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The Subprime Irony Bust for economy, boon for law practices

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For just about everyone else, the subprime mortgage meltdown and its economic repercussions are at the least a serious headache, but for lawyers it could signal a time to rev up the billable hour and contingent fee machines on an unprecedented scale.

The massive negative economic effect of the subprime industry's downfall are increasingly obvious, but the crisis could result in a boon for both corporate and plaintiffs attorneys.



Mark S. Olinsky

"It's hard to find something to compare it to," said Mark S. Olinsky, a partner with Sills Cummis & Gross in Newark, in assessing the financial scale and legal implications of the crisis.

"This is so much bigger than anything else."

Olinsky is not isolated in this assessment.

"As far as the scope and potential for litigation this is unprecedented," said Jeff Nielsen, a managing director with Navigant Consulting in Washington, D.C., and the primary author of a recent study looking at the issue.

While the report spotlighted a rising wave of litigation related to the subprime mess since mid-2007, many agree the real explosions could be yet to come.

According to Navigant, nearly 90 percent of the 278 subprime mortgage-related cases filed with federal courts in 2007 involved the expected mix of borrowers' class-action claims, securities fraud suits and lower-level contractual disputes between banks and loan consolidators.

However, Olinsky pointed out, the data does not account for two categories of litigation that could end up becoming the richest veins of legal work for firms here and nationwide.

First, there could be "an explosion of litigation if and when the big financial institutions start pointing fingers at each other," Olinsky said.

"That's where the big litigation is going to be."

The global financial players involved in all facets of structured finance or complex repackaging of thousands of risky debts into supposedly investmentgrade debt securities are still weighing their legal options, hesitant to be the first to sue their peers.

"There may be strong incentives to avoid litigation because all of these institutions have been on both sides of the coin," Olinsky said, noting most of the banks used the same methods to create and promote products to one another.

Zachary D. Rosenbaum, a partner in Lowenstein Sandler's capital markets litigation group, agrees the "large institutional Wall Street firms will be hesitant to sue one another."

However, he said "there are many funds and foreign institutional investors who are likely to be much more aggressive, and they have fewer concerns about this gun being pointed at them."

Given that industry-wide global losses are estimated between \$245 billion and \$500 billion, it is likely that some will overcome their aversion to litigation.

According to Rosenbaum, "There are enough institutional investors who feel they've been misled and lost such substantial sums of money that litigation is a serious option."

These investors have the "economic incentive to pursue viable claims because the legal fees will pale in comparison to their losses," he added.

It is in this niche that Rosenbaum, who works in Lowenstein's Roseland and New York offices, believes his firm and other similarly positioned firms could gain significant business.

Many of the larger Wall Street law firms "almost have institutional prohibitions on suing 'The Street'" because of their close and extensive dealings with the top investment banks.

"We are not so ingrained with them," Rosenbaum said of the largest banks, leaves the firm free to pursue actions on behalf of institutional investors.

Governments involved

The other sources of subprime legal business look to be the nascent regulatory and criminal investigations by state and federal authorities, Olinsky said.

That's good news at least for lawyers.

"Criminal and regulatory investigations are at a very early stage and it is likely that financial institutions and various individuals are going to need counsel" in multiple jurisdictions, Olinsky added.

In recent weeks and months, attorneys general from many states including California, New York, Ohio, Maryland and Maine — not yet New Jersey — have announced investigations of the industry.

Additionally, Nielsen, the Navigant Consulting executive, said the Securities and Exchange Commission has already

commenced three-dozen investigations, with another 14 announced by the FBI.

When asked if his firm would pursue this if Attorney General Anne M. Milgram were to look into subprime dealings of banks and other financial institutions, Olinsky was unequivocal.

"For sure!"

The same could be said of similarly positioned corporate firms looking to use their established client relationships with banks and other financial companies to become involved in these cases.

These investigations, in turn, could fuel further civil actions by plaintiffs and, of course, more work for corporate lawyers.

"As the regulatory investigations mature and facts come to life, that may serve as a trigger for additional litigation," Nielsen added.

Olinsky and others also pointed to another novel way in which governments have become involved in the issue. Cities, most notably Baltimore, have sued banks, accusing them of predatory lending that led to foreclosures and eventual damages to affected neighborhoods.

Growing tide

Of the 278 federal subprime cases detailed in the Navigant Consulting report, nearly two thirds occurred in the last six months

of the year, suggesting the wave of class action, shareholder and investor litigation has not yet reached its crest.

"I don't think we've seen the worst of this yet," agreed John P. "Sean" Coffey of plaintiffs firm Bernstein Litowitz Berger & Grossmann in Westfield and New York. "There's going to be a lot of work, our clients are very unhappy, and we're already very busy, as busy as we've been in years."

The report found that borrower class-action cases accounted for 43 percent of the total, with securities fraud and ERISA claims comprising 22 percent of the total.

The third most common actions were commercial contract disputes, mostly involving banks issuing the questionable loans and consolidators that purchased and repackaged them, also at 22 percent of all cases.

Coffey said his firm's dozen-lawyer-strong subprime litigation group is pursuing cases brought by investors large and small against financial institutions involved in all aspects of the complex process, alleging they knew about the shaky foundations of the market.

"The banks' excuses are 'everyone was caught by surprise' but that doesn't fly," Coffey said. He contends traders at such banks knew the securities were highly risky and accordingly traded them at deep discounts months before the markets crashed.