

Subprime Suits

The slow pace of litigation.

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As the American subprime mortgage crisis progresses, a litigation aftershock moves through U.S. courts. Though court filings lag behind the triggering subprime events, a wave of securities-related lawsuits reflects the magnitude of the current crisis. More than six hundred lawsuits have been filed through the second quarter of 2008, exceeding the total associated with the savings and loan crisis of the 1980s. In the civil cases filed to date, plaintiffs have employed various theories of liability, generally focusing on claims of fraud and inadequate disclosure and oversight. The litigation reflects the size of the subprime mortgage meltdown but only hints at the global nature of the crisis.

Many international economists, such as Martin Wolf of the *Financial Times*, trace the origins of the current crisis to foreign roots: the Asian financial crisis of the late 1990s. As affected governments sought to build large currency reserves to avoid borrowing again from the International Monetary Fund, many invested that money in the United States, giving a ready supply of cheap money that enabled the American housing bubble. When that bubble burst, foreign entities were injured alongside iconic American financial institutions.

The varied foreign players in the subprime crisis include sovereign wealth funds from nations such as Singapore, China, Abu Dhabi, and Kuwait, private multinational banks, including UBS and Credit Suisse, and individual investors. International investors lost billions alongside American investors when the subprime market crashed.

Wise foreign investors navigating the subprime crisis might take note of previous lessons learned. The Asian crisis precipitated a backlash against globalization and foreign investment. Certainly, the same reaction can be seen in debates over U.S. government bailout aid to foreign entities and nervousness over large stakes in American banks now held by sovereign wealth funds. Although the United States welcomed outside capital at the height of the crisis, a white knight in the throes of a desperate situation may be perceived as a villain once markets stabilize. Recent scrutiny of the lack of transparency of sovereign wealth funds has also fostered protectionist sentiments in the United States.

What does this mean for litigation? Foreign investors looking to recover their losses on securitized investments may face considerable challenges and uncertainties in the U.S. legal system. While subprime litigation largely mirrors the crisis driving it, it differs in one important way: its pace. Major events in the crisis such as sales and bankruptcies may take place over the course of weeks or even days, but the legal trail that follows will surely drag on for years. Surveys of in-house counsel published by the American Bar Association predict large increases in litigation involving subprime mortgages and investments. Only now are many of the suits filed in response to earlier subprime events beginning to reach the courts for resolution.

Additionally, a relatively thin body of precedent exists regarding many securitized lending issues to be litigated, due in part to recent events restricting the ability to recover in securities lawsuits. The Private Securities Litigation Reform Act, enacted in 1995, changed pleading standards to restrict securities class action lawsuits, and in January 2008, the U.S. Supreme Court disallowed lawsuits against secondary violators like credit rating agencies and mortgage consultants for fraud.

Foreign nationals have regarded the United States as a preferred venue for litigation because foreign courts were generally seen as more hostile to plaintiffs. As foreign subprime litigants try to follow Americans into court, they may change this view. U.S. courts are currently split on allowing foreign nationals to serve as class action representatives or even to participate at all. Sovereign wealth funds, long attacked for their lack of transparency and alleged political motivations, usually seek to keep low profiles, which may make them reluctant to pursue any remedies in court despite large losses. Foreign banks are active in U.S. litigation, both having sued and been sued in U.S. courts, but it is too early to tell how they will fare. Depending on how responsive foreign plaintiffs find U.S. courts, foreign courts may soon join the subprime mortgage meltdown fray as well.

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