June 19, 2006

VIA FED EX

The Honorable José A. Cabranes
The Honorable Richard C. Wesley
The Honorable Thomas J. Meskill
Circuit Judges
United States Court Of Appeals
40 Foley Square
New York, NY 10007

Re: United States v. Rigas 05:3577-CR

Dear Members of the Panel:

We request leave to submit this letter in connection with the above-captioned appeal argued June 14, 2006. The letter responds to the question asked at oral argument by Judge Cabranes concerning the sources of GAAP that are described at pages 9-10 of the amicus brief submitted by the NACDL. It also responds to Judge Wesley's invitation to review his opinion for the New York Court of Appeals dealing with joint and several liability and guarantees. We also include two paragraphs at the end of this letter that respond to the contention made by the government in this appeal for the first time at oral argument that FASB-5 does not apply to this case.

1. **Sources of GAAP**. The description of the sources of GAAP in the amicus brief is taken from a policy statement issued by the SEC in 1973, shortly after the Financial Accounting Standards Board ("FASB") was created. Since then, GAAP has become more structured. The FASB has promulgated over 100 "statements" or standards on various accounting issues, using formal notice and comment procedures. These FASB standards are regarded by the SEC as authoritative and govern the preparation of financial statements by publicly traded companies. *See* cases cited in appellants reply brief at 14 n. 12. *See also, Facts About FASB* (www.fasb.org/facts). It is our understanding that, if a FASB standard is unclear on a particular point, the other sources referred to in the amicus brief may be consulted as guidance and are therefore considered part of GAAP.

Appellants believe that the great majority of securities fraud cases will *not* require expert accounting testimony because they will involve only issues that are within the knowledge of lay jurors – *e.g.*, reporting of inflated income numbers, omission of significant expenses, recording of fictitious transactions. Indeed, all of them are likely to be accompanied by deception of outside auditors. However, when this is not the case and where a securities fraud case turns on

an accounting issue outside the knowledge or experience of lay jurors, it is our position that an expert is required; and where the expert testimony reveals that there is a FASB rule on point, the government will have to prove that the rule was violated.

These principles should not alter current practice to any material extent. Indeed, we are unaware of any case to which they apply – other than this one – in which the government did not call an expert.

If the Court agrees that the government was required to call an expert to acquaint the jury with the applicable accounting rules, Appellants submit that a new trial on the securities fraud counts is required for the reasons set forth in our main brief at 43-44 and 61-67.[1]

2. **The New York Court of Appeals Decision.** We have had the opportunity to read *Chemical Bank v. Meltzer*, 93 N.Y. 2d 296 (1999), which we take to be the decision to which Judge Wesley referred us. In that case, in connection with debt relating to a development project, three parties had signed a guaranty stating that they were "'jointly and severally, absolutely, irrevocably and unconditionally' primary obligors." *Id.* at 302 (internal quotes omitted). The issue was whether one of the three, appellant Meltzer, was entitled to surety status on the ground that he was in reality a "secondary obligor." *Id.*

The court stated that it was the "substance" of the entire transaction rather than its "form" that governed. *Id.* It concluded that another of the guarantors – Major Building, a company in which Meltzer served as president – was in economic reality the "primary obligor," having benefited from the loan in question; and that Meltzer was a secondary obligor, notwithstanding the contrary language in the guaranty. *Id.* at 303. In reaching this conclusion, the Court relied on the Restatement [Third] of Suretyship and Guaranty § 1 ("the Restatement").[2] The issue in *Meltzer* was whether Meltzer was entitled to the rights of a surety, giving him various remedies against the primary obligor Major Building. Here, the issue is a different one: whether Adelphia's liability for the RFEs' portion of the co-borrowed debt is subject to the FASB-5 rule on loss contingencies. However, the *Meltzer* court's focus on substance rather than form, is significant.

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[1] The alleged co-borrowing frauds dwarfed all the other allegations in the indictment; the government claimed the co-borrowing frauds caused Adelphia's bankruptcy and justified sentences of 20 and 15 years in this case. Moreover, there is no way to know whether the jury found any of the less cental allegations of fraud to have been proven. Here, the government's case was *legally* insufficient on the co-borrowing frauds because the jury was never informed of the applicable rules and standards. There is therefore every reason to fear that the jury relied for its verdict on the erroneously tried co-borrowing frauds. See cases cited at p. 64 n.33 of Appellant's main brief. *See also United States v. Griffin*, 502 U.S. 46, 55 n.1 (1991) (distinguishing between "legal insufficiency" and "evidentiary insufficiency" respecting one of several fraud theories contained in a single count, and requiring a new trial in the former but not the latter situation).

[2] Section 1 of the Restatement is also relied upon by Appellants to show that Adelphia was a "secondary obligor" on the RFE share of the co-borrowed debt. *See* Appellants' brief at 10-12.

We submit that FASB-5 is applicable to this case for the reasons stated in appellants' main brief at 10-13. These reasons are reasons of substance, not form. The RFE co-borrowers had beneficial use of their share of the co-borrowed debt. and were responsible to pay it back. *Id.* at 10-12. Consequently, the RFEs were the primary obligors on this portion of the debt, and the Adelphia co-borrowers were secondary obligors. *See* Appellants' main brief at 10-12, citing and quoting the Restatement. The Adelphia co-borrowers' obligation to repay the RFE portion of the debt was therefore *contingent*: they would have to pay the RFEs' share of the debt only if the RFEs failed to pay their share of the debt when due. The evidence in the record on this point is uncontradicted and is cited at page 12-13 of Appellants' main brief.

FASB-5 is the rule that governs how companies are supposed to account for "*contingencies,*" including "loss contingencies." This includes contingent debt. Thus, FASB-5 gives "guarantees of indebtedness of others" as one "*example*" of what the rule covers. *See* A-521 at A-524-25. Obviously, FASB-5 also covers loss contingencies that are similar to or substantially the same as guaranties. Here, Adelphia's responsibility to pay for the RFEs' share of the co-borrowed debt is indistinguishable in substance from that of a "guarantor of payment." *See General Phoenix Corp. v. Cabot*, 300 N.Y. 887, 92; 89 N.E. 2d 238 (1949) (describing a guaranty of payment as an unconditional obligation to pay upon default). In either case, the bank could not collect the debt from Adelphia until it was due; and in either case, it could collect the debt immediately after it was due if the RFEs failed to pay.[3]

All of this, we submit, should properly have been the subject of expert accounting testimony.

We hope this letter is responsive.

Respectfully submitted,

John W. Nields, Jr.

cc: Richard D. Owens, Esquire

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[3] Indeed, it turns out that the loan agreements in this case make the co-borrowers "guarantors of payment," and *also* make them "joint and several" obligors. *See, e.g.,* GX 10004 (CCH loan agreement) § 6.1 at ACC 0001247 ("guaranty of payment"), and § 9.6 at ACC 0001258 ("joint and several" liability). The substantive obligations owed by the Adelphia co-borrowers under the guaranty provisions in the loan agreements are substantially the same as their obligations as joint and several obligors: *i.e.,* under either provision they must pay the loan if the RFEs fail to pay it when due. *See, e.g.,* Form of Guaranty, Exhibit C to CCH loan agreement ¶ 5 at ACC 0001397-93 (payment due on "default"); and CCH loan agreement, § 10.1 at ACC 0001265-56 (defining default as failure to pay any part of the principal debt when due). The other co-borrowing agreements are substantially to the same effect. *See* GX 10005 (OCH loan agreement) § 6.1 at ACC 0000488, § 9.6 at ACC 0000504, § 10.1 at ACC 0000515; GX 10003 (HHC loan agreement) §§ 4.10, 4.11 at ACC 0000060, § 8.1.1 at ACC 0000089.