Total Return Meltdown: The Case for Treating Total Return Swaps as Disguised Secured Transactions

Colin P. Marks

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Total Return Meltdown: The Case for Treating Total Return Swaps as Disguised Secured Transactions

Colin P. Marks*

Abstract

Archegos Capital Management, at its height, had $35 billion in assets. But in the spring of 2021, in part through its use of total return swaps, Archegos sparked a $30 billion dollar sell-off that left many of the world’s largest banks footing the bill. Mitsubishi UFJ Group estimated a loss of $300 million; UBS, Switzerland’s biggest bank, lost $861 million; Morgan Stanley lost $911 million; Japan’s Nomura lost $2.85 billion; but the biggest hit came to Credit Suisse Group AG which lost $5.5 billion. Archegos, itself lost $20 billion over two days. The unique characteristics of total return swaps and Archegos’s formation as a family office made these losses possible, permitting Archegos to skirt trading regulations and reporting requirements. Archegos essentially purchased beneficial ownership in large amounts of stock, particularly ViacomCBS Inc. and Discovery Inc., on credit. Under Regulation T of the Federal Reserve Board, up to 50% of the purchase price of securities can be borrowed on margin. However, to avoid these rules, Archegos instead

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entered into total return swaps with the banks whereby the bank was the actual owner of the stock, but Archegos would bear the risk of loss if the price of the stock was to fall and reap the benefits if the stock was to go up or make a distribution. Archegos would still pay the transaction fees, but the device permitted Archegos to buy massive amounts of stock without having the initial margin requirements, thus making Archegos heavily leveraged. This Article argues that the total return swap contracts are analogous to and should be recharacterized as what they really are—disguised secured transactions. Essentially, the banks are lending money to enable the Archegoses of the world to buy stocks and are simply retaining a security interest in the stocks. Such a recharacterization should place these transactions back into Regulation T and the margin limits. But recharacterization also offers another contract law approach that is more draconian. If the structure of the contract violates a regulation, then total return swaps could be declared void as against public policy. This raises the specter that a court could apply the doctrine of in pari delicto and leave the parties where they found them in any subsequent suits to recover outstanding debts.
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I. Introduction

Archegos Capital Management, at its height, had $35 billion in assets. But in the spring of 2021, in part through its use of total return swaps, Archegos sparked a $30 billion sell-off that left many of the world’s largest banks footing the bill. Mitsubishi UFJ Group estimated a loss of $300 million; UBS, Switzerland’s biggest bank, lost $861 million; Morgan Stanley lost $911 million; Japan’s Nomura lost $2.85 billion; but the biggest hit came to Credit Suisse Group AG, which lost $5.5 billion. Archegos, which was managed by Bill Hwang, lost $20 billion over two days. The unique characteristics of total return swaps made these losses possible. Further, Archegos’s formation as a family office permitted Archegos to skirt other reporting requirements.

Archegos essentially purchased beneficial ownership in large amounts of stock, particularly ViacomCBS Inc. and Discovery, Inc., on credit. Under Regulation T of the Federal Reserve Board, Archegos could borrow up to 50% of the purchase price of securities that can be purchased on margin. Normally, this would require Archegos to initially own 50% of the stock. In other words, if Archegos wanted to buy $1 billion in Viacom stock on margin, it would first need to own $1 billion of Viacom or other marginable stock outright to buy the other $1 billion. To avoid these rules, Archegos instead entered into total return swaps with the banks. Under this arrangement, the

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3. Id.
4. Id., supra note 1.
5. Id.
6. Id.
8. Schatzker et al., supra note 1.
10. See id.
11. Pam Martens & Russ Martens, Archegos: Wall Street Was Effectively Giving 85 Percent Margin Loans on Concentrated Stock Positions – Thwarting the Fed’s Reg T and Its Own Margin Rules,
bank would be the actual owner of the stock, but Archegos would bear the risk of loss if the price of the stock was to fall and reap the benefits if the stock was to go up or make a distribution.\textsuperscript{12} Archegos would still pay the transaction fees, but the device permitted Archegos to buy massive amounts of stock without having the initial margin requirements, thus making Archegos heavily leveraged.\textsuperscript{13} But Archegos didn’t stop at going to one bank—instead, it approached several banks and entered into the same arrangement.\textsuperscript{14} When Viacom and Discovery stocks took a hit, banks began to sell their positions to protect themselves, spurring further sell-offs until Archegos could no longer cover its positions.\textsuperscript{15}

These highly leveraged transactions are made worse by the fact that they are not subject to normal stock ownership disclosure requirements.\textsuperscript{16} As the Wall Street Journal noted:

The Securities and Exchange Commission has so far taken the position that investors aren’t required to disclose positions in equity derivatives like total return swaps unless they have voting power over related shares. If an investor doesn’t have voting power, they aren’t deemed to be the ultimate owner of the shares—or what U.S. law calls the “beneficial owner.” Investors who become the beneficial owner of more than 10% of a company’s shares are also deemed to be corporate insiders, and thus must report changes in their holdings through other public filings.

So, even as Archegos was estimated to have had exposure to the economics of more than 10% of multiple companies’ shares, it didn’t have to report those positions.\textsuperscript{17}

\textsuperscript{12} See id.; Schatzker et al., supra note 1.


\textsuperscript{14} See Schatzker et al., supra note 1.

\textsuperscript{15} See Armstrong, supra note 13.

\textsuperscript{16} Id.

\textsuperscript{17} Quentin Webb et al., What Is a Total Return Swap and How Did Archegos Capital Use It?, WALL ST. J. (Mar. 30, 2021, 11:37 PM), https://www.wsj.com/articles/what-is-a-total-return-swap-
However, using total return swaps to skirt regulations is just form over substance, and a better approach would be the one for which Article 9 of the Uniform Commercial Code advocates.\textsuperscript{18}

Section 9-109(a)(1) of the U.C.C. provides, “[T]his article applies to: (1) a transaction, regardless of its form, that creates a security interest in personal property . . . by contract.”\textsuperscript{19} Indeed, the concept of ownership without the risks of ownership is analogous to the sale of an account with recourse, which is characterized as secured debt.\textsuperscript{20} If a bank buys the accounts receivable from a seller with the caveat that the seller must buy back any account that does not receive payment, the risk of ownership does not fall on the buyer.\textsuperscript{21} Such an arrangement is no different from the bank loaning a sum of money and taking a security interest in the accounts.\textsuperscript{22}

This Article argues that total return swap contracts are analogous to, and should be recharacterized as, secured transactions. Essentially, the banks are lending money to enable the Archegoses of the world to buy stocks and are simply retaining a security interest in those stocks.\textsuperscript{23} Such a recharacterization should place these transactions back into Regulation T and the margin limits.\textsuperscript{24} But, recharacterization also offers another contract law approach that is more draconian.\textsuperscript{25} If the structure of the contract violates a regulation, then total return swaps could be declared void as against public policy.\textsuperscript{26} This raises the specter that a court could apply the doctrine of in pari delicto and leave the parties where it found them in any subsequent suits to recover outstanding debts.\textsuperscript{27}

Part II of this Article explains the rules that would normally govern

\begin{footnotesize}
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\item \textsuperscript{18} See generally U.C.C. art. 9 (AM. L. INST. & UNIF. L. COMM’N 2010) (detailing the law governing secured transactions).
\item \textsuperscript{19} U.C.C. § 9-109(a)(1) (AM. L. INST. & UNIF. L. COMM’N 2010).
\item \textsuperscript{21} See sources cited \textit{supra} note 20.
\item \textsuperscript{22} See Hill, \textit{supra} note 20, at 1124–25.
\item \textsuperscript{23} See Martens & Martens, \textit{supra} note 11.
\item \textsuperscript{24} See Margin Regulation, FINRA, https://www.finra.org/rules-guidance/key-topics/margin-accounts (last visited Oct. 7, 2022).
\item \textsuperscript{25} See infra notes 244–48 and accompanying text.
\item \textsuperscript{26} See infra notes 244–48 and accompanying text.
\item \textsuperscript{27} See infra Part V.
\end{itemize}
\end{footnotesize}
purchasing stocks on margin, including Regulation T and the normal disclosure requirements that go with ownership.\textsuperscript{28} Part III then explores how using total return swaps enabled Archegos to skirt these rules.\textsuperscript{29} However, allowing these transactions’ labels to govern rather than what they actually are is to value form over substance. Part IV of this article argues that total return swaps are really just disguised secured transactions and should be recast as such.\textsuperscript{30} Having established that the transactions are in fact disguised secured transactions, Part V concludes that this opens such contracts up to the possibility of being void because they run afoul of Regulation T.\textsuperscript{31}

II. REGULATIONS THAT GOVERN STOCK PURCHASES

Investors are permitted to purchase stocks on credit, which is referred to as buying on margin, but most transactions are subject to limitations set by the Federal Reserve Board (FRB).\textsuperscript{32} Further, once an investor has control over 5\% of a given company’s stock, additional reporting requirements apply.\textsuperscript{33} Total return swap contracts (TRS) manage to avoid both sets of regulations, however, by disguising the ownership of the stocks.\textsuperscript{34} Before delving into the use of TRS to avoid FRB regulations, a brief primer on these regulations is useful.

A. Regulation T

Most investors who wish to purchase stock on margin are subject to the limitations imposed by Regulation T of the FRB.\textsuperscript{35} Regulation T governs extensions of credit by brokers and dealers, including establishing initial margin

\textsuperscript{28} See infra Part II.
\textsuperscript{29} See infra Part III.
\textsuperscript{30} See infra Part IV.
\textsuperscript{31} See infra Part V.
\textsuperscript{32} See Margin: Borrowing Money to Pay for Stocks, supra note 9 (discussing buying on margin and the risks and regulations involved).
\textsuperscript{34} See Daniel Bertaccini, To Disclose or Not to Disclose? CSX Corp., Total Return Swaps, and Their Implications for Schedule 13d Filing Purposes, 31 CARDOZO L. REV. 267, 274–77(2009) (discussing the mechanics of total return swaps).
requirements. When customers purchase stocks from broker-dealers they can do so either through a “cash account” or on a “margin account.” Customers of broker-dealers who want to buy stocks on credit must first establish a margin account. The SEC summarizes the difference between these two types of accounts:

A “cash account” is a type of brokerage account in which you must pay the full amount for securities purchased. In a cash account you cannot borrow funds from your broker-dealer to pay for transactions in the account. A “margin account” is a type of brokerage account in which your broker-dealer lends you cash, using the account as collateral, to purchase securities (known as “margin securities”). Brokerage firms may allow you to have both a margin account and a cash account at the same time.

Except for purchases of exempted securities, Regulation T requires an initial margin account equal to “50[%] of the current market value of the security or the percentage set by the regulatory authority where the trade occurs, whichever is greater.” To demonstrate, assume that you want to purchase $20,000 worth of stock X that currently trades at $200 per share. If you were using your cash account, you would need to fully fund the purchase at $20,000. However, assuming your broker-dealer follows the minimum initial margin requirements, you could instead purchase the $20,000 worth of stock for $10,000, so long as your margin account had $10,000 in it or securities that equal the same. Alternatively, you could purchase fifty shares of stock X by borrowing the $10,000 against fifty shares you purchase with cash. Essentially you would be borrowing $10,000 from the broker-dealer against the margin account.

Once stock is purchased on margin, there is of course the risk that the

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36. Id. § 220.1(a).
38. See 12 C.F.R. § 220.4(a).
39. See SEC’s Office of Investor Education and Advocacy, supra note 38. Brokerage firms benefit from clients trading on margin because they get interest payments from margin balances and trading commissions since clients would likely place bigger trades and trade more often. Id.
40. 12 C.F.R. § 220.12(a) (2021). Individual firms may require more than this minimum. See Margin: Borrowing Money to Pay for Stocks, supra note 32.
stock will go down in value.\textsuperscript{41} To address this risk, many broker-dealers require that the margin account maintains a minimum equity value known as the maintenance requirement.\textsuperscript{42} By law, this can be no lower than 25% of the value of the stock,\textsuperscript{43} but some firms set a higher amount.\textsuperscript{44} So, in our above hypothetical, if you purchased $10,000 worth of stock with cash and the other half on margin, and if the value of the stock fell from $20,000 to $12,000, then the equity in the account would be $2,000 because you have $12,000 worth of stock but owe $10,000. This would be below the 25% threshold for the $12,000 worth of stock, which is $3,000. In such a case, broker-dealers would make a margin call and require you to deposit enough money into the account to meet the maintenance amount (in our hypothetical, $1,000) or transfer fully paid for marginable securities of at least $1,000 value into their margin account.\textsuperscript{45} If you cannot do so, the broker-dealer will sell the stock to reach the minimum requirement.\textsuperscript{46}

Not all borrowers are subject to the limitations in Regulation T.\textsuperscript{47} Section 220.1(b) exempts from its scope “exempted borrowers.”\textsuperscript{48} The C.F.R. defines an exempted borrower as:

[A] member of a national securities exchange or a registered broker or dealer, a substantial portion of whose business consists of transactions with persons other than brokers or dealers, and includes a borrower who:

(1) Maintains at least 1000 active accounts on an annual basis for persons other than brokers, dealers, and persons associated with a

\begin{footnotesize}
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\item \textsuperscript{41} See SEC’s Office of Investor Education and Advocacy, supra note 38.
\item \textsuperscript{42} See id.
\item \textsuperscript{43} FINRA, RULE 4210(c)(1) (2022), https://www.finra.org/rules-guidance/rulebooks/finra-rules/4210/the-rule.
\item \textsuperscript{45} SEC’s Office of Investor Education and Advocacy, supra note 38; see, e.g., Margin—Nonretirement—Brokerage, supra note 44.
\item \textsuperscript{46} SEC’s Office of Investor Education and Advocacy, supra note 38; see, e.g., Margin—Nonretirement—Brokerage, supra note 45.
\item \textsuperscript{47} 12 C.F.R. § 220.1(b)(3)(ii) (2021).
\item \textsuperscript{48} Id. ("This part does not apply to: . . . (ii) Credit extended by a creditor based on a good faith determination that the borrower is an exempted borrower.").
\end{itemize}
\end{footnotesize}
broker or dealer;

(2) Earns at least $10 million in gross revenues on an annual basis from transactions with persons other than brokers, dealers, and persons associated with a broker or dealer; or

(3) Earns at least 10 percent of its gross revenues on an annual basis from transactions with persons other than brokers, dealers, and persons associated with a broker or dealer.49

Thus, many broker-dealers are not subject to the same limitations as that of ordinary borrowers.50

B. Policies Underlying Regulation T

At its heart, purchasing stock on margin is a secured transaction.51 Securities as collateral qualify as “investment property”52 and are governed by Article 9 of the U.C.C.53 For a security interest to attach, Article 9 requires that value be given, that the debtor has rights in the collateral being offered, and that there be an authenticated security agreement with a description of the

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49. Id. § 220.2.
50. Id. Archegos was formed as a “family office.” Schatzker et al., supra note 1. A family office is defined as:
[A] company (including its directors, partners, members, managers, trustees, and employees acting within the scope of their position or employment) that:
(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this section for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event;
(2) Is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and
(3) Does not hold itself out to the public as an investment adviser.
Because family offices are not registered, they would not appear to fall within the scope of an exempted borrower. Id.
51. See infra Part IV.
52. U.C.C. § 9-102(a)(49) (AM. L. INST. & UNIF. L. COMM’N 2010) (“‘Investment property’ means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.”).

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In terms of buying on margin, the funds advanced for the purchase of the investment property are the value given; as owner of the investment property, including security entitlements, the debtor has rights in the collateral; and the authenticated security agreement requirement is met by the margin agreement acting as the authenticated security agreement or by the broker-dealer controlling the investment property. Further, by maintaining control of the investment property, the broker-dealer will perfect its security interest.

Given that broker-dealers’ loans are secured by the underlying stock, one might wonder why any additional equity by the borrower is required. However, without this additional equity, broker-dealers would risk being under-secured if the stock were to go down in value. When borrowers hold large positions in a single company, the risk of loss can be great. In fact, it was the experience of the stock market crash of the late 1920s that led to Regulation T and the creation of the SEC.

In the years leading up to the market crash, borrowers were putting up as little as 10% equity to purchase stocks. To continue with our earlier hypothetical, with a 10% initial margin requirement, you now only need $2,000 worth of stock in Company X (or ten shares assuming they cost $200 each) and can borrow the remaining $18,000. By borrowing at such a highly leveraged amount, the borrower increases the relative gains from an increase in the

54. See U.C.C. § 9-203(b) (AM. L. INST. & UNIF. L. COMM’N 2010) (“[A] security interest is enforceable against the debtor and third parties with respect to the collateral only if: (1) value has been given; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and (3) one of the following conditions is met: (A) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned.”).

55. See, e.g., Margin—Nonretirement—Brokerage, supra note 45.

56. U.C.C. § 9-203(b)(3)(D) (AM. L. INST. & UNIF. L. COMM’N 2010) (providing that control may be used instead of an authenticated security agreement if the collateral is investment property).

57. Id. § 9-314(a).

58. See id.


60. See id. at 736 n.2.


62. See id. (“Margin loans of 80–90[%] were common.”).
stock price, but also does so for the losses.\textsuperscript{63} Furthermore, with such a thin level of equity, even seemingly minor dips in stock can cause the lending broker-dealer to be under-secured.\textsuperscript{64} For instance, if Company X’s share price were to dip from $200 per share to $175, then the borrower would own $17,500 worth of stock to cover an $18,000 debt, excluding interest.

As noted above, in such a situation, the lending broker-dealer can make a margin call, requiring the borrower to offer up additional cash or stock to cover its position, but if the borrower cannot (or if the lender simply chooses to not make a margin call), the lender can sell the collateral to cover its position.\textsuperscript{65} This sell-off can then have a cascading effect by driving the price of Company X shares lower, causing more margin calls if other borrowers also own the same stock on margin.\textsuperscript{66}

Many factors contributed to the great market crash of the late 1920s, including the unregulated use of purchasing on margin.\textsuperscript{67} Investors were engaging in highly speculative trading, sometimes based on misinformation insiders were feeding to the public with the purpose of unloading stock at a much higher price.\textsuperscript{68} Unregulated purchasing on margin fed into this frenzy, resulting in the above-mentioned cascading effect across the entire market.\textsuperscript{69} The results of the crash were devastating.\textsuperscript{70} As one author noted:

The stock market crash triggered a staggering liquidity squeeze—not just a liquidity crunch of the 1974 variety but a wrenching one-third shrinkage of the money supply from 1929 to 1933 interwoven with the dominoes effect of nearly 10,000 bank failures, the unwillingness

\textsuperscript{63}. See Jeff Madura & John M. Cheney, \textit{An Intuitive Explanation of How Margin Trading Affects the Risk of Investments}, 24 \textit{J. Fin. Educ.} 71, 72 (1998) ("When buying a common stock on margin, the investor’s rate of return is magnified because of the lower equity investment needed.").

\textsuperscript{64}. See Hardouvelis, supra note 60, at 736 n.1.

\textsuperscript{65}. SEC’s Office of Investor Education and Advocacy, \textit{supra} note 38 ("Your brokerage firm may sell some or all of your securities without consulting you to pay off your margin loan.").

\textsuperscript{66}. See Peter Fortune, \textit{Margin Requirements, Margin Loans, and Margin Rates: Practice and Principles}, Sept./Oct. 2000 \textit{NEW ENG. ECON. REV.} 19, 25, 27 ("This lending, it was argued, not only stimulated demand for common stocks, thereby elevating stock prices and encouraging a subsequent crash, but also promoted a sharper decline in prices when customers’ equity positions vanished and brokers made margin calls requiring a deposit of additional cash and securities to restore customer equity.").

\textsuperscript{67}. \textit{Id.} at 25.


\textsuperscript{69}. \textit{See id.}

\textsuperscript{70}. \textit{See id.} at 161–62.
of the Federal Reserve to be a lender of last resort to major financial institutions, and a worldwide financial crisis that brought its own downward spiral of liquidity and widespread defaults by overseas borrowers from American banks and bondholders.\textsuperscript{71} It was against this backdrop that the Securities Exchange Acts of 1933 and 1934 were enacted.\textsuperscript{72} These acts provided for the creation of the SEC as well as reporting and disclosure requirements for publicly traded companies.\textsuperscript{73} They also provided for initial margin and maintenance rules found in Regulation T.\textsuperscript{74} These margin rules were meant to prevent volatility in the markets and stem systemic risk for the protection of both investors and the financial system as a whole.\textsuperscript{75}

\textbf{C. Other Reporting Requirements}

Notably, there are two other regulations that normally would have helped detect Archegos’s market activities: Schedules 13D and 13F of the Securities Exchange Act.\textsuperscript{76} Rather than place limits on trading, such as Regulation T, these provisions require reporting to the SEC.\textsuperscript{77} The purpose of these schedules is to provide more transparency, but as discussed below, the use of TRS contracts and family offices can provide a means to avoid these provisions.\textsuperscript{78}

Schedule 13D filing is governed by 17 C.F.R. § 240.13d-1, which provides that once an investor directly or indirectly acquires 5% of a voting class

\textsuperscript{71} Walter W. Heller, \textit{The Great Crash: Past and Present: Can There Be Another Crash?}, 30 CHALLENGE 6, 7 (1987).
\textsuperscript{72} Id. at 6.
\textsuperscript{73} Id. at 6–7.
\textsuperscript{74} See Fortune, supra note 67, at 25–27.
\textsuperscript{75} See Hardouvelis, supra note 60, at 736. But see \textsc{Charles F. Rechlin et al.}, \textsc{Securities Credit Regulation} § 1:6 (2d ed. 2021) (calling into question whether investor protection "was ever an important policy objective behind the margin regulations").

Along these lines, it is worth noting that not all stocks can be purchased on margin. See 12 C.F.R. § 220.11(a)–(b) (1998). Under 12 C.F.R. § 220.11, securities must meet certain threshold requirements to be listed as marginable OTC stocks and to maintain that status. See id. These requirements tend to exclude what some might term higher risk penny-stocks by creating average trading value thresholds of $5 and $2 per share, respectively. Id. § 220.11(a)(2), (b)(2).

\textsuperscript{76} See \textsc{Gary Shorter} & \textsc{Eva Su}, \textsc{Cong. Rsch. Serv.}, IF11825, \textsc{Family Office Regulation in Light of the Archegos Fallout} 2 (May 10, 2021).
\textsuperscript{77} See id.
\textsuperscript{78} See id.
of stock, the investor must submit a Schedule 13D form to the SEC. This schedule requires the investor to submit, among other things, their name, the amount of their ownership, the type of stock, the source of funds used for the purchase, and the purpose of the transaction. Schedule 13D filings are an important tool for detecting early signs of unsolicited takeovers and providing transparency when investors begin to accumulate large stakes in publicly traded companies. Further, as the schedule itself notes:

> Because of the public nature of the information, the Commission can use it for a variety of purposes, including referral to other governmental authorities or securities self-regulatory organizations for investigatory purposes or in connection with litigation involving the federal securities laws or other civil, criminal[,] or regulatory statutes or provisions.

A failure to file a Schedule 13D form can result in civil penalties and criminal action.

While Schedule 13D has a monetary threshold to track large holdings in a single company, Schedule 13F is a tool to track the investments of large institutional investors. If an institutional investor has investment discretion over $100 million in “13(f) securities” (i.e., securities traded on a national exchange), then the investor must file a Schedule 13F report. This form requires disclosure of the securities holdings of such large investors with the intention to “increase investor confidence through transparency” and to “help the SEC . . . assess the investors’ influence and impact on fair and orderly trading.”

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79. See 15 U.S.C. § 78m(d); 17 C.F.R. § 240.13d-1 (2010) (“(a) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is specified in paragraph (i) of this section, is directly or indirectly the beneficial owner of more than five percent of the class shall, within 10 days after the acquisition, file with the Commission, a statement containing the information required by Schedule 13D . . . .”). As will be discussed later, it has been estimated that at its peak, Archegos had an interest in as much as 34% of ViacomCBS. See Martens & Martens, supra note 11.


81. See SHORTER & SU, supra note 76.


83. Id.

84. See id. § 240.13f-1 (2011).

85. Id. § 240.13f-1(c).

86. Id. § 240.13f-1(a).
III. **Total Return Swaps as a Device to Avoid Securities Regulations**

As described above, existing SEC regulations should operate to prevent investors from getting involved in highly leveraged purchases of individual stocks. For example, when an investor acquires a large stake of over 5% in a single company, or a large institutional investor acquires a stock, the holdings should be disclosed to the SEC and made available to the public. However, Archegos utilized two devices to avoid these regulations, exposing major loopholes in the existing SEC regulations in the process. These two devices are total return swap contracts and family offices.

**A. Total Return Swaps and Family Offices: A Primer**

1. **Total Return Swaps**

A total return swap (TRS) contract is a derivative device that provides investors with the ability to gain access to investments that is just short of outright ownership. TRS contracts involve two parties, typically large institutional investors such as investment banks or mutual funds; one of the parties is the total return payer and the other is the total return receiver. Typically, the payer will have a large holding in an asset, such as a bond, which may have a fixed or variable interest rate. Depending on the rates and the bond issuer’s stability, bonds themselves can go up or down in value as they are
bought and sold. To offload some of the risk, the payer will enter into a contract with the receiver whereby the payer agrees to pay any interest payments to the receiver. Further, if the asset appreciates, the receiver will be paid for the appreciation once the TRS contract expires or the asset is sold. In return, the receiver agrees to pay the total return payer a fixed interest rate—typically London Interbank Offered Rate (LIBOR) based—and any depreciation in the value of the asset at the maturity of the contract or once the asset is sold.

For example, Bank A has large holdings in bonds issued by Company X with variable interest payments. Fund F wishes to have exposure to the bond market but does not wish to payout to buy the bonds, so instead it can enter into a TRS contract with Bank A. Bank A remains the owner of the bonds, but now gets a steady fixed stream of payments from Fund F. In return, Fund F does not have to outlay the money to purchase the bonds, but it gets to be the beneficial owner of the bonds. Interest payments made under the bonds will go to Fund F, and if the bonds sell at a higher price, Fund F will get the profits. However, should the bonds tank, Fund F will be liable to Bank A for the shortfall.

Institutional investors like TRS contracts because, from the payer’s standpoint, they act as a useful hedge when the parties—such as our hypothetical Bank A—have a large position in an asset and do not want to be fully exposed

96. Kim, supra note 93, at 734; see Gina-Gail S. Fletcher, Hazardous Hedging: The (Unacknowledged) Risks of Hedging with Credit Derivatives, 33 REV. BANKING & FIN. L. 813, 820 (2013–14) (“With credit derivatives, firms are able to transfer credit risk to those who are able and willing to bear the risks more efficiently or at a lower cost. This is the purpose of hedging.”).
97. Kim, supra note 93, at 732–34; see JOHN D. FINNERTY, THE PRICEWATERHOUSECOOPERS CREDIT Derivatives Primer 6 (PriceWaterhouseCoopers 2000) (“The total return payer makes payments equal to the interim cash flows (interest payments on a bond) plus any capital appreciation on the reference asset. Usually the total return receiver pays a floating interest rate, generally one of the LIBOR . . . rates, plus any capital depreciation on the reference asset.”); see also CSX Corp., 654 F.3d at 279–80 (discussing the periodic payments made by the long party based on the agreed interest rate).
98. See Feder, supra note 95, at 712 (illustrating how the buyer receives interest payments); FINNERTY, supra note 98, at 9 (explaining how the buyer receives the periodic interest on the bond and the excess if the bond has increased in value).
99. See FINNERTY, supra note 98, at 9 (explaining the receiver must pay the difference in value if the bond drops in price).
should the asset depreciate.\textsuperscript{101} Furthermore, payers can make large sums of money simply off of the fees generated under such arrangements.\textsuperscript{102} Receivers like TRS contracts because they allow receivers to get exposure to the market without having to front all the costs of purchasing the underlying asset.\textsuperscript{103} Essentially, the receivers are betting the underlying asset will go up and are willing to pay the fixed interest rate to have access to the markets.\textsuperscript{104}

As one commentator has noted, the arrangement is much like leasing a car, whereby the lessee gets all the benefits of owning the car without having to buy it.\textsuperscript{105} The investor gets a chauffeur. The investor does not have to worry about parking the car, putting gas in the car, maintaining the car, or servicing the car. The investor does not pay luxury tax since the investor does not own the car. At the end of the lease, the investor must pay the lessor any depreciation in the value of the car. If the car has not depreciated in value, the investor pays nothing.

If the car appreciates in value, the investor gets a payment from the lessor for the value of the appreciation of the car. For all of this, the investor pays a lease fee. There is one catch, however. If the car is damaged as defined in the lease agreement, the investor must pay the difference between the original value and the damaged value, and the

\textsuperscript{101} Kim, \textit{supra} note 93, at 732–33 (discussing how a TRS has potential to manage risk and create profit).

\textsuperscript{102} See Armstrong, \textit{supra} note 13 (“Banks earn steady income streams on total return swaps through the regular fees investors such as hedge funds pay to enter into the agreement.”).

\textsuperscript{103} . Kim, \textit{supra} note 93, at 732 (“From the investor’s point of view, a TRS provides the means for collecting cash flow without buying the reference asset in person.”); see \textit{CSX Corp.}, 654 F.3d at 279 (“[T]he long party periodically pays the short party a sum calculated by applying an agreed-upon interest rate to an agreed-upon notional amount of principal, as if the long party had borrowed that amount of money from the short party. Meanwhile, the short party periodically pays the long party a sum equivalent to the return to a shareholder in a specified company—the increased value of the shares, if any, plus income from the shares—as if the long party owned actual shares in that company.”).

\textsuperscript{104} See Anita K. Krug, \textit{Investing and Pretending}, 100 IOWA L. REV. 1559, 1568 (2015) (“One party to the swap holds the ‘long’ side of the swap, effectively betting that the reference asset will increase in value or is otherwise a sound asset, while the other party holds the ‘short’ side, effectively betting that the reference asset will decline in value or that there will be a default as to it.”); see, e.g., FINNERTY, \textit{supra} note 98, at 12–14.

lease terminates. Alternatively, the investor can take ownership of the car and pay the original value of the car to the lessor.106

Under this analogy, the TRS is the lease agreement, and the asset is the car.107 At the end of the “lease,” the receiver will either reap the benefits of appreciation or pay for the depreciation.108

2. Family Offices

The other device used by Archegos and many other funds is a family office.109 “‘Family offices’ are entities established by wealthy families to manage their wealth and provide other services to family members, such as tax and estate planning services.”110 On June 22, 2011, the SEC adopted Rule 202(a)(11)(G)-1 (effective August 29, 2011) which defined a “family office” as a firm that: “(a) Provides investment advice only to family members . . . ; (b) Is wholly owned and controlled by family members; and (c) Does not hold itself out to the public as an investment adviser.”111 If a firm meets the definition of a “family office” then it is exempt from registering with the SEC under the Advisers Act.112

The exemption for family offices is grounded in the rationale that such offices operate differently than other advisers, and without the exemption, the “costs of complying with the adviser rules would be too burdensome.”113 As the SEC explained:

The core policy judgment that formed the basis of our exemptive orders (and which prompted Congressional action) is the lack of need for application of the Advisers Act to the typical single family office. The Act was not designed to regulate the interactions of family members in the management of their own wealth. Accordingly, most of

106. Id.
107. Id.
108. Id.
112. Koehler & Lambert, supra note 111.
the conditions of the proposed rule (like our exemptive orders) operate to restrict the structure and operation of a family office relying on the rule to activities unlikely to involve commercial advisory activities, while permitting traditional family office activities involving charities, tax planning, and pooled investing.\textsuperscript{114}

Though it is true that family offices have historically focused on wealth preservation, this reasoning is questionable considering the recent rise and use of family offices.\textsuperscript{115} As Shorter and Su report:

Robert Casey, a consultant, estimates that as of 2020, there were 3,500 family offices with more than $2.1 trillion in assets under management in the United States. . . . A report from investment management firm UBS found that around 70% of the largest family offices globally were formed in the past two decades . . . . Through the years, various hedge fund founders and traders such as Hwang [of Archegos] have transitioned to founding family offices. Unlike earlier generations of family offices, some of these firms are said to employ aggressive investment strategies.\textsuperscript{116}

This rise, and in particular the meltdown of Archegos, has brought new scrutiny to the regulation of family offices.\textsuperscript{117}

\section*{B. How Archegos Used TRS Contracts and the Family Office Form}

Bill Hwang, a former hedge fund manager, started Archegos Capital Management in 2013—the same year he was effectively banned from trading due to allegations he committed insider trading and attempted to manipulate the markets.\textsuperscript{118} Hwang formed Archegos as a family office by converting one

\textsuperscript{115} SHORTER & SU, supra note 76.
\textsuperscript{116} Id.
\textsuperscript{117} See Mark Schoeff Jr., Archegos Implosion Could Lead to Family-Office Regulation, INVESTMENT NEWS (Apr. 8, 2021), https://www.investmentnews.com/archegos-implosion-could-lead-to-family-office-regulation-204956 (noting the Archegos incident “is likely to draw regulatory scrutiny of family offices”).
of his previous hedge funds.\textsuperscript{119} Rather than use the family office to simply maintain wealth, however, Hwang used it to engage in an aggressive investment strategy, focusing in particular on two stocks: ViacomCBS Inc. and Discovery, Inc.\textsuperscript{120} Instead of buying the stocks outright, or even on margin, Archegos used TRS contracts to purchase even greater shares, thus staking a highly leveraged position.\textsuperscript{121}

By using TRS contracts, Archegos was able to avoid both Regulation T and filing Schedule 13D because the SEC does not consider TRS contracts the same as ownership due to the lack of voting rights.\textsuperscript{122} Furthermore, as a family office, Archegos was not registered and did not file Schedule 13F forms to lend transparency to its holdings.\textsuperscript{123} Archegos used TRS contracts to acquire margins as thin as 10\%, far below what would be acceptable under Regulation T.\textsuperscript{124} But Hwang was not content to simply enter into TRS

\begin{quote}
betrayed his fiduciary obligations when he defrauded his investors by collecting fees earned from his attempted manipulation scheme.”); see also \textsc{Shorter} \& \textsc{Su}, supra note 76 (explaining that Hwang’s settlement agreement “prohibited Hwang from associating with brokers, dealers, municipal securities dealers, municipal advisors, transfer agents, or credit rating agencies”). The SEC vacated this ban in 2020. Id.
\end{quote}
contracts with one investment bank; he entered into such arrangements with several investment banks, all for the purpose of purchasing stakes in the same companies.\textsuperscript{125} The investment banks were happy to oblige considering Archegos paid over $100 million a year in associated fees and seemed content with the mere 10% equity.\textsuperscript{126} Due to the fact that these transactions are not public, no bank was aware of the others’ arrangements with Archegos.\textsuperscript{127}

Despite the lack of transparency, Archegos seemed to be justified in its moves.\textsuperscript{128} As of the fourth quarter of 2020, seven of the ten stocks Archegos held were up more than 30% on the year.\textsuperscript{129} By mid-March of 2021, shares in ViacomCBS Inc. and Discovery, Inc. had skyrocketed, prompting Archegos to actually request, and receive, a return of some its margin capital from Credit Suisse Group.\textsuperscript{130} It is estimated that as of mid-March, Archegos owned a remarkable 34% of the outstanding shares in ViacomCBS, none of which were public.\textsuperscript{131} So long as the stock maintained its high levels, Archegos was safe;
but soon, events would unravel.132

As Bloomberg Businessweek recounts, all of this highly leveraged activity made Archegos particularly vulnerable to a sell-off event.133

The first in a cascade of events during the week of March 22 came shortly after the 4 p.m. close of trading that Monday in New York. ViacomCBS, struggling to keep up with Apple TV, Disney+, Home Box Office, and Netflix, announced a $3 billion sale of stock and convertible debt. The company’s shares, propelled by Hwang’s buying, had tripled in four months. Raising money to invest in streaming made sense. Or so it seemed in the ViacomCBS C-suite.

Instead, the stock tanked 9% on Tuesday and 23% on Wednesday. Hwang’s bets suddenly went haywire, jeopardizing his swap agreements. . . .

That Thursday his prime brokers held a series of emergency meetings. Hwang, say people with swaps experience, likely had borrowed roughly $85 million for every $20 million, investing $100 and setting aside $5 to post margin as needed. But the massive portfolio had cratered so quickly that its losses blew through that small buffer as well as his capital.

The dilemma for Hwang’s lenders was obvious. If the stocks in his swap accounts rebounded, everyone would be fine. But if even one bank flinched and started selling, they’d all be exposed to plummeting prices. Credit Suisse wanted to wait.

Late that afternoon, without a word to its fellow lenders, Morgan Stanley made a preemptive move. The firm quietly unloaded $5 billion of its Archegos holdings at a discount, mainly to a group of hedge funds. On Friday morning, well before the 9:30 a.m. New York open, Goldman started liquidating $6.6 billion in blocks of Baidu, Tencent Music Entertainment Group, and Vipshop. It soon followed with $3.9 billion of ViacomCBS, Discovery, Farfetch, Iqiyi, and GSX

132. See id.
133. See Schatzker et al., supra note 1.
When the dust had settled, Archegos had sparked a $30 billion sell-off that left many of the world’s largest banks footing the bill. Mitsubishi UFJ Financial Group estimated a loss of $300 million; UBS, Switzerland’s biggest bank, lost $861 million; Morgan Stanley lost $911 million; Japan’s Nomura Holdings lost $2.85 billion; but the biggest hit came to Credit Suisse Group AG, which lost $5.5 billion. Other investment banks which moved more quickly to sell their position—Goldman Sachs, Deutsche Bank AG, and Wells Fargo—escaped unscathed.

What is striking about the Archegos meltdown, aside from the large amount of money that was lost, is the similarity it bears to the circumstances that led to the passage of the Securities Exchange Acts of 1933 and 1934 and Regulation T. Leading up to the stock market crash of 1929, firms were trading with as little as 10% margin.

Similarly, Archegos was trading at highly leveraged levels approaching 10%. The cascading sales of stocks...
due to unmet margin calls was seen as contributing to the market crash and large losses by banks.\textsuperscript{141} Likewise, the cascading sales of stock in the bundle of companies that Archegos had an interest in led to billions of dollars in losses for five of the largest banks in the world.\textsuperscript{142} While Archegos fortunately did not lead to a larger sell-off in the market, the incident did expose a weakness in the current securities regulatory system.\textsuperscript{143}

IV. TOTAL RETURN SWAPS AS DISGUISED SECURED TRANSACTIONS

The Archegos meltdown has understandably caused much self-reflection by the investment banks, regulators, and commentators.\textsuperscript{144} Much of the criticism has been aimed at the unregistered nature of family offices.\textsuperscript{145} However,
TRS contracts had much more to do with the situation than the family office form.\textsuperscript{146} Indeed, Warren Buffet has referred to TRS contracts as “financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal.”\textsuperscript{147}

Rather than address the family office through further regulation, this Article suggests a simpler approach that has long been used by courts: recast TRS contracts as purchases on margin that should be subject to Regulation T and Schedule 13D.\textsuperscript{148} Courts have frequently recast transactions that purport to be something else, such as a lease, to comport with the substance of the transaction.\textsuperscript{149} A review of the various ways courts have recast transactions provides a path for doing the same with TRS contracts.\textsuperscript{150}

A. Treatment of Transactions as in the Nature of Security

1. Recasting Leases of Goods as Secured Sales

As noted above, securities and security entitlements are governed by Article 9 of the U.C.C.\textsuperscript{151} Section 9-109 instructs that “this article applies to . . . a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract.”\textsuperscript{152} This “intended as security” doctrine is particularly relevant in the context of the leasing of goods or equipment.\textsuperscript{153} In

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\textsuperscript{146}. See Schoeff Jr., supra note 117 (“The Archegos blow up didn’t occur because of lack of oversight of family offices, said David Guin, a partner at Withers Bergman. It had to do with regulation of derivatives trading. ‘The issue was that there is no required reporting of swaps positions,’ said Guin, who has family-office clients. ‘Fixing this situation would require swaps reporting, not regulating family offices. It’s possible the SEC will change course and say family offices ought to be regulated, but it seems unlikely to me.’”).


\textsuperscript{148}. See discussion infra Section IV.B (analyzing common themes from cases in which courts recast commercial leases or sales as a secured transaction and explaining how those themes translate to TRS contracts).

\textsuperscript{149}. See discussion infra Section IV.A.1.

\textsuperscript{150}. See discussion infra Section IV.B.

\textsuperscript{151}. U.C.C. § 9-109 (AM. L. INST. & UNIF. L. COMM’N 2010).

\textsuperscript{152}. Id. § 9-109(a)(1).

\textsuperscript{153}. See generally id. § 1-203 (describing how a court determines if a lease is a true lease or disguised sale).
the typical case, the “lessor” leases a good to the lessee for a term with an option for the lessee to purchase the good at the end of the lease. Depending on the type of transaction, the monthly lease rate may mirror what the good would actually sell for. For instance, Company A could sell a car to Buyer for $48,000 on credit with terms under which the Buyer will pay $1,000 per month (plus interest) for four years, and Company A would retain a security interest in the car until it is paid off. At the end of the four years, Buyer will own an unencumbered car. But Company A could also structure the transaction to look like a lease. Company A could arrange for Lessee to lease the car for four years at an amount equal to the monthly payments in the sale situation ($1,000 per month plus an amount that would have equaled the interest) with an option to keep the car at the end of the lease for no additional consideration, but during the term of the lease Company A will retain ownership and title. Such a situation looks identical to the terms of the sale.

To address such situation, the U.C.C. has developed a “bright-line” test under Section 1-203. Section 1-203(b) provides a two-part test for determining whether a lease is in fact a disguised secured sale. The first prong is that the term cannot be terminable by the lessee prior to the end of the lease term. If the first prong is met, then the second prong can be met in one of four alternate ways, each of which looks to the likelihood that the lessor is going to retain a revisionary interest:

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156. See, e.g., Dominic A. Liberatore et al., Leases, 74 BUS. LAW. 1225, 1225–31 (2019) [hereinafter Liberatore et al. (2019)]. This fact pattern, or a variation thereof, is so familiar that such cases are a fixture in the ABA’s Annual Survey of Leases. See generally Dominic A. Liberatore et al., Leases, 76 BUS. LAW. 1315, 1315–19 (2021) [hereinafter Liberatore et al. (2021)] (covering several 2020 cases where courts decided “whether a transaction that is documented as a lease creates[d] a true ‘lease’ or a security interest?”); Dominic A. Liberatore et al., Leases, 75 BUS. LAW. 2633, 2633–36 (2020) [hereinafter Liberatore et al. (2020)] (covering several 2019 cases where courts decided “whether a transaction documented as a lease creates[d] a true ‘lease’ or a security interest?”); Liberatore et al. (2019), supra, at 1225–31 (covering several 2018 cases where courts decided “whether a transaction documented as a lease creates[d] a true ‘lease’ or a security interest?”).

157. See U.C.C. § 1-203(b) (AM. L. INST. & UNIF. L. COMM’N 2010).

158. See id.

159. See id.
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(1) the original term of the lease is equal to or greater than the remaining economic life of the goods;

(2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;

(3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or

(4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.\(^{160}\)

If both prongs are met, then the transaction is deemed a disguised sale.\(^ {161}\) However, even if the bright-line test is not met, courts will still proceed to the economic realities test.\(^ {162}\) This test is a fact-specific analysis which hinges on whether the lessor retained a reversionary interest in the goods upon completion of the lease transaction.\(^ {163}\) The focus is on the economics of the situation; the U.C.C. provides a laundry list of items that, in and of themselves, should not indicate that the lease is actually a sale, such as the lessee retaining risk of loss or being obliged to pay taxes and insurance,\(^ {164}\) though courts certainly might consider such factors in the aggregate.\(^ {165}\)

One interesting type of lease arrangement that draws some parallels to the TRS is a commercial lease with a “Terminal Rental Adjustment Clause” (TRAC).\(^ {166}\) TRAC clauses “provid[e] for an upward or downward rental
adjustment to reflect the difference, if any, between the actual disposition value” received by the lessor “and the residual value anticipated by the parties at lease commencement and specified in the lease.” 167 Such an arrangement mirrors the TRS in that, if the residual value is less than the anticipated value, the lessee must make a payment to the lessor; but if it exceeds the anticipated value, then the lessor must pay the lessee. 168 Every state and the District of Columbia “have enacted laws that provide that ‘for commercial leases of cars, trucks and trailers, the mere presence of a TRAC clause does not destroy true lease status or create a sale or security interest.’” 169 Though many courts follow these statutes, others who focus on the revisionary interest have held that such provisions indicate the arrangement is more in the nature of a secured sale. 170

In re Brankle Brokerage & Leasing, Inc. provides a useful example of how such a transaction might arise and a court’s willingness to reclassify the transaction as a sale. 171 In that case, a bankruptcy debtor, Brankle Brokerage, had leased six truck-tractors from Volvo Financial for sixty-month terms. 172 Each of relevant the leases contained TRAC provisions that gave the debtor three options at the end of the sixty-month lease period. 173 First, the debtor

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167. Id.
168. Id.
170. In re Double G Trucking of the Arklaxt, Inc., 432 B.R. 789, 801 (Bankr. W.D. Ark. 2010) (“A split of authority exists on the issue of whether such open-ended TRAC leases leave a revisionary interest in the lessor or whether the transaction between the parties creates equity in the lessee so that the transaction is, in fact, a security interest. However, typically, courts hold that such a provision supports the finding of the existence of a security interest.”). There appears to be some controversy on whether the courts which have treated TRAC leases as disguised sales are correctly decided. See Gross et al., supra note 166 at 1082. As Edward K. Gross and his colleagues noted: Most lessors have assumed that the courts in any state considering the characterization implications of a TRAC provision in a purported lease would inarguably follow the pertinent TRAC statute and, unless there were other provisions that were wildly inconsistent with the applicable U.C.C. characterization test (e.g., the lease contained a $1 purchase option), deem the transaction to constitute a true lease. This presumption that these state TRAC statutes afford a reliable safe harbor from a re-characterization is supported by most of the published cases that have addressed this issue.

171. 394 B.R. 906 (Bankr. N.D. Ind. 2008).
172. Id. at 908.
173. Id.
could purchase the vehicles for 20% of what Volvo had paid for them.\textsuperscript{174} Second, it could resell the vehicles itself on the condition that Volvo consents and that the vehicles do not sell for less than 20% of the price Volvo had paid for them.\textsuperscript{175} The third option was to return the vehicles to Volvo, pay an amount equal to the 20% option purchase price, and then let Volvo try to sell them.\textsuperscript{176}

“Following a sale, any amounts received in excess of the 20[%] purchase price (plus any unpaid amounts due Volvo Financial) belonged to the debtor and would be paid to, or kept by, it; any shortfall was to be immediately paid by the debtor to Volvo Financial.”\textsuperscript{177} The bankruptcy court noted that, regardless of which option the debtor elected, Volvo was guaranteed full rental payments for sixty months plus 20% of its purchase price.\textsuperscript{178}

The debtor asked the court to recast the transaction as a secured sale rather than as a lease because it bore the risk of the vehicles appreciating or depreciating under the arrangement.\textsuperscript{179} Volvo pointed to the relevant state U.C.C. analog to Article 2A, which provided that a lease included an agreement that was classified as a lease under section 7701(h) of the Internal Revenue Code.\textsuperscript{180} Section 7701(h) in turn states that:

\begin{quote}
For purposes of this title, in the case of a qualified motor vehicle operating agreement \textit{which contains a terminal rental adjustment clause—}

(A) such agreement shall be treated as a lease if (but for such terminal rental adjustment clause) such agreement would be treated as a lease under this title, and

(B) the lessee shall not be treated as the owner of the property subject to an agreement during any period such agreement is in effect.\textsuperscript{181}
\end{quote}

Despite this provision, the court held that U.C.C. § 1-203 was the relevant

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\item 174. \textit{Id.} at 908–09.
\item 175. \textit{Id.} at 909.
\item 176. \textit{Id.}
\item 177. \textit{Id.}
\item 178. \textit{Id.}
\item 179. \textit{Id.} at 908–09.
\item 180. \textit{Id.} at 909.
\item 181. I.R.C. § 7701(h)(1) (emphasis added).
\end{itemize}
\end{footnotesize}
provision for determining whether a lease is a secured sale. The court concluded that either under section 1-203(b) or (c), the transaction was a disguised sale. Under subsection (c), the court noted “[a] key, some would say pivotal, consideration in this regard is whether the lessee acquires some type of ownership or equity interest in the property.” The court concluded that because Volvo had no reversionary interest, in that it held no up- or downside risk, the lease was in fact a disguised sale.

2. Recasting Intangibles as Secured Transactions

Though issues regarding disguised secured transactions often arise with tangible goods, Section 9-109 is broad enough to cover other concepts as well, including the sale of accounts and intangibles. The practice of selling accounts receivable (“accounts” under U.C.C. § 9-102(a)(2)), or “factoring,” provides another area where substance can rule over form. Factoring involves buying accounts receivable at a discount—the discount represents the risk of nonpayment and collection efforts. To demonstrate, assume Credit Card Company (CCC) wishes to raise capital quickly. Rather than wait to

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183. Id. at 912–13. The court’s analysis under subsection (b) is a bit confusing as the court concludes that the debtor could keep the car for no additional consideration at the end of the lease. Id. at 913. This seems to ignore the 20% required payment, but it is the court’s analysis under Section 1-203(c) that is more relevant to the current discussion. See id. at 913–14.
184. Id. at 913. “Commentators make much the same point. ‘If there is a meaningful reversionary interest—either an up-side right or a down-side risk—the parties have signed a lease, not a security agreement. If there is no reversionary interest, the parties have signed a security agreement, not a lease.’” Id. at 914 (quoting 4 WHITE & SUMMERS, UNIFORM COMMERCIAL CODE § 30-3, p. 30 (5th ed. 2002)).
185. Id. at 914; see also In re Grubbs Constr. Co., 319 B.R. 698, 724 (Bankr. M.D. Fla. 2005) (holding a lease with a TRAC provision was a sale where debtor would receive credit or pay deficiency in the collateral); In re Zerkle Trucking Co., 132 B.R. 316, 322 (Bankr. S.D. W. Va. 1991) (finding a TRAC lease, which allocated to the lessee all the entrepreneurial risk to equity, was a disguised sale); In re McNutt, 37 B.R. 95, 96 (Bankr. D. Or. 1984) (holding the presence of a termination formula providing the lessee with loss or gain on the disposition of the vehicle indicated a disguised sale).
186. FREDERICK H. MILLER & CARL S. BIERRE, 8 HAWKLAND UCC SERIES § 9-109:7 (2022) (“Article 9 generally applies to sales of accounts, chattel paper, payment intangibles and promissory notes.”).
188. Factoring, BLACK’S LAW DICTIONARY (11th ed. 2019) (“The buying of accounts receivable at a discount. The price is discounted because the factor (who buys them) assumes the risk of delay in collection and loss on the accounts receivable.”).
collect on all its accounts, it could sell $10 million worth of accounts to Bank A and let Bank A worry about collection. However, Bank A will not buy the accounts at $10 million, as it is not assured of repayment. Instead, it buys the accounts at a discount—say for $9 million. Should it collect more than $9 million, Bank A has made a profit.

In such a hypothetical, CCC and Bank A have entered into a true sale, and issues of secured lending would not arise. But consider the following variation: Instead of selling $10 million in accounts, CCC borrows $9 million and offers the accounts as collateral. Such a transaction is clearly governed by Article 9 of the U.C.C. But CCC and Bank A could also structure the transaction to look like a sale to achieve the same result. Instead of borrowing $9 million, CCC could sell the accounts for $9 million with an agreement that should an account become uncollectable, it will buy the account back at full value. In other words, though there is a sale of accounts, it is with recourse, meaning the risk of non-payment remains with CCC just as it would in a secured lending situation.

The primary reason for Article 9’s coverage of this property, without regard to whether the transaction creates a security interest that secures an obligation, is that it can be virtually impossible, in some cases, to distinguish between an assignment as security and an outright sale of this sort of property. Thus, the drafters of Article 9 broadly included sales of this type of property, except when it could be said that the sale was clearly not part of a financing scheme.

A rather extreme instance of a court recasting a sale of accounts as a disguised secured transaction arose, although in a somewhat more complex manner, in

189. See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: PRACTITIONER TREATISE SERIES § 30-7, at 49 (5th ed. 2002). U.C.C. § 9-109(d)(4)-(7) excludes certain types of transactions from Article 9’s scope including true sales of accounts, such as what happens in the sale of a business or sales of accounts to collection agencies. U.C.C. § 9-109(d)(4)-(7) (AM. L. INST. & UNIF. L. COMM’N 2010).

190. See U.C.C. § 9-406(a) (AM. L. INST. & UNIF. L. COMM’N 2010) (allowing an assignor to collect a debt secured by accounts directly from the underlying account debtor).

191. See Ben J. Sopranzetti, The Economics of Factoring Accounts Receivable, 50 J. ECON. AND Bus. 339, 340 n.3 (“[I]f a receivable is sold with recourse, then the seller may be responsible for a portion or even all of the uncollected amount, depending upon the terms of the factoring agreement. The recourse guarantee is, in essence, a put option. The factor will be able to put the delinquent receivable back to the firm if the realized payoff is less than the promised amount.”).

192. MILLER & BIERRE, supra note 186.
the case of *In re LTV Steel Co.* LTV Steel (LTV), the debtor in a bankruptcy proceeding, entered into a transaction whereby it purported to sell its accounts to a wholly-owned subsidiary, LTV Sales Finance Co. (Sales Finance), who in turn borrowed $270 million from a U.K. bank, Abbey National, secured by the sold accounts. The deal was structured this way so that, should LTV later enter into bankruptcy, the accounts would not be a part of LTV’s bankruptcy estate. Once in bankruptcy, LTV sought an order to use the money collected on the accounts receivables by Sales Finance as cash collateral, despite the fact that it had purportedly sold those accounts outright to Sales Finance. The court granted the order. Abbey National sought relief from this order, arguing that the accounts were no longer the property of LTV and therefore not a part of the bankruptcy estate. The court disagreed, holding that LTV held “at least some equitable interest” in the accounts due to the efforts it put forth to create them. The court held that “[t]his equitable interest is sufficient to support the entry of the interim cash collateral order.” Though not explicit in the opinion, the “equitable” language strongly implied the court viewed LTV as still being in some way responsible for the sold accounts. As one commentator noted, “[t]his case sent shockwaves through the securitization industry.” It serves as a cautionary tale to those who try to avoid the effects of securitization through drafting—if a transaction in substance appears to be a secured loan, a court may recast it as such.

Though there is little case law discussing recasting TRS contracts, the issue of whether they confer beneficial ownership for reporting purposes under Schedule 13D has arisen. In *CSX Corp. v. Children’s Investment Fund*
Management (UK) LLP, two hedge funds, The Children’s Investment Fund Management (TCI) and 3G Capital Partners (3G) (collectively “the Funds”) entered into various TRS contracts with a number of banks for shares of CSX Corporation (CSX). The Funds and the banks purchased shares of CSX, but the Funds were careful to make sure neither they, nor any individual bank, purchased more than 5% ownership so as to avoid the reporting requirements of Schedule 13D. The Funds later sought to elect a slate of candidates to CSX’s board of directors, but CSX brought an action in the district court alleging that the Funds failed to comply in a timely fashion with the Schedule 13D disclosure requirements. The district court subsequently granted an injunction barring the Funds from any future reporting violations (but denied CSX’s request for an injunction preventing the Funds from voting their CSX shares).

In finding for CSX on the issue of reporting, the district court relied on two provisions of 15 U.S.C. § 78m(d), which governs when reporting requirements will arise. Section 78m(d) provides that reporting requirements arise when a person acquires “beneficial ownership” in the shares of a company and that “[w]hen two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ‘person’ for the purposes of this subsection.” The definition of “beneficial owner” is found in 17 C.F.R. § 240.13d-3(a) and turns on a person having “(1) [v]oting power which includes the power to vote, or to direct the voting of, such security; and/or, (2) [i]nvestment power which includes the power to dispose, or to direct the disposition of, such security.” The district court declined to hold that the receivers (referred to as the long parties by the court)
were beneficial owners under 17 C.F.R. § 240.13d-3(a), but instead held that the TRS receivers had beneficial ownership of the CSX stock under § 240.13d-3(b).\textsuperscript{213} which provides the relevant definition:

Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose of [sic] effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of section 13(d) or (g) of the Act shall be deemed for purposes of such sections to be the beneficial owner of such security.\textsuperscript{214}

The district court found that the TRS arrangement was “created and used . . . with the purpose and effect of preventing the vesting of beneficial ownership” in the TRS receivers “as part of a plan or scheme to evade the reporting requirements of Section 13(d).”\textsuperscript{215} Though no single holding exceeded 5%, the district court considered the multiple holdings as a group under 15 U.S.C. § 78m(d)(3).\textsuperscript{216} Ultimately, on appeal, the Second Circuit did not reach the merits of whether the district court was correct in ruling that the Funds’ TRS contracts made them beneficial owners.\textsuperscript{217} Instead, the Second Circuit remanded on the issue of whether a “group” was formed, noting that the Funds actual holdings in CSX, aggregated, would have met the 5% threshold.\textsuperscript{218}

\textquote{The [district court] did not distinguish in its group finding between CSX shares deemed to be beneficially owned by the Funds and those owned outright by the Funds. However, with our current consideration of a group violation confined to CSX shares owned outright by the Funds, a precise finding, adequately supported by specific evidence, of whether a group existed for purposes of acquiring CSX shares outright during the relevant period needs to be made in order

\begin{enumerate}
\item \textsuperscript{213} CSX Corp., 654 F.3d at 281–82.
\item \textsuperscript{214} 17 C.F.R. § 240.13d-3(b) (1998).
\item \textsuperscript{215} CSX Corp., 654 F.3d at 282 (quoting CSX Corp. v. Child.’s Inv. Fund Mgmt. (UK) LLP, 562 F. Supp. 2d 511, 548–49 (S.D.N.Y. 2008)).
\item \textsuperscript{216} \textit{Id.} at 283–84.
\item \textsuperscript{217} \textit{Id.} at 284.
\item \textsuperscript{218} \textit{Id.}
\end{enumerate}
to facilitate appellate review, and we will remand for that purpose. 219

B. The Substance of a TRS Contract Is That of a Disguised Secured Transaction

Though there is no case law addressing recasting TSR contracts as secured sales for Regulation T purposes, themes from the above cases provide a framework for doing so. 220 From the above, two common themes arise. 221 First, in each instance, the parties to the transaction tried to avoid the effects of a secured transaction by structuring the deal as something else, be it a lease or an outright sale. 222 Second, in each instance the lessee, in the case of leased goods, or the seller, in the case of accounts, ultimately bore the risk of appreciation or depreciation of the asset. 223 With leases and TRAC leases, the lessee either would actually become the owner of the goods, be liable to pay for any depreciation in them, or receive the benefit of any appreciation. 224 In the context of a sale of accounts, the seller still bore the risk that the account could be uncollectable, making it indistinguishable from a secured loan. 225

TRS contracts likewise share these two characteristics. 226 The TRS contract, at least in the way Archegos used it to buy securities that would otherwise be subject to Regulation T and Schedule 13D, appears to be structured as a work around. 227 Absent the TRS contract, Archegos would have had to...

219. Id.
220. See generally supra note 204 and accompanying text (discussing cases where the deals at issue were in essence disguised secure transactions).
221. See infra notes 222–223 and accompanying text.
222. See CSX Corp. v. Child.’s Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276, 281 (2d Cir. 2011) (showing a party who attempted to avoid becoming a “beneficial owner” to evade statutory requirements); In re LTV Steel Co., 274 B.R. 278, 285–86 (Bankr. N.D. Ohio 2001) (discussing a bankruptcy transaction structured as a sale without the debtor intending to transfer ownership); In re Brankle Brokerage & Leasing, Inc., 394 B.R. 906, 914 (Bankr. N.D. Ind. 2008) (holding that the purported lease was in fact a disguised sale).
223. See In re Brankle Brokerage, 394 B.R. at 914 (pointing out that in Volvo’s purported lease, the lessee ultimately bore the financial risk); In re LTV Steel Co., 274. B.R. at 285–86 (exemplifying a debtor-seller bearing liabilities of purportedly sold accounts).
224. See In re Brankle Brokerage, 394 B.R. at 913–14 (discussing a lessee of a TRAC lease who would either become the owner of the good or bear its financial risks).
225. See In re LTV Steel Co., 274 B.R. at 286 (finding that the purported sale of a debtor’s account essentially operated as a secured loan).
226. See infra text accompanying note 227.
227. See, e.g., CSX Corp., 654 F.3d at 282 (“Ultimately, the District Court did not rule on whether TCI was a beneficial owner under Rule 13d–3(a) . . . but did rule that TCI was deemed a beneficial
have abided by the initial and maintenance margin limits, and reported its more than 5% ownership. Furthermore, much as in the TRAC leasing situations, the TRS receiver bears the risk of appreciation or depreciation of the underlying asset. Thus, recasting appears to be the proper course under U.C.C. Section 9-109(a)(1).

This approach has been suggested by others. In fact, Ashley Alder, chair of the International Organization of Securities Commissions, while addressing the general meeting of the International Swaps and Derivatives Association in the shadow of the Archegos losses, stated, “Total return swaps are equity derivatives which would be subject to these margin requirements. Therefore, it is valid to ask whether—assuming full implementation—margin requirements would or could have worked to reduce losses arising in this type of incident.” Indeed, it is reported that many banks themselves book TRS contracts as collateralized loans for accounting purposes. It seems fair then that the SEC, under the above approach, needs to simply treat TRS contracts as what they are substantively—secured loans. This approach would then enable the SEC to make use of its enforcement powers to police such contracts and subject broker-dealers to civil penalties. Though this approach would...
not necessarily help with the issue of avoiding Schedule 13F, as it was avoided due to the family office form, much of the mischief at issue in Archegos could have been avoided by treating TRS contracts as disguised secured transactions.236

V. TOTAL RETURN SWAPS AS CONTRACTS CONTRARY TO PUBLIC POLICY

While recasting TRS contracts as secured loans would give the SEC the ability to enforce Regulation T, it offers little utility to the TRS receiver who is still liable for covering its positions.237 In one sense, TRS receivers like Archegos are not very sympathetic—after all it was trying to game the system so why shouldn’t it be liable?238 But if there was a way for the TRS receiver to avoid the contract, this could offer a powerful incentive for broker-dealers to be cautious in entering into such transactions.239 The contract law doctrine of in pari delicto as applied to illegal contracts provides just such a defense.240

A. The Doctrine of In Pari Delicto

Contracts that are illegal are unenforceable despite having all of the other characteristics of an enforceable contract—offer, acceptance and consideration.241 However, a distinction should be made between contracts that are illegal due to their subject matter, i.e., malum per se, such as contracts to commit murder, and contracts that are against public policy—malum prohibitum.242 Not all courts distinguish between such contracts, but others,

236. See 12 C.F.R. § 220.1 (1998) (providing regulatory requirements for secured transactions, which Archegos would not have been able to evade if the SEC recognized the TRS contract as such).
237. See 12 C.F.R. § 220.1(a) (1998) (describing the scope of Regulation T, which does not include protecting customers or creditors).
238. See Martens & Martens, supra note 11, (discussing how Archegos used TRS contracts to evade Regulation T requirements).
239. See Section V.A.
242. See HUNTER, supra note 241, §§ 19:20–21; 8 WILLISTON ON CONTRACTS, supra note 241, § 19:46. A crime that is malum per se (also known as malum in se) is “[a] crime or an act that is inherently immoral, such as murder, arson, or rape.” Malum In Se, BLACK’S LAW DICTIONARY (11th ed. 2019). A crime that is malum prohibitum is “[a]n act that is a crime merely because it is prohibited by statute, although the act itself is not necessarily immoral.” Malum Prohibitum, BLACK’S LAW
when considering whether a contract should be upheld, consider the underlying policies of the relevant statute. Further, even if no penalty is imposed by the underlying statute, a court may invalidate the contract if it determines that the contract violates a strong public policy.

If a contract serves a purpose that is prohibited by statute and the statute provides certain penalties and remedies, none of which are directly implicated by the facts of the case, it has been stated that the court must then inquire whether the underlying purpose of the statute mandates holding the contract unenforceable or whether the penalties and remedies provided in the statute are intended to be exclusive.

When a contract does not violate the letter of the law, but offends the policy underlying a statute, a court may nonetheless find it as void. The Restatement (Second) of Contracts Section 78 addresses the factors a court should consider in such a situation, stating:

(1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.

(2) In weighing the interest in the enforcement of a term, account is taken of

(a) the parties’ justified expectations,

(b) any forfeiture that would result if enforcement were denied, and

(c) any special public interest in the enforcement of the particular term.
(3) In weighing a public policy against enforcement of a term, account is taken of:

(a) the strength of that policy as manifested by legislation or judicial decisions,

(b) the likelihood that a refusal to enforce the term will further that policy,

(c) the seriousness of any misconduct involved and the extent to which it was deliberate, and

(d) the directness of the connection between that misconduct and the term. 247

The Restatement also advises that public policy may be derived not only from legislation, but also from a need to protect the public welfare. 248 When a court does find that a contract is in violation of a statute or public policy, it may apply the doctrine of in pari delicto 249 under which it will not grant the plaintiff relief when they have participated in the wrongdoing. 250

B. In Pari Delicto as Applied to Violations of Federal Securities Laws

The treatment of contracts that violate the federal securities laws have generally followed the principles of contract law. 251 The United States Supreme Court addressed when a contract that runs afoul of the securities laws may be invalidated in Bateman Eichler, Hill Richards, Inc. v. Berner. 252 In

248. Id. § 179.
250. See Restatement (Second) of Contracts § 197 (Am. L. Inst. 1981) (“[A] party has no claim in restitution for performance that he has rendered under or in return for a promise that is unenforceable on grounds of public policy unless denial of restitution would cause disproportionate forfeiture.”); In Pari Delicto Doctrine, Black’s Law Dictionary (11th ed. 2019) (“The principle that a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing.”).
251. See, e.g., Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 301 (1985) (analyzing the underlying cause of action involving a contract that violates federal securities laws through the lens of contract doctrines such as in pari delicto).
252. Id.
Berner, investors in T.O.N.M. Oil & Gas Exploration Corporation (TONM) claimed that they purchased the shares based on alleged insider information provided by Charles Lazzaro, their broker, and Leslie Neadeau, President of TONM. The investors alleged that they were told that TONM had purchase options on thousands of acres of land with large gold deposits, that this information was not public, and that the TONM stock would soon increase from trading in the $1.50–$3.00 range to the $10-$15 range, and maybe as high as $100. The investors brought suit alleging they suffered substantial trading losses due to the incorrect information, though they admitted that they made the purchases “on the premise that Lazzaro was privy to certain information not otherwise available to the general public.”

The district court dismissed the complaint, reasoning that because the investors were trading on insider information they had violated the very insider trading laws under which they sought recovery. The district court therefore concluded that the investors were in pari delicto with the defendants and barred from recovery. On appeal, the Ninth Circuit reversed, concluding that “securities professionals and corporate officers who have allegedly engaged in fraud should not be permitted to invoke the in pari delicto doctrine to shield themselves from the consequences of their fraudulent misrepresentation.”

On appeal, the Supreme Court began by outlining two premises that underlie the in pari delicto defense: First, “courts should not lend their good offices to mediating disputes among wrongdoers; and second, that denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality.” After reviewing its own jurisprudence in the area, the Court concluded that there are two elements for when a defendant may raise the in pari delicto defense: “(1) [A]s a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.”

253. Id. at 301–02.
254. Id.
255. Id. (quoting Complaint at ¶ 15, Berner v. Lazzaro, 730 F.2d 1319 (9th Cir. 1984).
256. Id. at 304.
257. Id.
258. Id. at 304–05 (quoting Berner v. Lazzaro, 730 F.2d 1319, 1320 (9th Cir. 1984)).
259. Id. at 306.
260. Id. at 310–11.
Applying this standard to the facts before it, the Court found that under the first prong, the investors were not equally culpable, stating “insiders and broker-dealers who selectively disclose material nonpublic information commit a potentially broader range of violations than do tippees who trade on the basis of that information.”

Further, turning to the second prong, the Court also concluded that applying *in pari delicto* to the investors would hinder, rather than enhance, the policies underlying insider trading rules. “The *in pari delicto* defense, by denying any incentive to a defrauded tippee to bring suit against his defrauding tipper, would significantly undermine” the goal of exposing unlawful conduct.

After *Bateman Eichler*, there was some question as to whether the *in pari delicto* standard announced was limited to insider trading cases or could extend to a further class of securities violations. The Supreme Court addressed this question just three years later in *Pinter v. Dahl*. The controversy in *Pinter* arose from the sale of unregistered securities in oil and gas leases by Pinter to Dahl and his friends whom he had encouraged to invest in the opportunity. The evidence presented showed Dahl had approached Pinter seeking oil and gas investment opportunities, Pinter found such opportunities, and after conducting his own investigation, Dahl invested $310,000 of his own money and persuaded friends and family to also invest. Dahl assisted the other investors in filling out their subscription agreement forms that Pinter prepared—the forms stated that the interests were being sold without the benefit of registration under the SEC. The venture subsequently failed, and the investors brought suit against Pinter seeking rescission under Section 12(1) of the Securities Act for the unlawful sale of unregistered securities. Pinter countered, among other things, that Dahl should be barred from recovery under the doctrine of *in pari delicto*.

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261. *Id.* at 313.
262. *Id.* at 315.
263. *Id.* at 316.
264. *See*, e.g., *Pinter v. Dahl*, 486 U.S. 622, 629–33 (1988) (noting the procedural history of the case, specifically the debate amongst the Court of Appeals judges over their holding that the *in pari delicto* defense was limited to 10(b) claims, and ultimately rejecting the defense’s narrow view).
265. *Id.*
266. *Id.* at 625–26.
267. *Id.*
268. *Id.* at 626.
269. *Id.* at 627.
270. *Id.* at 628.
The district court dismissed Pinter’s counterclaims, concluding that the evidence was insufficient, but did not specifically explain its ruling with regard to the *in pari delicto* defense.271 A divided panel of the Fifth Circuit Court of Appeals affirmed the dismissal, reasoning that the *Bateman Eichler* standard was not applicable to the Section 12(1) violation because, unlike the insider trading statute, violations of Section 12(1) lacked a scienter requirement.272 On appeal, the Supreme Court made clear that the Fifth Circuit’s limitation was not justified, noting that *Bateman Eichler* did not suggest that *in pari delicto* was limited to Section 10(b) violations.273 Stressing that *in pari delicto* is premised upon a policy that “denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality,” the Court concluded “*Bateman Eichler* provides the appropriate test for allowance of the *in pari delicto* defense in a private action under any of the federal securities laws.”274

Turning to the facts before the Court, however, it was unable to conclude whether the two prongs were met.275 As to both prongs, the Court indicated that if Dahl were a promoter rather than just an investor, he could be *in pari delicto*, but that the district court had not adequately articulated findings to support the defense.276

C. *In Pari Delicto* as Applied to TRS Contracts

Since *Pinter*, lower courts have applied *in pari delicto* to other securities violations, analyzing the facts under the two prongs laid out in *Bateman Eichler*:277 Though the application of *in pari delicto* is fact specific to each case,

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271. *Id.* at 628–29.
272. *Id.* at 629.
273. *Id.* at 633.
275. *Id.* at 639–41.
276. *Id.*
277. See, e.g., Ross v. Bolton, 904 F.2d 819, 825 (2d Cir. 1990) (“In 1985 the Supreme Court considered the defense’s proper scope in securities litigation and determined that it could bar a plaintiff’s suit in that field so long as (1) plaintiff truly bears at least substantially equal responsibility for the transactions for which he seeks to recover, and (2) barring the suit will not ‘significantly interfere with the effective enforcement of the securities laws and protection of the investing public.’” (quoting *Bateman Eichler*, 472 U.S. at 310–11)); Nisselson v. Lernout, 469 F.3d 143, 151 (1st Cir. 2006) (“The doctrine is grounded on twin premises. The first is that ‘courts should not lend their good offices to mediating disputes among wrongdoers.’ . . . The second is that ‘denying judicial relief to an admitted wrongdoer is an effective means for deterring illegality.’” (quoting *Bateman Eichler*, 472 U.S. at 306)); Silva Run Worldwide Ltd. v. Gaming Lottery Corp., No. 96 CIV. 3231, 1998 WL 167330, at
given the broad proclamation of \textit{Pinter}, it would appear that the doctrine could also apply in the TRS context.\footnote{9 (S.D.N.Y. Apr. 8, 1998) ("\textit{In pari delicto} is only available where '(1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public." (quoting \textit{Bateman Eichler} 472 U.S. at 310–11)).} As a preliminary matter, a court might have to find that the TRS contracts at issue were in fact disguised secured transactions that run afoul of Regulation T and Schedule 13D reporting.\footnote{278. \textit{See Pinter}, 486 U.S. at 633–34 (summarizing the broad proclamation of the applicability of the \textit{in pari delicto} doctrine).} But even absent such a finding, a court could nonetheless find that the TRS contracts violate the public policy underlying Regulation T and proceed with the two-prong analysis of \textit{Bateman Eichler}.\footnote{279. \textit{See U.C.C.} § 1-203(b) (AM. L. INST. & UNIF. L. COMM’N 2010) (laying out test for finding a disguised secured transaction).}

The Archegos situation presents a perfect fact pattern under which to examine how such a defense might play out.\footnote{280. \textit{See Bateman Eichler}, 472 U.S. at 306.} As noted in Part III, a number of the banks that were involved ended up with large losses.\footnote{281. \textit{See supra} Section III.B.} Assume that Archegos had remaining assets, and Credit Suisse sued to recoup its $5.5 billion loss. In court, Archegos could raise \textit{in pari delicto} to avoid liability. Analyzing under the first prong of \textit{Bateman Eichler}, as a direct result of its own actions, did Credit Suisse bear at least substantially equal responsibility for the violations it seeks to redress?\footnote{282. \textit{See Patrick & Webb, supra} note 2 and accompanying text.} The answer would appear to be yes.\footnote{283. \textit{See, e.g.}, Martens & Martens, \textit{supra} note 11.} Archegos could not force a bank to enter into such a transaction.\footnote{284. \textit{See supra} notes 261–62 and accompanying text.} Essentially Credit Suisse enabled Archegos to skirt the margin rules by agreeing to stake positions on the stocks and look to Archegos to cover any shortfall.\footnote{285. \textit{See, e.g.}, Martens & Martens, \textit{supra} note 11.} Turning to the second prong, would preclusion of Credit Suisse’s suit significantly interfere with the effective enforcement of the securities laws and protection of the investing public?\footnote{286. \textit{See id.}} The answer here appears to be no — indeed it could be argued that it would further the effective enforcement of the securities laws
laws. Regulation T is said to exist for both the protection of investors from getting in over their heads on thinly marginalized stock and also to promote stability in the markets. By using TRS contracts to avoid the limitations imposed under Regulation T, Archegos triggered the very type of cascading event Regulation T was designed to prevent.

Avoiding the TRS contracts and applying in pari delicto would act as a serious disincentive for future banks to design transactions to avoid the limitations of Regulation T. This would be in keeping with the twin premises annunciated by the Bateman Eichler Court that underpin in pari delicto: “courts should not lend their good offices to mediating disputes among wrongdoers;” and “denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality.” This is not to say that every TRS contract should be subject to the in pari delicto defense. As noted above, TRS contracts can be used as effective devices to hedge risks and grant access to markets. Further, if the underlying assets are not otherwise subject to Regulation T, then there would be no opportunity to raise the defense. But as the Archegos meltdown demonstrates, TRS contracts can also wreak havoc on markets and result in billions of dollars in losses. When the TRS contract is used as a device to simply skirt existing securities regulations, application of in pari delicto should be available.

VI. CONCLUSION

The journey of Archegos Capital Management and Bill Hwang from a high-flying master of Wall Street to one of the single largest losses of personal wealth ever is jarring. Not only did Archegos’ activities cause $20 billion

288. See Martens & Martens, supra note 11.
290. See supra Section II.B. Another interest that was negatively affected here that may be overlooked is that of the companies Archegos was investing in; ViacomCBS, unaware of Archegos’ position, made the logical decision to offer a sale of stock to raise more capital. See Martens & Martens, supra note 11. Due to Archegos’ position, the stock subsequently tanked, hurting many innocent shareholders in the process. Id.
292. See supra notes 102–04.
293. See 12 C.F.R. § 220.1(b).
294. See Martens & Martens, supra note 11.
295. See id.
296. See Schatzker et al., supra note 1.
in losses for itself, it caused some of the largest banks in the world to suffer billions in losses and triggered ViacomCBS and Discovery to register their worst share value downturns on record. Archegos was able to amass massive positions in companies and margins that would not have been allowed under normal trading regulations. It did so undetected thanks to the use of two devices: the family office form and total return swap contracts. The first permitted Archegos to avoid registering with the SEC and avoid reporting its positions. But it was the use of TRS contracts that really facilitated Archegos’ activities. By staking positions through TRS contracts, Archegos was able to avoid margin limits and reporting when its ownership exceeded 5% of the companies’ outstanding shares. Furthermore, because TRS contracts are not publicly reported, none of the banks involved in the transactions were aware of each other’s involvement or the additional risks that Archegos was taking on.

In light of the massive losses, many regulators, commentators and legislators are reexamining the existing rules and regulations, particularly those involving the family office form. But the role TRS contracts played in the fiasco should not be overlooked. Archegos revealed a hole in existing reporting requirements that could be exploited by others. While the Archegos incident fortunately remained contained to its holdings, the specter of systemic volatility has now been raised. This Article proposes a simple solution in two parts that would not require new legislation.

First, the SEC should recast TRS contracts that are used to skirt Regulation T as disguised secured transactions. Article 9 of the U.C.C. governs

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298. See SHORTER & SU, supra note 76.
299. See id.
300. See id.
301. See Schoeff Jr., supra note 117.
302. See id.
303. See Schatzker et al., supra note 1.
304. See supra note 145 and accompanying text.
305. See Schoeff Jr., supra note 117.
306. See id.
307. See id.
308. See supra notes 228–230.
investment property and instructs that substance should rule over form. By doing so, the SEC could make clear that TRS contracts are subject to the margin limits in place under Regulation T and the reporting requirements of Schedule 13D.

Second, courts should treat such contracts as void as against public policy. Once recast as disguised secured transactions, TRS contracts clearly violate Regulation T, but even if a court did not recast them, such contracts frustrate the purpose of Regulation T to protect investors and promote systemic stability. Under the Bateman Eichler two-part test, should banks that entered into such transactions seek to recover their losses from investors, they could be barred from doing so under the doctrine of in pari delicto. This would further disincentivize banks from entering into such risky transactions in the furtherance of the goal of preventing market volatility.

311. See supra notes 244–251 and accompanying text.
312. Fletcher, III, supra note 289, at 1106–08.