

Subprime Suits on the Rise

NEWS

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Lawyers USA - The quiet times are over for securities litigators.

The subprime mortgage meltdown has spurred a record number of investor class actions and other litigation, and attorneys and researchers say this is just the tip of the iceberg.

"I think we are just seeing the beginning of the wave of subprime suits," said J. Boyd Page, a senior partner at the Atlanta firm Page Perry, which represents investors.

Lawsuits by investors hit by the drop in valuation of mortgage-backed securities are filling court dockets, many seeking class action status and aimed at nearly every player in the mortgage and securities arenas: mortgage lenders, investment firms, loan specialists and even bond rating agencies.

Powerhouse companies like Merrill Lynch, Citigroup and Washington Mutual are facing lawsuits from investors who say the companies failed to disclose the risky nature of the subprime loans backing their stocks. Wall Street firms that repackage and sell mortgage-backed investments are facing securities claims. Bond rating companies like Moody's, Standard & Poor's and Fitch Ratings are facing litigants who say the companies gave high ratings to bonds even though they were backed by high-risk mortgages, resulting in valuations falling by more than 50 cents on the dollar in many cases.

The flurry of suits comes in what would have otherwise been a slow time for securities litigation.

The number of securities fraud class actions rose by 43 percent overall from 2006 to 2007, according to a recent study released by Stanford Law School and Cornerstone Research. Most of that increase came in the second half of 2007, after the subprime mortgage crisis unfolded. But for those cases, the study said, 2007 would have been a slow year for securities class action litigation.

"When litigation related to the subprime crisis is excluded from the calculation ... the resulting core litigation rate remains well below historical norms," said Joseph Grundfest, director of the Stanford Law School Securities Class Action Clearinghouse.

Another study released in February by Navigant Consulting shows that subprime-related litigation in federal court has outpaced activity in the 1990s in

the wake of the savings and loan collapses. The 278 cases filed in 2007 alone are nearly half the amount filed over the course of the 1990s, the study found.

What's more, about 43 percent of the subprime litigation last year involved investor class actions.

But unlike the 1990s' savings and loan suits and the fraud complaints in the wake of the fall of Enron, WorldCom and other companies a few years ago - where defendants were eager to settle quickly - subprime defendants are aggressively defending these new claims.

"The initial reaction has resulted in a low settlement rate," said Brian Meenaghan, a Seattle securities class action defense attorney at the firm Lane Powell.

"It's yet to be seen [how] these cases will be defended long term, but certainly what we are seeing in these initial lawsuits is different when we are used to seeing in securities litigation in the last several years," he added.

Uncharted territory

One reason defense attorneys are slow to pull the settlement trigger is the legal uncertainty regarding investor lawsuits. Because these claims involve complex and multi-layered causes of action and present open questions as to the duties owed investors, defendants are looking for guidance before making settlement offers, Meenaghan said.

"I think [defendants] are waiting for the courts to give some sort of preliminary indication as to how viable these claims are," he said.

The U.S. Supreme Court's recent decision in *Stoneridge Investment Partners v. Scientific-Atlanta*, No. 06-43, suggests the road ahead will be tough for plaintiffs.

In that case, the Court held that investors must show reliance in order to bring a securities action against third-party actors, even if those actors took part in a fraudulent scheme to boost stock valuations.

"These are not easy cases," Page said.

But he suggested that cases where there is evidence that investment firms, brokers and other players held out stocks backed by high-risk mortgages as having a "Triple A" rating are more than viable. "Given the size and nature of what has been going on the subprime market, I think there is some real dynamite there. "

Given the unsettled state of the law, many plaintiffs are trying to proceed with alternative legal theories.

While some suits involve standard securities claims of misrepresentation and fraud in the inducement, others rely on more unusual bases.

For example, "a lot of claims that are brought by pension plans are based on violations of ERISA," Page said.

He said he isn't concerned by the low number of settlements offers, noting that the Securities and Exchange Commission has teamed up with the Federal Bureau of Investigation to investigate more than three dozen subprime cases.

This shows the system has failed investors, asserted Page.

"I've been looking into this for 18 months now, and the more I get into [the details] of some of these deals, the more I know I would be more than happy to present these cases to a jury or an arbitration panel and take my chances," he said.