Volume 50 | Issue 1

Article 2

1-20-2023

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

Colin P. Marks

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

* Ernest W. Clemens Professor of Corporate and Securities Law, St. Mary's University School of Law. I would like to thank the following individuals for their feedback on this article during its development: Carl S. Bjerre, Wallace L. & Ellen A. Kaapcke Professor of Business Law, University of Oregon School of Law; Julie A. Hill, Professor of Law, University of Alabama Law; Joan MacLeod Heminway, Rick Rose Distinguished Professor of Law, University of Tennessee College of Law; Samir Parikh, Professor of Law, Lewis & Clark Law School; and Professors Matthew Dawson, Violeta Díaz, Dave Hague, and Chad Pomeroy—my St. Mary's colleagues. I would like to thank and acknowledge the hard work and contributions of my research assistants Emma Blackwood, Caitlin Harrington, Peyton Janssen, Caitlin Palomin, Maggi Robert, and Sabrina Salazar in researching and writing this article. I would also like to thank my wife Jill, daughter Savannah, and son George for their love and support.

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.*

TABLE OF CONTENTS

I. INTRODUCTION

Archegos Capital Management, at its height, had $35 billion in assets.[1] 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.[2] 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.[3] Archegos, which was managed by Bill Hwang, lost $20 billion over two days.[4] The unique characteristics of total return swaps made these losses possible.[5] Further, Archegos's formation as a family office permitted Archegos to skirt other reporting requirements.[6]

Archegos essentially purchased beneficial ownership in large amounts of stock, particularly ViacomCBS Inc. and Discovery, Inc., on credit.[7] 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.[8] Normally, this would require Archegos to initially own 50% of the stock.[9] 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.[10] To avoid these rules, Archegos instead entered into total return swaps with the banks.[11] Under this arrangement, the

---

1. Erik Schatzker et al., *Bill Hwang Had $20 Billion, Then Lost It All in Two Days*, BLOOMBERG (Apr. 27, 2022, 7:19 AM), https://www.bloomberg.com/news/features/2021-04-08/how-bill-hwang-of-archegos-capital-lost-20-billion-in-two-days.

2. Margot Patrick & Quentin Webb, *Archegos Hit Tops $10 Billion After UBS, Nomura Losses*, WALL ST. J., https://www.wsj.com/articles/ubs-takes-surprise-774-million-archegos-hit-11619501547 (Apr. 27, 2021, 7:24 AM).

3. *Id.*

4. Schatzker et al., *supra* note 1.

5. *Id.*

6. *Id.*

7. Emily Glazer et al., *Inside Credit Suisse's $5.5 Billion Breakdown*, WALL ST. J. (June 7, 2021, 9:33 AM), https://www.wsj.com/articles/inside-credit-suisses-5-5-billion-breakdown-archegos-11623072713.

8. Schatzker et al., *supra* note 1.

9. *See Margin: Borrowing Money to Pay for Stocks*, U.S. SEC. & EXCH. COMM'N (Apr. 17, 2009), https://www.sec.gov/reportspubs/investor-publications/investorpubsmarginhtm.html.

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.[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.[13] But Archegos didn't stop at going to one bank—instead, it approached several banks and entered into the same arrangement.[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.[15]

These highly leveraged transactions are made worse by the fact that they are not subject to normal stock ownership disclosure requirements.[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.[17]

WALL ST. ON PARADE (Apr. 6, 2021), https://wallstreetonparade.com/2021/04/archegos-wall-street-was-effectively-giving-85-percent-margin-loans-on-concentrated-stock-positions-thwarting-the-feds-reg-t-and-their-own-margin-rules/.

12. *See id.*; Schatzker et al., *supra* note 1.

13. Robert Armstrong, *Archegos Debacle Reveals Hidden Risk of Banks' Lucrative Swaps Business*, FIN. TIMES (Mar. 31, 2021), https://www.ft.com/content/fb364689-9b04-47cb-aba9-5eb15d1cea85; Schatzker et al., *supra* note 1.

14. *See* Schatzker et al., *supra* note 1.

15. *See* Armstrong, *supra* note 13.

16. *Id.*

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.[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."[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.[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.[21] Such an arrangement is no different from the bank loaning a sum of money and taking a security interest in the accounts.[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.[23] Such a recharacterization should place these transactions back into Regulation T and the margin limits.[24] But, recharacterization also offers another contract law approach that is more draconian.[25] If the structure of the contract violates a regulation, then total return swaps could be declared void as against public policy.[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.[27]

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

---

and-how-did-archegos-capital-use-it-11617125839.

18. *See generally* U.C.C. art. 9 (AM. L. INST. & UNIF. L. COMM'N 2010) (detailing the law governing secured transactions).

19. U.C.C. § 9-109(a)(1) (AM. L. INST. & UNIF. L. COMM'N 2010).

20. *See* Claire A. Hill, *Is Secured Debt Efficient?*, 80 TEX. L. REV. 1117, 1124–25 (2002) (defining secured debt); *see also* Kia Treece, *Recourse Loans Vs. Non-Recourse Loans*, FORBES, https://www.forbes.com/advisor/loans/recourse-loans-vs-non-recourse-loans/ (Aug. 12, 2020) (discussing the difference between recourse and non-recourse loans).

21. *See* sources cited *supra* note 20.

22. *See* Hill, *supra* note 20, at 1124–25.

23. *See* Martens & Martens, *supra* note 11.

24. *See Margin Regulation*, FINRA, https://www.finra.org/rules-guidance/key-topics/margin-accounts (last visited Oct. 7, 2022).

25. *See infra* notes 244–48 and accompanying text.

26. *See infra* notes 244–48 and accompanying text.

27. *See infra* Part V.

purchasing stocks on margin, including Regulation T and the normal disclosure requirements that go with ownership.[28] Part III then explores how using total return swaps enabled Archegos to skirt these rules.[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.[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.[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).[32] Further, once an investor has control over 5% of a given company's stock, additional reporting requirements apply.[33] Total return swap contracts (TRS) manage to avoid both sets of regulations, however, by disguising the ownership of the stocks.[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.[35] Regulation T governs extensions of credit by brokers and dealers, including establishing initial margin

28. *See infra* Part II.

29. *See infra* Part III.

30. *See infra* Part IV.

31. *See infra* Part V.

32. *See Margin: Borrowing Money to Pay for Stocks*, *supra* note 9 (discussing buying on margin and the risks and regulations involved).

33. *See Acquiring More Than 5% of a Publicly Traded Company*, INV. FUND L. BLOG, https://www.investmentfundlawblog.com/resources/investments-by-funds/acquiring-5-publicly-traded-company/ (last visited Oct. 7, 2022).

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).

35. *See* 12 C.F.R. §§ 220.1–.12 (2021).

requirements.[36] When customers purchase stocks from broker-dealers they can do so either through a "cash account" or on a "margin account."[37] Customers of broker-dealers who want to buy stocks on credit must first establish a margin account.[38] 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.[39]

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."[40] 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

---

36. *Id.* § 220.1(a).

37. *See* SEC's Office of Investor Education and Advocacy, *Investor Bulletin: Understanding Margin Accounts*, U.S. SEC. & EXCH. COMM'N (June 10, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_marginaccount.

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.[41] To address this risk, many broker-dealers require that the margin account maintains a minimum equity value known as the maintenance requirement.[42] By law, this can be no lower than 25% of the value of the stock,[43] but some firms set a higher amount.[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.[45] If you cannot do so, the broker-dealer will sell the stock to reach the minimum requirement.[46]

Not all borrowers are subject to the limitations in Regulation T.[47] Section 220.1(b) exempts from its scope "exempted borrowers."[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

41. *See* SEC's Office of Investor Education and Advocacy, *supra*, note 38.
42. *See id.*
43. FINRA, RULE 4210(c)(1) (2022), https://www.finra.org/rules-guidance/rulebooks/finra-rules/4210#the-rule.
44. *See* SEC's Office of Investor Education and Advocacy, *supra* note 38; *see, e.g.*, *Margin—Nonretirement—Brokerage*, FID. INVS. (Mar. 2022), https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/bmargin.pdf.
45. SEC's Office of Investor Education and Advocacy, *supra* note 38; *see, e.g.*, *Margin—Nonretirement—Brokerage*, *supra* note 44.
46. SEC's Office of Investor Education and Advocacy, *supra* note 38; *see, e.g.*, *Margin—Nonretirement—Brokerage*, *supra* note 45.
47. 12 C.F.R. § 220.1(b)(3)(ii) (2021).
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.").

> 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

---

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.

17 CFR § 275.202(a)(11)(G)-1(b).

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.").

53. *Id.* §§ 9-106, 8-106 (AM. L. INST. & UNIF. L. COMM'N 1994).

collateral.[54] 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[55] or by the broker-dealer controlling the investment property.[56] Further, by maintaining control of the investment property, the broker-dealer will perfect its security interest.[57]

Given that broker-dealers' loans are secured by the underlying stock,[58] 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.[59] When borrowers hold large positions in a single company, the risk of loss can be great.[60] 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.[61]

In the years leading up to the market crash, borrowers were putting up as little as 10% equity to purchase stocks.[62] 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.*

59. *See* Gikas A. Hardouvelis, *Margin Requirements, Volatility, and the Transitory Component of Stock Prices*, 80 AM. ECON. REV. 736, 736–37 (1990) (discussing whether additional equity in the form of margin requirements "curb[s] speculative excesses in the stock market and reduce[s] stock price volatility").

60. *See id.* at 736 n.2.

61. *See generally* Paul S. Atkins, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks Before the Securities Traders Association (Oct. 7, 2004), *at* https://www.sec.gov/news/speech/spch100704psa.htm (noting the SEC was created following the stock market crash in the 1920s).

62. *See id.* ("Margin loans of 80–90[%] were common.").

stock price, but also does so for the losses.[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.[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.[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.[66]

Many factors contributed to the great market crash of the late 1920s, including the unregulated use of purchasing on margin.[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.[68] Unregulated purchasing on margin fed into this frenzy, resulting in the above-mentioned cascading effect across the entire market.[69] The results of the crash were devastating.[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

---

63. *See* Jeff Madura & John M. Cheney, *An Intuitive Explanation of How Margin Trading Affects the Risk of Investments*, 24 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.").

64. *See* Hardouvelis, *supra* note 60, at 736 n.1.

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

66. *See* Peter Fortune, *Margin Requirements, Margin Loans, and Margin Rates: Practice and Principles*, Sept./Oct. 2000 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.").

67. *Id.* at 25.

68. *See* STEVEN H. JAFFE & JESSICA LAUTIN, CAPITAL OF CAPITAL: MONEY, BANKING + POWER IN NEW YORK CITY 1784–2012 154 (Colombia Univ. Press 2014).

69. *See id.*

70. *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.[71]

It was against this backdrop that the Securities Exchange Acts of 1933 and 1934 were enacted.[72] These acts provided for the creation of the SEC as well as reporting and disclosure requirements for publicly traded companies.[73] They also provided for initial margin and maintenance rules found in Regulation T.[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.[75]

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.[76] Rather than place limits on trading, such as Regulation T, these provisions require reporting to the SEC.[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.[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

---

71. Walter W. Heller, *The Great Crash: Past and Present: Can There Be Another Crash?*, 30 CHALLENGE 6, 7 (1987).

72. *Id.* at 6.

73. *Id.* at 6–7.

74. *See* Fortune, *supra* note 67, at 25–27.

75. *See* Hardouvelis, *supra* note 60, at 736. *But see* CHARLES F. RECHLIN ET AL., 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).

76. *See* GARY SHORTER & EVA SU, CONG. RSCH. SERV., IF11825, FAMILY OFFICE REGULATION IN LIGHT OF THE ARCHEGOS FALLOUT 2 (May 10, 2021).

77. *See id.*

78. *See id.*

of stock, the investor must submit a Schedule 13D form to the SEC.[79] 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.[80] 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.[81] 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.[82]

A failure to file a Schedule 13D form can result in civil penalties and criminal action.[83]

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.[84] If an institutional investor has investment discretion over $100 million in "13(f) securities" (i.e., securities traded on a national exchange),[85] then the investor must file a Schedule 13F report.[86] 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

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.

80. 17 C.F.R. § 240.13d-101 (2008).

81. *See* SHORTER & SU, *supra* note 76.

82. 17 C.F.R. § 240.13d-101 (2008).

83. *Id.*

84. *See id.* § 240.13f-1 (2011).

85. *Id.* § 240.13f–1(c).

86. *Id.* § 240.13f–1(a).

securities markets."[87]

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.[88] 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.[89] However, Archegos utilized two devices to avoid these regulations, exposing major loopholes in the existing SEC regulations in the process.[90] These two devices are total return swap contracts and family offices.[91]

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.[92] 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.[93] Typically, the payer will have a large holding in an asset, such as a bond, which may have a fixed or variable interest rate.[94] Depending on the rates and the bond issuer's stability, bonds themselves can go up or down in value as they are

87. SHORTER & SU, *supra* note 76.
88. *See supra* Part II.
89. *See* 17 C.F.R. § 240.13d-1(a) (2010).
90. *See* Schatzker et al., *supra* note 1.
91. *See* Webb et al., *supra* note 17; SHORTER & SU, *supra* note 76.
92. *See* Bertaccini, *supra* note 34, at 274–77.
93. *See* Jongho Kim, *From Vanilla Swaps to Exotic Credit Derivatives: How to Approach the Interpretation of Credit Events*, 13 FORDHAM J. CORP. & FIN. L. 705, 732 (2008).
94. *See* Norman Menachem Feder, *Deconstructing Over-The-Counter Derivates*, 2002 COLUM. BUS. L. REV. 677, 702 (2002) ("A swap party obligated to make fixed rate payments is long or has bought the swap, and the counterparty required to pay the floating rate is short or has sold the swap." (emphasis omitted)).

bought and sold.[95] 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.[96] Further, if the asset appreciates, the receiver will be paid for the appreciation once the TRS contract expires or the asset is sold.[97] 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.[98]

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.[99] However, should the bonds tank, Fund F will be liable to Bank A for the shortfall.[100]

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

95. *See* John S. "Chip" Rainey & Patrick J. Beaton, *Managing Credit Risk in "Interesting" Times Through the Use of Credit Derivatives*, 120 BANKING L.J. 894, 906–07 (2003).

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 733; *see also* CSX Corp. v. Child.'s Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276, 279–80 (2d Cir. 2011) (discussing the payment structure for total return swaps).

98. 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).

99. *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).

100. *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.[101] Furthermore, payers can make large sums of money simply off of the fees generated under such arrangements.[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.[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.[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.[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

---

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

102. *See* Armstrong, *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.").

103. . Kim, *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 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.").

104. *See* Anita K. Krug, *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, *supra* note 98, at 12–14.

105. Janet Tavakoli, *Introduction to Total Return Swaps*, TAVAKOLI STRUCTURED FIN. LLC, https://www.tavakolistructuredfinance.com/trs/ (last visited Sept. 26, 2022).

> 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.*
109. *See* Schatzker et al., *supra* note 1.
110. *Family Office: A Small Entity Compliance Guide*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/rules/final/2011/ia-3220-secg.htm#P2_44 (Nov. 21, 2011).
111. *Id.*; James F. Koehler & P. Wesley Lambert, *Impact of the Dodd-Frank and Registration Acts of 2010 on Investment Advisers*, 13 DUQ. BUS. L.J. 29, 38 (2011).
112. Koehler & Lambert, *supra* note 111.
113. Robert Daily, *Deducting Family Office Investment Expenses After* Lender, 45 ACTEC L.J. 179, 211–12 (2020).

> 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.[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.[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.[116]

This rise, and in particular the meltdown of Archegos, has brought new scrutiny to the regulation of family offices.[117]

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.[118] Hwang formed Archegos as a family office by converting one

114. Family Offices, 75 Fed. Reg. 63753, 63755 (Oct. 18, 2010) (to be codified at 17 C.F.R. pt. 275).
115. SHORTER & SU, *supra* note 76.
116. *Id.*
117. *See* Mark Schoeff Jr., *Archegos Implosion Could Lead to Family-Office Regulation*, INV. 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").
118. *See* Press Release, U.S. Sec. & Exch. Comm'n, Hedge Fund Manager to Pay $44 Million for Illegal Trading in Chinese Bank Stocks (Dec. 12, 2012), sec.gov/news/press-release/2012-2012-264htm ("Hwang betrayed his duty of confidentiality by trading ahead of the private placements, and

of his previous hedge funds.[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.[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.[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.[122] Furthermore, as a family office, Archegos was not registered and did not file Schedule 13F forms to lend transparency to its holdings.[123] Archegos used TRS contracts to acquire margins as thin as 10%, far below what would be acceptable under Regulation T.[124] But Hwang was not content to simply enter into TRS

betrayed his fiduciary obligations when he defrauded his investors by collecting fees earned from his attempted manipulation scheme."); *see also* SHORTER & 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.*

119. *See* SHORTER & SU, *supra* note 76; *see also* Ollie A. Williams, *Archegos Sparks Family Office Feud Among Their Billionaire Owners*, FORBES (May 16, 2021, 5:47 AM), https://www.forbes.com/sites/oliverwilliams1/2021/05/16/archegos-sparks-family-office-feud-among-their-billionaire-owners/?sh=b622ccd48815 (noting that the family office was "essentially a private company [used] to manage his wealth").

120. *See* Glazer et al., *supra* note 7; *see also* Alexis Goldstein, *These Invisible Whales Could Sink the Economy*, N.Y. TIMES (May 18, 2021), https://www.nytimes.com/2021/05/18/opinion/archegos-bill-hwang-gary-gensler.html (noting that Archegos's rationale was that "Discovery and ViacomCBS were investing in streaming services, a booming sector").

121. *See* Schatzker et al., *supra* note 1.

122. *See* SHORTER & SU, *supra* note 76 ("These [TRS] instruments allowed Archegos to receive economic exposure to the relevant stocks without directly owning them, thus avoiding direct-ownership-based disclosure requirements.").

123. *See* Katherine Burton et al., *Archegos Founder Was Amassing Enormous Hidden Fortune When His Bets All Unraveled*, FORTUNE (Mar. 30, 2021, 12:59 AM), https://fortune.com/2021/03/30/archegos-founder-amassing-enormous-hidden-fortune-when-bets-unraveled/ ("Family offices that exclusively manage one fortune are generally exempt from registering as investment advisers with the U.S. Securities and Exchange Commission."); *see also* Goldstein, *supra* note 121 ("As a family fund, Archegos did not have to file reports with the S.E.C. detailing its positions. Even if it were a hedge fund, there is no requirement for reporting total return swaps on 13Fs."); Granville J. Martin, *Reporting Threshold for Institutional Investment Managers*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 14, 2020), https://corpgov.law.harvard.edu/2020/10/14/reporting-threshold-for-institutional-investment-managers/ (suggesting that an institution "could use total return swaps or similar instruments to avoid 13F reporting requirements").

124. *Margin Regulation: Overview of Margin Requirements*, FINRA, finra.org/rules-guidance/key-topics/margin-accounts#:~:text=Overview%20of%20Margin%20Requirements,-The%20terms%

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.[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.[126] Due to the fact that these transactions are not public, no bank was aware of the others' arrangements with Archegos.[127]

Despite the lack of transparency, Archegos seemed to be justified in its moves.[128] As of the fourth quarter of 2020, seven of the ten stocks Archegos held were up more than 30% on the year.[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.[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.[131] So long as the stock maintained its high levels, Archegos was safe;

20on&text=In%20general%2C%20under%20Federal%20Reserve,new%2C%20or%20initial%2C%20purchases. (last visited Sept. 26, 2022) (permitting, "under Federal Reserve Board Regulation T, firms [to] lend a customer up to 50[%] of the total purchase price of a margin security," but requiring "the customer's equity in the account . . . not fall below 25[%] of the current market value of the securities in the account").

125. *See Explained: Why Regulators Failed to Spot the Ticking Time Bomb at Archegos*, CNBCTV18 (Apr. 5, 2021, 6:25 AM), https://www.cnbctv18.com/market/stocks/explained-why-regulators-failed-to-spot-the-ticking-time-bomb-at-archegos-8806301.htm ("Archegos had total return swap arrangements with multiple investment banks for the same set of stocks.").

126. *See* Akane Otani, *Investors Embraced Big Risks in a Wild Quarter for Trading*, WALL ST. J., Apr. 1, 2021, at A1 ("[I]nvestors big and small showed no fear of risk-taking . . . . In fact, they embraced it.").

127. *See* Schatzker et al., *supra* note 1 ("And because lenders had details only of their own dealings with him, they, too, couldn't know he was piling on leverage in the same stocks via swaps with other banks. ViacomCBS Inc. is one example."); Armstrong, *supra* note 13 ("The lack of transparency means firms such as Archegos can enter into similar swaps with several lenders, which are not privy to the investor's overall exposure, magnifying the risk to hedge funds and banks if the positions backfire.").

128. *See* Schatzker et al., *supra* note 1 ("The fourth quarter of 2020 was a fruitful one for Hwang.").

129. *See id.*

130. *See* Glazer et al., *supra* note 7 ("As is standard practice, Archegos had handed over cash to Credit Suisse to secure its bets. With the stocks more than doubling since the start of the year, Archegos asked for some of that money back, and it was credited, according to people familiar with the matter.").

131. *See* Martens & Martens, *supra* note 11 ("The Times' report indicates that the $20 billion value held by Archegos in ViacomCBS shares occurred 'mid March.' Using an average price between March 15 and March 19 of $96, that would mean that Archegos owned 208,333,333 shares of ViacomCBS. . . . [This means] that Archegos owned a stunning 34[%] of the outstanding shares without anyone being the wiser.").

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.

Techedu.[134]

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.[135] 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.[136] Other investment banks which moved more quickly to sell their position—Goldman Sachs, Deutsche Bank AG, and Wells Fargo—escaped unscathed.[137]

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.[138] Leading up to the stock market crash of 1929, firms were trading with as little as 10% margin.[139] Similarly, Archegos was trading at highly leveraged levels approaching 10%.[140] The cascading sales of stocks

134. *Id.*

135. *See* Patrick & Webb, *supra* note 2.

136. *See id.*

137. *See* Schatzker et al., *supra* note 1 ("There's no question they moved faster to sell. It's also possible they had extended less leverage or demanded more margin."); *see also* Goldstein, *supra* note 121 ("Goldman Sachs . . . didn't wait for a plan to be finalized and jumped first."). There appears to be some discrepancy regarding whether Morgan Stanley escaped unscathed. *Compare* Schatzker et al., *supra* note 1, *with* Patrick & Webb, *supra* note 2. Bloomberg Businessweek reported on April 8, 2021 that it did, but the later reporting of the Wall Street Journal reported that it posted a loss of $911 million. *Compare* Schatzker et al., *supra* note 1, *with* Patrick & Webb, *supra* note 2.

138. *See Securities Law History*, CORNELL L. SCH., https://www.law.cornell.edu/wex/securities_law_history (last visited Sept. 26, 2022) ("In the period leading up to the stock market crash, companies issued stock and enthusiastically promoted the value of their company to induce investors to purchase those securities. Brokers in turn sold this stock to investors based on promises of large profits but with little disclosure of relevant information about the company. In many cases, the promises made by companies and brokers had little or no substantive basis, or were wholly fraudulent. With thousands of investors buying up stock in hopes of huge profits, the market was in a state of speculative frenzy that ended in October 1929, when the market crashed as panicky investors sold off their investments en masse.").

139. *See* Gary Richardson et al., *Stock Market Crash of 1929*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/stock-market-crash-of-1929 ("Purchasers put down a fraction of the price, typically 10 percent, and borrowed the rest.").

140. *See* Noah Manskar, *Bill Hwang at Center of Massive Margin Call and Billions of Losses*, N.Y. POST, https://nypost.com/2021/03/30/bill-hwang-of-archegos-at-center-of-massive-margin-call/ (Mar. 30, 2021, 6:28 PM) (identifying comparisons to the stock market crash, Elizabeth Warren tweeted, "Archegos' meltdown had all the makings of a dangerous situation—largely unregulated hedge fund, opaque derivatives, trading in private dark pools, high leverage, and a trader who wriggled out of the SEC's enforcement").

due to unmet margin calls was seen as contributing to the market crash and large losses by banks.[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.[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.[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.[144] Much of the criticism has been aimed at the unregistered nature of family offices.[145] However,

141. *See* Yun Li, *How Archegos' $20 Billion Move to Flee Certain Names Led to Banks' Share Prices Tumbling*, CNBC (Mar. 29, 2021, 3:21 PM), https://www.cnbc.com/2021/03/29/the-archegos-blowup-and-its-ripple-effect-across-markets.html ("The initial weakness in ViacomCBS triggered a chain of events where the prime brokers rushed to exit the positions on Archegos' behalf and resulted in a massive margin call. The hedge fund was forced to inject more cash to cover the losses, amassing a forced liquidation of more than $20 billion.").

142. *See* Armstrong, *supra* note 13 ("This is exactly the situation Archegos faced when several of its positions cratered, leaving the banks to sell off the hedges—the stocks—in a great rush. The situation was made more severe because Archegos had entered into swap agreements with multiple banks.").

143. *See* Erik Schatzker et al., *Leveraged Blowout: How Hwang's Archegos Blindsided Global Banks*, BLOOMBERG (Apr. 1, 2021, 12:46 PM), https://www.bloomberg.com/news/articles/2021-04-01/leveraged-blowout-how-hwang-s-archegos-blindsided-global-banks ("The SEC has already opened a preliminary investigation into Hwang's trades and is calling other big investors to inquire about their use of swaps and access to leverage from prime brokers. A regulatory shadow is creeping over the industry.").

144. *See, e.g.*, Rupert Neate & Kalyeena Makortoff, *Regulators Around the World Monitor Collapse of US Hedge Fund*, GUARDIAN (Mar. 29, 2021, 4:09 PM), https://www.theguardian.com/business/2021/mar/29/credit-suisse-nomura-archegos-sell-off-hedge-fund (noting that "[f]inancial regulators across the world [were] monitoring the collapse" of Archegos, and "[t]he investment banks Nomura and Credit Suisse . . . warned investors that they [were] facing huge losses from their exposure to Archegos"); Hayley McDowell, *The Collapse of Archegos Capital Management*, TRADE (July 16, 2021, 10:22 AM), https://www.thetradenews.com/the-collapse-of-archegos-capital-management/ (explaining how, in the wake of the Archegos collapse, "Morgan Stanley and other prime brokers involved have started to review their relationships with clients," and commenting that "[t]he multi-billion-dollar fiasco may prove to be a huge wake-up call for the entire industry").

145. *See* SHORTER & SU, *supra* note 76 ("Some observers propose to subject family offices to regulation as investment advisers . . . . Others argue for enhanced disclosure requirements for family offices . . . ."); Schoeff Jr., *supra* note 117 ("Securities regulators are investigating the Archegos situation, and it's also drawing attention from Capitol Hill. Sen. Sherrod Brown, D-Ohio and chairman of the Senate Banking Committee, on Thursday sent a letter to Credit Suisse Securities, Nomura Holding America, Goldman Sachs and Morgan Stanley asking the investment banks to explain their role in the Archegos meltdown."); Letter from Sen. Sherrod Brown, Chairman U.S. Senate Comm. on Banking,

TRS contracts had much more to do with the situation than the family office form.[146] Indeed, Warren Buffet has referred to TRS contracts as "financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal."[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.[148] Courts have frequently recast transactions that purport to be something else, such as a lease, to comport with the substance of the transaction.[149] A review of the various ways courts have recast transactions provides a path for doing the same with TRS contracts.[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.[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."[152] This "intended as security" doctrine is particularly relevant in the context of the leasing of goods or equipment.[153] In

---

Hous., and Urb. Affs., to Crystal Lalime, Gen. Couns., Credit Suisse Sec. (USA) LLC (Apr. 7, 2021) https://www.banking.senate.gov/imo/media/doc/brown_letter_to_credit_suisse_48.2021.pdf.

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.'").

147. Letter from Warren Buffet, Chairman Bd., Berkshire Hathaway Inc., to S'holders of Berkshire Hathaway Inc. (Feb. 21, 2003) https://www.berkshirehathaway.com/letters/2002pdf.pdf; *see also* Webb et al., *supra* note 17.

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).

149. *See* discussion *infra* Section IV.A.1.

150. *See* discussion *infra* Section IV.B.

151. U.C.C. § 9-109 (AM. L. INST. & UNIF. L. COMM'N 2010).

152. *Id.* § 9-109(a)(1).

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.[154] Depending on the type of transaction, the monthly lease rate may mirror what the good would actually sell for.[155] 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.[156]

To address such situation, the U.C.C. has developed a "bright-line" test under Section 1-203.[157] Section 1-203(b) provides a two-part test for determining whether a lease is in fact a disguised secured sale.[158] The first prong is that the term cannot be terminable by the lessee prior to the end of the lease term.[159] 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:

---

154. *Cf.* Conserv Equip. Leasing, LLC v. Green Parts Int'l, Inc., No. 19- 53617, 2004 WL 3713691, at *3 (Bankr. N.D. Ga. Aug. 6, 2019) (explaining how a lease of heavy equipment provided the lessee with the option to purchase at the end of lease).

155. *Cf.* Cardinal Grp., LLC v. McQuaig, No. 18-20259, 2019 WL 1470891, at *1 (Bankr. S.D. Ga. Mar. 28, 2019) (noting that the aggregate of the monthly lease payments would be "equal to the full price" of the leased property).

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 create[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 create[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 create[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.*

(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

160. *Id.*

161. *See id.*

162. *See id.* § 1-203(a) ("Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case."); Liberatore et al. (2021), *supra* note 156, at 1317 ("[The] holding [in *Huntington Tech. Fin., Inc. v. Neff*] makes clear that the bright-line test is only the starting point of the 'facts of each case' analysis to be applied when determining whether a transaction creates a lease or a security interest, and if not 'knocked out' by that test, a court will consider all of the pertinent facts and circumstances, including the economic realities of the transaction.").

163. *See, e.g.*, Liberatore et al. (2021), *supra* note 156, at 1315–19 (summarizing several 2020 cases applying the economic realities test).

164. U.C.C. § 1-203(c) (AM. L. INST. & UNIF. L. COMM'N 2010).

165. *See* Liberatore et al. (2021), *supra* note 156, at 1317 (noting that when a court applies the economic realities test, it will "consider all of the pertinent facts and circumstances").

166. *See* Edward K. Gross et al., *Leases*, 72 BUS. LAW. 1079, 1081 (2017).

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

---

167. *Id.*

168. *Id.*

169. *Id.* (quoting Edwin E. Huddleson, *TRAC Vehicle Leasing*, 33 J. EQUIP. LEASE FIN. 1, 3 (2015).

170. *In re* Double G Trucking of the Arklatex, 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 reversionary 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.

Id.; *see also Introduction—Lease Versus Security Interest—Application—Terminal Rent Adjustment Clause*, CORP. COUNS.'S GUIDE TO UNIF. COMM. CODE § 16:5.7 (2022) (summarizing the various treatments the issue has received by courts).

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.[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.[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.[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."[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.[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.[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.[180] Section 7701(h) in turn states that:

> For purposes of this title, in the case of a qualified motor vehicle operating agreement *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.[181]

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

174. *Id.* at 908–09.
175. *Id.* at 909.
176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.* at 908–09.
180. *Id.* at 909.
181. I.R.C. § 7701(h)(1) (emphasis added).

provision for determining whether a lease is a secured sale.[182] The court concluded that either under section 1-203(b) or (c), the transaction was a disguised sale.[183] 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."[184] 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.[185]

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.[186] 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.[187] Factoring involves buying accounts receivable at a discount—the discount represents the risk of nonpayment and collection efforts.[188] To demonstrate, assume Credit Card Company (CCC) wishes to raise capital quickly. Rather than wait to

182. *In re Brankle Brokerage & Leasing*, 394 B.R. at 909–10.

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. BJERRE, 8 HAWKLAND UCC SERIES § 9-109:7 (2022) ("Article 9 generally applies to sales of accounts, chattel paper, payment intangibles and promissory notes.").

187. *See* U.C.C. § 9-102(a)(2) (AM. L. INST. & UNIF. L. COMM'N 2010) (defining "account" as a right to payment of a monetary obligation, whether or not earned by performance).

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.[189] 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.[190] 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.[191] As the Hawkland treatise notes:

> 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.[192]

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 & BJERRE, *supra* note 186.

the case of *In re LTV Steel Co.*[193] 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.[194] 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.[195] 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.[196] The court granted the order.[197] 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.[198] 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.[199] The court held that "[t]his equitable interest is sufficient to support the entry of the interim cash collateral order."[200] 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.[201] As one commentator noted, "[t]his case sent shockwaves through the securitization industry."[202] 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.[203]

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.[204] In *CSX Corp. v. Children's Investment Fund*

193. 274 B.R. 278 (Bank. N.D. Ohio 2001).
194. *Id.* at 280.
195. *Id.* Presumably the money loaned went to LTV to pay for the accounts. *See id.*
196. *Id.* at 281.
197. *Id.*
198. *Id.* at 285.
199. *Id.* (emphasis added).
200. *Id.*
201. *See id.*
202. Stephen J. Lubben, *Beyond True Sales: Securitization and Chapter 11*, 1 N.Y.U. J.L. & BUS. 89, 90 n.7 (2004).
203. *See* WHITE & SUMMERS, *supra* note 189, at 49 (cautioning that such a recharacterization stands as "threatening precedent").
204. *See* CSX Corp. v. Child.'s Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276, 279 (2d Cir. 2011) ("The parties have endeavored to frame issues that would require decision as to the circumstances under which parties to cash-settled total-return equity swap agreements must comply with the disclosure

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).[205] 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.[206] 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.[207] 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).[208]

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.[209] Section 78m(d) provides that reporting requirements arise when a person acquires "beneficial ownership" in the shares of a company,[210] 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."[211] 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."[212] The district court declined to hold that the receivers (referred to as the long parties by the court)

provisions of section 13(d). Such issues would turn on the circumstances under which the long party to such swap agreements may have or be deemed to have beneficial ownership of shares purchased by the short party as a hedge."); S.E.C. v. Wyly, 117 F. Supp. 3d 381, 386 (S.D. N.Y. 2015) ("The Wylys contend that the evidence was insufficient to show that they were beneficial owners of offshore securities for the purposes of section 13.").

205. 654 F.3d at 278.
206. *Id.* at 281.
207. *Id.* at 278.
208. *Id.* at 281–82.
209. *Id.* at 282.
210. 15 U.S.C. § 78m(d)(1).
211. *Id.* § 78m(d)(3).
212. 17 C.F.R. § 240.13d-3(a) (1998).

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),[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.[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)."[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).[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.[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.[218]

> [T]he [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

213. *CSX Corp.*, 654 F.3d at 281–82.
214. 17 C.F.R. § 240.13d-3(b) (1998).
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)).
216. *Id.* at 283–84.
217. *Id.* at 284.
218. *Id.*

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.[228] Furthermore, much as in the TRAC leasing situations, the TRS receiver bears the risk of appreciation or depreciation of the underlying asset.[229] Thus, recasting appears to be the proper course under U.C.C. Section 9-109(a)(1).[230]

This approach has been suggested by others.[231] 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."[232] Indeed, it is reported that many banks themselves book TRS contracts as collateralized loans for accounting purposes.[233] It seems fair then that the SEC, under the above approach, needs to simply treat TRS contracts as what they are substantively—secured loans.[234] 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.[235] Though this approach would

owner under Rule 13d–3(b) because it had 'created and used the [swaps] with the purpose and effect of preventing the vesting of beneficial ownership in TCI as part of a plan or scheme to evade the reporting requirements of Section 13(d)'" (quoting CSX Corp. v. Child.'s Inv. Fund Mgmt. (UK) LLP, 562 F. Supp. 2d 511, 548–49 (S.D.N.Y. 2008))).

228. *See* Martens & Martens, *supra* note 11 (discussing how Archegos used TRS contracts to evade regulatory margin limits).

229. *See id.* (noting investment losses of the receivers of Archegos TRS contracts).

230. *See* U.C.C. § 9-109(a)(1) (AM. L. INST. & UNIF. L. COMM'N 2010) (noting that Article 9 applies to "a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract").

231. *See infra* text accompanying note 232.

232. Jon Macaskill, *Archegos Capital? Not Ringing Any Bells…*, EUROMONEY (May 14, 2021), https://www.euromoney.com/article/28j20nbuwgeph6b6s4pvk/capital-markets/archegos-capital-not-ringing-any-bells.

233. *See* Armstrong, *supra* note 13 ("Some banks treat equity total return swaps as collateralised [sic] loans for accounting purposes, according to Nick Dunbar of Risky Finance, a consultancy specialising [sic] in bank disclosures."). *But see* Jeffrey L. Rubinger, *Can a Total Return Equity Swap Avoid FIRPTA?*, 4 J. TAX'N FIN. PRODS., 23, 25 (2003) (noting that "practitioners generally agree that a long position in an equity swap" should not make the TRS receiver the owner for tax purposes, in part due to the lack of voting rights).

234. *See supra* Section IV.B.

235. *See* 17 CFR § 200.1(i) (1962) (providing remedies for non-compliance with the Article governing secured transactions, which would apply to TRS contracts if the SEC considers them secured transactions).

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.

240. *See In Pari Delicto*, CORNELL L. SCH., https://www.law.cornell.edu/wex/in_pari_delicto (last visited Oct. 12, 2022) (explaining that courts try to avoid awarding relief to plaintiffs with "unclean hands").

241. *See* HOWARD O. HUNTER, MODERN LAW OF CONTRACTS § 19:20 (2022); 8 WILLISTON ON CONTRACTS § 19:42 (4th ed. 2022).

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.[243] 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.[244]

> 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.[245]

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.[246] 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.

DICTIONARY (11th ed. 2019). "As customarily used these phrases are mutually exclusive. An offense malum prohibitum is not a wrong which is prohibited, but something which is wrong *only* in the sense that it is against the law." *Id.* (quoting ROLLIN M. PERKINS & RONALD N. BOYCE, CRIMINAL LAW 884–85 (Found. Press, 3d ed. 1982)).

243. 8 WILLISTON ON CONTRACTS, *supra* note 241, § 19:46.

244. *Id.* § 19:44.

245. *See id.* § 19:42.

246. *Id.* § 19:56.

> (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

247. RESTATEMENT (SECOND) OF CONTRACTS § 178 (AM. L. INST. 1981).

248. *Id.* § 179.

249. *See In Pari Delicto*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining the phrase as "equally at fault.").

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.[253] 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.[254] The investors brough 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."[255]

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.[256] The district court therefore concluded that the investors were *in pari delicto* with the defendants and barred from recovery.[257] 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."[258]

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."[259] 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."[260]

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."[261] 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.[262] "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.[263]

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.[264] The Supreme Court addressed this question just three years later in *Pinter v. Dahl*.[265] 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.[266] 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.[267] 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.[268] 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.[269] Pinter countered, among other things, that Dahl should be barred from recovery under the doctrine of *in pari delicto*.[270]

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,

271. *Id.* at 628–29.
272. *Id.* at 629.
273. *Id.* at 633.
274. *Id.* at 633–35 (emphasis added) (quoting Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985)).
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 *Pinter*, it would appear that the doctrine could also apply in the TRS context.[278] 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.[279] 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 *Bateman Eichler*.[280]

The Archegos situation presents a perfect fact pattern under which to examine how such a defense might play out.[281] As noted in Part III, a number of the banks that were involved ended up with large losses.[282] Assume that Archegos had remaining assets, and Credit Suisse sued to recoup its $5.5 billion loss. In court, Archegos could raise *in pari delicto* to avoid liability. Analyzing under the first prong of *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?[283] The answer would appear to be yes.[284] Archegos could not force a bank to enter into such a transaction.[285] 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.[286] 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?[287] The answer here appears to be no —indeed it could be argued that it would further the effective enforcement of the securities

*9 (S.D.N.Y. Apr. 8, 1998) ("[*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 *Bateman Eichler* 472 U.S. at 310–11)).

278. *See Pinter*, 486 U.S. at 633–34 (summarizing the broad proclamation of the applicability of the *in pari delicto* doctrine).

279. *See* U.C.C. § 1-203(b) (AM. L. INST. & UNIF. L. COMM'N 2010) (laying out test for finding a disguised secured transaction).

280. *See Bateman Eichler*, 472 U.S. at 306.

281. *See supra* Section III.B.

282. *See* Patrick & Webb*, supra* note 2 and accompanying text.

283. *See, e.g.*, Martens & Martens, *supra* note 11.

284. *See supra* notes 261–62 and accompanying text.

285. *See, e.g.*, Martens & Martens, *supra* note 11.

286. *See id.*

287. *See supra* notes 261, 263 and accompanying text.

laws.[288] 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.[289] 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.[290]

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."[291] 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.[292] Further, if the underlying assets are not otherwise subject to Regulation T, then there would be no opportunity to raise the defense.[293] But as the Archegos meltdown demonstrates, TRS contracts can also wreak havoc on markets and result in billions of dollars in losses.[294] When the TRS contract is used as a device to simply skirt existing securities regulations, application of *in pari delicto* should be available.[295]

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.[296] Not only did Archegos' activities cause $20 billion

288. *See* Martens & Martens, *supra* note 11.

289. *See* C. Edward Fletcher, III, *Sophisticated Investors Under the Federal Securities Laws*, 1988 DUKE L.J. 1081, 1106–08 (1988).

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.*

291. Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985).

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.[297] Archegos was able to amass massive positions in companies and margins that would not have been allowed under normal trading regulations.[298] It did so undetected thanks to the use of two devices: the family office form and total return swap contracts.[299] The first permitted Archegos to avoid registering with the SEC and avoid reporting its positions.[300] But it was the use of TRS contracts that really facilitated Archegos' activities.[301] 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.[302] 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.[303]

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.[304] But the role TRS contracts played in the fiasco should not be overlooked.[305] Archegos revealed a hole in existing reporting requirements that could be exploited by others.[306] While the Archegos incident fortunately remained contained to its holdings, the specter of systemic volatility has now been raised.[307] 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.[308] Article 9 of the U.C.C. governs

297. *See* Mark DeCambre, *'This Has to Be One of The Single Greatest Losses of Personal Wealth in History,' Says Stock-Market Pro of Archegos Margin Call*, MARKETWATCH (Apr. 3, 2021, 4:17 pm EST), https://www.marketwatch.com/story/this-has-to-be-one-of-the-single-greatest-losses-of-personal-wealth-in-history-says-stock-market-pro-of-archegos-margin-call-11617123343

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.[309] 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.[310]

Second, courts should treat such contracts as void as against public policy.[311] 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.[312] 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*.[313] This would further disincentivize banks from entering into such risky transactions in the furtherance of the goal of preventing market volatility.

309. MILLER & BJERRE, *supra* note 186, § 9-109:7.

310. *See* Schoeff Jr., *supra* note 117; 12 C.F.R. § 220.1(b); 15 U.S.C. § 78m(d); 17 C.F.R. § 240.13d-1 (2010).

311. *See supra* notes 244–251 and accompanying text.

312. Fletcher, III, *supra* note 289, at 1106–08.

313. *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310–11 (1985).