now enough (Defs. Resp. Br. 5). "[T]he disclosure must be real. And it must be a disclosure to the investor". Louis D. Brandeis, *Other People's Money* 104 (1914). The disclosure was neither "real" nor to the "investor". Before they were caught, defendants tilted the playing field and failed to make the required disclosures. (CSX Br. 39-41.) Then, at trial, they testified falsely—early and often. No "real" disclosure there. And after trial, they prevented "real" disclosure. The district court could not provide the "truth" to the market because defendants deposited contradictory information into the market (and continue to do so this day).[9] *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 167-68 (2d Cir. 2000). The market did not have the "correct[] information[, which] must be conveyed to the public 'with a degree of intensity and credibility

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24) and asserting that the *status quo* works fine and that everyone should conduct business as usual (*e.g.*, CPIC Br. 3-4, 20-21; ISDA Br. 25, MFA Br. 1-3, 7).

[9] Defendants' proxy statement falsely disclaimed beneficial ownership; misrepresented Group formation and the number of shares the Group beneficially owned; failed to disclose the details of the swap arrangements; and misrepresented their control intent (JX 19 at 3, 5, 18, Annex A). *See* 17 C.F.R. § 240.14a-101.

sufficient to counter-balance effectively any misleading information created by' the . . . misstatements". *Id.* at 167. Defendants' wrongful denials of wrongdoing counteracted disclosure of the truth: "[t]he meaning of these comments to the average investor, their truth or falsity, and their completeness" is not necessarily ascertainable. *Westwood v. Cohen*, 838 F. Supp. 126, 134 (S.D.N.Y. 1993). Indeed, defendants and their "friends and family"—including ISS—continue to deny the truth.[10]

Eighth, the requirement that hedge funds not violate the securities laws and lie about it has nothing to do with "Big Brother".[11] We do not invite the Court to

[10] Defendants make another joke—"apparently without intended irony"—when they assert that "CSX suggests that it was somehow an unwitting victim of a 'clandestine effort to take control' that took the company and shareholders by surprise at the 'eleventh hour'". (Defs. Resp. Br. 5-6.) We did not "bur[y]" our knowledge of their "interest" at "the end of [our] presentation". (Defs. Resp. Br. 6.) We knew of their interest and disclosed the facts that we knew. But nowhere did defendants disclose all the facts, the facts that *they* knew, which we had to go to trial to prove. And which we did prove, even though they dismissed our lawsuit as a public relations stunt, and even though they lied repeatedly about what they knew but failed to disclose. Moreover, even now, they and their surrogates deny the facts.

[11] The accusation that we are "positively Orwellian" (Defs. Resp. Br. 3) is hard to understand. We do not challenge the operation of the "invisible hand" in the "marketplace of ideas". An English writer earlier than Orwell described this well. "And though all the windes of doctrin [sic] were let loose to play upon the earth, so Truth be in the field, we do injuriously by licencing and prohibiting to misdoubt her strength. Let her and Falsehood grapple; who ever knew Truth put to the wors [sic] in a free and open encounter?" John Milton, *Areopagitica: For the Liberty of unlicenc'd Printing* (Nov. 23, 1644), 51-52 (Oxford Univ. Press 3d ed. 1882); *see also Abrams v. United States*, 250 U.S. 616, 630 (1919) (Holmes, J., dissenting).

regulate Section 13(d) compliance generally. Defendants' contrary argument (Defs. Resp. Br. 37) is hyperbolic and wrong. This case is about defendants' efforts to steal an election and testifying falsely to that end, not about miscellaneous stock transactions during the period of an uncorrected Section 13(d) violation.[12] Indeed, it is about the need for honesty, even if only "honesty alone". This is not entirely a quixotic quest in a brave new world. The SEC has stressed the importance of setting the "tone at the top" of "fundamental[] honest[y]" in corporations:

> "In short, we're trying to induce companies to address matters of tone and culture. We're trying to get the fundamentally honest, decent CEO or CFO or General Counsel—the one who wouldn't break the law—to say to herself when she wakes up in the morning: 'I'm going to spend part of my day today worrying about, and doing something about, the culture of my company. I'm going to make sure that others at the company don't break the law, and don't even come close to breaking the law'". Stephen M. Cutler, Director, Division of

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Again from Milton, defendants mean "license" when they cry "liberty". We, however, do not propose Orwell's "Big Brother"—we do not invite the Court to limit the information available to the electorate; and we do not invite the Court to issue propaganda where words have the opposite of their real meaning. Quite the reverse. In the district court, we criticized defendants, using *Alice*, for their failure to disclose, their use of words to mean exactly what defendants said, the grin without the cat, *etc.* (CSX Post-Trial Reply 5-13.) We could equally well have used *1984*'s Ministry of Truth, doublethink and doublespeak.

[12] Defendants' reference to the Section 18 cause of action (Defs. Resp. Br. 20 & n.3) is irrelevant because, as the district court noted (6/9/08 Hr'g 34:13-22), it has no bearing on the harm to the *present* shareholders who were forced to vote on an unlevel playing field.

Enforcement, Second Annual General Counsel Roundtable: Tone at the Top: Getting it Right (Dec. 3, 2004).

Perhaps "honesty alone" will triumph in "a free and open encounter".

I. THE REQUESTED INJUNCTION PROMOTES THE GOALS OF THE WILLIAMS ACT.

The principles governing this Court's issuance of an injunction to remedy irreparable harm are, by and large, not subject to serious dispute:

- The Court has the power to use all traditional equitable remedies, including injunctions, to redress any harm for securities law violations (CSX Br. 43);
- The Court's remedial powers are flexible and construed broadly, especially where, as here, Congress has not limited their scope (CSX Br. 43-44)[13];

[13] Defendants' argument that "this Court has squarely rejected that sweeping interpretation of *Franklin* [*v. Gwinnett County Pub. Schs.*, 503 U.S. 60 (1992)] in the specific context of § 13(d)" and has held that "adding a remedy to § 13(d) beyond disclosure would 'actually frustrate congressional purposes'" (Defs. Resp. Br. 28, 31) is without merit. This Court held that *monetary* damages were unavailable under Section 13(d) because unlike injunctive relief, "monetary damages for issuers would not similarly benefit investors", but affirmed the availability of injunctive relief: issuers have the right to "seek[] equitable or prophylactic relief" under Section 13(d). *Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*, 286 F.3d 613, 621 (2d Cir. 2002). While a damages remedy "is likely to 'tip the balance'" between incumbent management and those seeking control, "the issuer's ability to sue for injunctive relief does not do anything of the kind". *Id.* "Allowing an issuer to seek injunctive relief 'furthers the object of § 13(d) by increasing honest disclosure for the benefit of investors without placing incumbent management in a stronger position than aspiring control groups'". (A-5663 (quoting *Hallwood*, 286 F.3d at 620-21).)

- A plaintiff must show irreparable harm to the interests the Williams Act seeks to protect (CSX Br. 44)[14];
- Equity requires the Court to mould each decree to the necessities of the particular case (CSX Br. 45-46);
- Deterrence is inherent in the injunctive process, which aims to address the danger of recurrent violation (CSX Br. 46).

A. CSX Shareholders Will Suffer Irreparable Harm to Their Williams Act Rights Without An Injunction.

In the absence of an injunction against voting, CSX shareholders will suffer irreparable harm to the "[f]air corporate suffrage" that the Williams Act seeks to protect. As the district court found:

> "Defendants' actions may have contributed to creating a corporate electorate that is materially different today than it was before [TCI and 3G] made th[eir] purchases. Those who are content with present management and unconvinced by [TCI's and 3G's] blandishments may be in a weaker position than they might have occupied had [TCI and 3G] made full and timely disclosure".[15] (A-5665-66.)

[14] We have never tried "to resuscitate the theory dispatched in *Rondeau* that a violation of § 13(d) invariably inflicts irreparable injury, and justifies injunctive relief, as a matter of law". (Defs. Resp. Br. 30-31.) Irreparable harm is required for injunctive relief. *Rondeau* so held. Defendants' citation to cases like *Grupo Mexicano de Desarollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999) (Defs. Resp. Br. 27) is thus irrelevant.

[15] Defendants' argument that the increase in hedge fund ownership was due to public information rather than tipping by defendants (Defs. Resp. Br. 8-9) is wrong. Within the first quarter of 2007, before any public announcements of TCI's or 3G's interests in CSX, ownership by hedge funds was already on the rise, and ownership by funds other than defendants more than doubled during that time period. (*E.g.*, A-2655-759.) Their argument is also irrelevant; the "friends and family" knew of defendants' Group and their undisclosed control intent.

Defendants' misconduct thus tilted the playing field in their favor to the detriment of the shareholders' "free exercise of [their] voting rights" and "[f]air corporate suffrage". *Virginia Bankshares*, 501 U.S. at 1103. "By disclosing their positions selectively, TCI and 3G were aware of, and traded on, information not available to the public and not reflected in the share price. The integrity of the market for CSX stock was undermined and an uneven playing field was created". (Levitt Br. 29-30.)

Defendants' first response is that the only cognizable interest under the Williams Act is disclosure. (Defs. Resp. Br. 29-32.) That is wrong. The Supreme Court and this Court have *never* held that sunlight is the *only* disinfectant. *Rondeau* and *Treadway did* focus on the informational purpose of Section 13(d) because that was the only purpose implicated in those cases. But disclosure is not the only interest the Williams Act seeks to protect. *ICN Pharms.*, 2 F.3d at 490. Indeed, in *Treadway* itself, this Court expressly left open the possibility of injunctions against voting in certain circumstances not present in that case. *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 380 n.45 (2d Cir. 1980). Defendants concede that. (Defs. Resp. Br. 23.)

Indeed, defendants concede that "Congress wanted to remain *neutral* as between management and dissident shareholders, and avoid 'tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid'". (Defs. Resp. Br. 31.) This is obviously a problem for defendants

who tipped the playing field and gained an illegal advantage by ignoring the regulations that were supposed to be "*neutral* as between management and dissident shareholders". Defendants' response is the flat assertion that there cannot be a remedy because that "would tilt the field dramatically in incumbent management's favor", *i.e.*, the "only persons who are 'harmed' by the change in the composition of the electorate are incumbent managers". (Defs. Resp. Br. 32.) This leap defies logic. This is doublespeak, words meaning what defendants say they mean. Defendants' tilting of the playing field has undermined the *shareholders'* "free exercise of [their] voting rights" and "[f]air corporate suffrage", *Virginia Bankshares*, 501 U.S. at 1103; it is the *shareholders'* voice that was weakened.[16] Indeed, the district court referred to the *shareholders*' "weaker position than they might have occupied had [TCI and 3G] made full and timely

[16] Defendants initially asserted that this litigation is a public relations stunt designed to entrench management. (TCI Counterclaims and Third-Party Claim ¶¶ 1-2, 24-26, 108; *see also* Defs. Post-Trial Br. 117, 126; Defs. Br. 1.) Although their latest brief has toned down some of the more purple rhetoric, it still appears in such phrases as "great irony" that the lawsuit is an entrenchment tool. (Defs. Resp. Br. 12.) Similarly, defendants argue that our observation that defendants' "ability to have their voice heard is . . . magnified" by their illegal conduct is "just another way of complaining that incumbent management may be disadvantaged". (Defs. Resp. Br. 32-33.) Defendants further complain that there are no limitations placed on CSX management "to ensure that management does not use the additional time to tilt the playing field unfairly in *its* favor (for example, by amending bylaws to add supermajority requirements)". (Defs. Resp. Br. 37-38.) Defendants are just wrong. This case is about defendants' lying and manipulation of the electorate, not takeover defenses.

disclosure". (A-5666.) "That all of the facts now have been disclosed does not alter this prospect". (A-5666.)

Moreover, the requested injunction[17] also promotes the Williams Act's goals by deterring violations. The *Piper* Court stated that deterrence may be "a meaningful goal" in fashioning relief for "the most flagrant sort of violations" of the Williams Act. *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 40 n.26 (1977). This was entirely consistent with the *Rondeau* Court's holding that the district court was within its discretion to deny "relief which is historically 'designed to deter, not to punish'".[18] 422 U.S. at 62. Contrary to defendants' argument that *we* are "simply playing word games" (Defs. Resp. Br. 39-44), nothing in *Rondeau* limits the concept of deterrence only to injunctions against future violations. Indeed, defendants' argument represents a refusal to make sense. Injunctive relief granted in Section 13(d) cases is principally disclosure, which is aimed at addressing past violations. Moreover, past violations are highly relevant to the likelihood of future violations (*N.L.R.B. v. Express Publ'g Co.*, 312 U.S. 426, 435

[17] Contrary to defendants' argument (Defs. Resp. Br. 36-37), we specifically argued that "TCI's and 3G's votes of their illegally-obtained shares should be deemed null and void". (CSX Br. 1.) So there is no "red flag" or any efforts "not [to] have the Court consider too carefully the implications" (Defs. Resp. Br. 37) of anything.

[18] The SEC has stated that remedies beyond corrective disclosure "may be necessary or appropriate" to deter future violations "particularly in cases where the defendant deliberately violated Section 13(d)". (CSX Br. 46-47 n.34.)

(1941), *Kapps v. Wing*, 404 F.3d 105, 122-23 (2d Cir. 2005)), at which deterrence is aimed. Here, an injunction against voting is necessary to take away the incentives raised by the substantial benefits defendants stand to gain as a result of their claim of having four board seats. (CSX Resp. Br. 54.)

Finally, defendants assert that even if an injunction against voting were available, "there can be no credible assertion that the alleged violations of § 13(d) at issue here are somehow worse in kind from that in *Treadway*". (Defs. Resp. Br. 44.) Despite this provocation, we do not repeat our "forty pages" (Defs. Resp. Br. 1) to show that defendants are "bad actors". In *Treadway*, the defendant made a timely Schedule 13D filing upon acquiring over 5 percent of the target company's stock and there were no other indicia of effective control present. *Treadway*, 638 F.2d at 380. Moreover, defendants' further assertion that "[t]his case does not remotely fall within [the] category" of the "most flagrant sort of violations" (Defs. Resp. Br. 42) is remarkable. We again refrain from repeating the "forty pages". Defendants' violations *were* flagrant—the district court's opinion is based on the straightforward application of law to the "overwhelming" evidence (CSX Resp. Br. 14-31). The issues decided in this case are not "novel" and "difficult questions of line-drawing" (Defs. Resp. Br. 42-43). If they had been, defendants would not have needed to offer false testimony. *See Dyer v. MacDougall*, 201 F.2d 265, 269 (2d Cir. 1952) (Hand, J.); *see also United States v. Philatelic Leasing, Ltd.*, 601 F. Supp. 1554, 1565-66 (S.D.N.Y. 1985), *aff'd*, 794 F.2d 781 (2d Cir. 1986).

B. This Court Has the Inherent Power to Sanction Defendants' Abuse of the Judicial Process.

The district court found that defendants "went to considerable lengths to cover their tracks" (A-5634), including that they "testified falsely in a number of respects, notably including incredible claims of failed recollection, to avoid responsibility for their actions" and that they would do it again (A-5673).

Our arguments on the Court's inherent power (CSX Br. 57-58) are not a sign of "desperation" (Defs. Resp. Br. 44 n.6). They reflect a serious argument based on serious misconduct.

Defendants' two contrary arguments are without merit.

First, contrary to defendants' assertion (Defs. Resp. Br. 44-45 n.6), CSX *expressly* argued below that "[t]he relief that we request is entirely appropriate under . . . the Court's inherent power and interest in making sure people are nothing but truthful in its Courtroom" (CSX's Post-Trial Reply 4). Indeed, at the relief hearing, CSX argued that "defendants came to this court and were economical with the truth", and invoking Judge Hand, argued that the court can say "you can't do that in my court". (6/9/08 Hr'g 8:19-9:12.)

Second, CSX is not urging the Court to use inherent authority to "circumvent limitations on its substantive remedial authority" (Defs. Resp. Br. 44-45 n.6). In *Carlisle v. United States*, 517 U.S. 416 (1996), the Court held that a court cannot use its "inherent supervisory power" to take action that "contradict[s] the plain

language" of a rule or statute and that a untimely entry by the district court of a judgment of acquittal "effectively annulled [Rule 29(c)'s] 7-day filing limit". *Id* at 425-26.

II. DEFENDANTS' *AMICI* OPPOSE THE GOALS OF THE WILLIAMS ACT.

Defendants' *amici* repeat many of defendants' legal arguments rejected by the district court in support of their argument that the *status quo* is good and that the district court's ruling "threatens to upset the vitality and efficiency" (CPIC Br. 2) of their business. Each of these legal arguments is without merit for the reasons described fully in CSX's Response Brief.[19]

[19] *First*, the district court did not rely on the use of swaps alone to support its findings under Rule 13d-3(b) and Rule 13d-3(a). (CSX Resp. Br. 24-31, 41-48; CPIC Br. 9-11; ISDA Br. 2, 12; MFA Br. 4, 12-13.) *Second*, beneficial ownership under Rule 13d-3(a) is not a precondition for a finding under Rule 13d-3(b). (CSX Resp. Br. 33-34; CPIC Br. 5-6, 9-10; ISDA Br. 10; MFA Br. 11.) *Third*, interpreting Rule 13d-3(b) to apply where there is no beneficial ownership under Rule 13d-3(a) does not exceed the scope of Section 13(d). (CSX Resp. Br. 34-35; CPIC Br. 9 n.2; ISDA Br. 4; MFA Br. 4.) *Fourth*, voting or investment power under Rule 13d-3(a) is not limited to the actual authority to vote or to dispose of securities. (CSX Resp. Br. 41-47; CPIC Br. 9-14; ISDA Br. 14-20; MFA Br. 3-10.) *Fifth*, the district court's conclusion that "influence" is the relevant standard depended on several cases and SEC Staff Interpretive Guidance stating that Rule 13d-3(a) emphasizes "the ability to control *or influence* the voting or disposition of the securities". (A-5611 n.160 (quoting Interpretive Release on Rules Applicable to Insider Reporting and Trading, Exchange Act Release No. 34-18114, 46 Fed. Reg. 48,147, 48,149 n.17 (Oct. 1, 1981)); ISDA Br. 17-18.) *Sixth*, the Commodity Futures Modernization Act of 2000's provision that a standard total return swap is not a security, 15 U.S.C. § 78c-1(b)(3), does not exempt swapholders from the beneficial ownership rules. (CSX Resp. Br. 35 & n.17; ISDA Br. 12-13, 21; MFA Br. 6.)

Lacking a legal argument, defendants' *amici* argue that the district court's findings under Rule 13d-3(b) and Rule 13d-3(a) were "unsupported by any evidence from the factual record". (ISDA Br. 28.) This argument is peculiar because ISDA stated "we do not address the particular factual findings in this case" (ISDA Br. 21); CPIC stated that its analysis was "[w]ithout regard to the facts of this case" (CPIC Br. 16); and MFA stated that it "takes no position concerning [the district court's] findings" (MFA Br. 2). In any event, it is wrong. The district court found "overwhelming" evidence that defendants engaged in a plan and scheme to evade within the plain meaning of Rule 13d-3(b). (*E.g.*, A-5613, A-5618-21, A-5625-28, A-5574-87, A-5596.) Moreover, although it did not need to decide the issue, the district court found "persuasive" evidence that defendants exercised significant investment and voting influence over the CSX shares referenced in their swaps through arrangements, understandings and relationships with their swap counterparties within the meaning of Rule 13d-3(a),[20] especially

[20] CPIC contends without citation that the district court's opinion was based on a "fundamental misunderstanding of how the swaps markets operate". (CPIC Br. 14-18.) Although CPIC asserts that swapholders do not necessarily control the voting or disposition of referenced shares because they are not contractually entitled to do so (CPIC Br. 16-17), it ignores the other arrangements understandings and relationships that exist in this case (A-5615-21). Likewise, although CPIC argues that equity swaps do not necessarily facilitate more rapid acquisitions of shares (CPIC Br. 15), it ignores the district court's finding that TCI had "a real advantage in converting its exposure from swaps to physical shares even if it does not unwind the swaps in kind" (A-5573) and availed itself of this advantage by purchasing large blocks of CSX shares at prices very close to the

with respect to Deutsche Bank.[21] (*E.g.*, A-5615-21, A-5556, A-5587.)

With "the law" and "the facts" against them, defendants' *amici* assert that the district court's decision "will lead to substantial uncertainties in the derivatives and securities markets".[22] (ISDA Br. 25-29.) That too is wrong. "[T]here is no reason to believe that there are many situations in which the 5 percent reporting threshold under Section 13(d) would be triggered by [its] ruling".[23] (A-5623.) An *amicus* brief filed here spells out why this is so:

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prices obtained by its counterparties on sales of the shares they had held as a hedge (A-1268-71, A-1550-55).

[21] Deutsche Bank represented that it would not vote shares held as a hedge to its swaps. (A-603-608, A-679, Defs. Post-Trial Br. 16-17.) Deutsche Bank held 8,729,187 CSX shares in DTC Account #573, 5,966,538 of which were identified as being held for "DB AG Equity Swaps Offshore". Of the shares in DTC Account #573, 5,610,109 were voted in favor of defendants' slate.

[22] Defendants and two of their three *amici* (ISDA and CPIC) made these same arguments in the district court, which the district court rejected as "exaggerated". (A-5621-23.) The rhetoric of repetition led to further exaggeration—they argue that the district court's opinion "may threaten the economic stakes of persons holding total return swaps referencing publicly-traded REITs [real estate investment trusts]" (CPIC Br. 26-27) and that the opinion "has had the unintended consequence of frustrating state legislative intent, as well as inadvertently triggering state anti-takeover provisions" (CPIC Br. 27-28).

[23] Defendants' *amici* suggest that the SEC Staff and others share their concerns. (ISDA Br. 27.) The Staff's letter to the district court, however, expressly disclaimed that it was considering or commenting on the facts of this case. (A-5548.) Moreover, the SEC and its Staff were fully aware of the district court's decision, including its interpretation of Rules 13d-3(a) and 13d-3(b), and have not filed an *amicus* brief disagreeing with the district court's decision.

- The "District Court's interpretation of Rule 13d-3(b) bites only when a party actively seeks to influence corporate management or corporate control, a context that is hardly at the core of the international derivatives market" (Levitt Br. 28); and

- Since "in our analysis, the hedged equity shares would have to be pre-positioned, the swaps would have to be structured in a manner calculated to reduce counterparty disclosure obligations, and the information withheld from the market would have to be material. This is undoubtedly an infrequent occurrence" (Levitt Br. 28-29).

The district court did not create a new rule of broad and unforeseen application.[24] The district court decided the case before it on the specific and unique facts presented, and neither makes new law nor crafts "wide-ranging policy decisions . . . better left to Congress and the SEC". (CPIC Br. 21.) Defendants' *amici*'s concerns about wide-ranging effects only matter if this type of misconduct is widespread. It is not. But even if it were, that is hardly a reason to refrain from granting relief to stop illegality. The response to undisputed illegality should not be "what's the big deal?". The "everyone does it" defense indeed demonstrates

[24] Derivatives counsel and other industry participants have cautioned investors about the possible beneficial ownership exposure risks presented by cash-settled swaps. For example, one derivatives counsel warned that the "use of long swaps in strategic situations (*e.g.*, contests for corporate control of an issuer) may invite close scrutiny of the factual basis for non-reporting" of beneficial ownership. Witold Balaban, *et al.*, *Equity Derivatives: Selected US Legal Issues, in Practical Derivatives: A Transactional Approach*, 157 (Jonathan Denton ed., 2006); *see also, e.g.*, Edward F. Greene, *et al.*, *U.S. Regulation of the International Securities and Derivatives Markets*, 13.02[2] n.23 (2006) ("[A]n equity swap may be subject to recharacterization under which the synthetic long position would be deemed to be beneficial ownership of . . . the underlying shares".).

why sunlight should not be the only disinfectant here. The "everyone" is the "friends and family" who are in the know; the marketplace is not. While tilting the playing field may be profitable for defendants and defendants' friends (at the expense of the marketplace generally), it is exactly what the Williams Act sought to prevent. *See ICN Pharms.*, 2 F.3d at 490; *Treadway*, 638 F.2d at 380.

Conclusion

For the foregoing reasons, this Court should deem null and void the votes of TCI's and 3G's illegally-obtained shares in connection with the CSX 2008 annual meeting of shareholders.

Dated: July 30, 2008
New York, NY

Respectfully submitted,

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July 30, 2008

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See Second Circuit Interim Local Rule 25(a)6.

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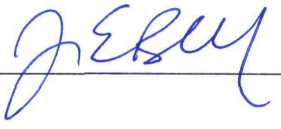
(Your Signature) 

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