

Business Insurance

Subprime rulings favor defendants

Several securities suits over credit-crisis losses don't pass early tests

By Zack Phillips

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Defendants seem to be faring better than usual in subprime and credit crisis-related litigation, although many cases are pending, legal observers say.

In late March, judges dismissed at least five credit crisis-related lawsuits against financial services firms, and 13 lawsuits were dismissed in the first quarter this year, according to New York-based Advisen Ltd.

Recent dismissals include subprime securities suits against BankUnited Financial Corp. and Fremont General Corp.; a derivative suit against directors and officers at American International Group Inc.; an auction rate securities suit against Merrill Lynch & Co.; and a securities class action against Security Capital Assurance Ltd., XL Capital Ltd., and some directors and officers.

Legal observers caution that the cases are fact-specific and it is too early to say how the overall litigation will unfold. So far, 62 of 348 credit crisis-related securities cases have been dismissed, according to Advisen.

Still, the observers say the recent dismissals may indicate that the courts will view many plaintiff claims with skepticism. They also say the global nature of the financial crisis

and recession makes it more difficult for plaintiffs to prove that losses were the result of fraud or mismanagement.

“It appears that plaintiffs are having some significant causation issues because, as is obvious to all, there was a very large, negative macroeconomic event,” said Joseph A. Grundfest, director of the Stanford Law School Securities Class Action Clearinghouse. “The question therefore arises as to whether the losses suffered in any one of these institutions were attributable to fraud or to the natural consequences of that large macroeconomic event.”

To survive a motion to dismiss, plaintiffs must make allegations convincing enough that a reasonable person would be as likely to infer that the defendants intended to commit fraud as to infer that they acted innocently, said Kevin LaCroix, a Beachwood, Ohio-based partner with executive liability intermediary OakBridge Insurance Services L.L.C.

Mr. LaCroix, who has blogged extensively about subprime and credit crisis litigation, said he thinks it is probably too early to draw firm conclusions about how the courts will rule in these cases. But he also said

defendants have fared better than plaintiffs in cases decided so far.

“Most judges are starting from the point of view that reflects an awareness of the global economic crisis,” Mr. LaCroix said. “There were financial losses across the economy and that doesn't necessarily mean there was fraud; and that has been important in many of these decisions.”

Mr. LaCroix said about 65% of dismissal motions in subprime suits have been granted compared with a historical average of 33% to 40% for securities litigation.

Richard A. Roth, partner and founder of the New York-based **Roth Law Firm P.L.L.C.**, said the spate of litigation is reminiscent of suits filed after the technology stock bubble burst in the early 2000s. Initially, judges and arbitration panels were sympathetic to plaintiffs, but they became more skeptical as they saw more cases, he said.

“Judges and arbitrators became numb to everyone losing money,” **Mr. Roth** said. “We're not that far into the future and the same judges and arbitration panels who saw people lose money in 2000, 2001 are seeing more of the same.”

“It's very hard (for plaintiffs' suits), in light of the market crash, without some

extenuating circumstances,” to survive a motion to dismiss, he added.

When plaintiffs are able to show a difference between what a company said publicly and privately, they have been more successful in surviving motions to dismiss, Mr. LaCroix said. Plaintiffs also have been more successful when there is evidence of insider trading or third-party investigations have disclosed seemingly damning facts, he said.

Such suits that do survive a motion to dismiss are highly likely to be settled, and few ever go to trial, Mr. LaCroix said.

Several high-profile cases have survived recent dismissal motions and several others have settled, Mr. LaCroix said.

According to Advisen, 32 subprime and credit crisis-related securities suits have settled, including settlements of more than \$400 million in suits against Merrill Lynch & Co. and Credit Suisse Group A.G.

“It all depends on the facts of the case,” said Thomas D. Graber, a Dallas-based attorney at McGlinchey Stafford P.L.L.C. “You need to have actual misrepresentations” for plaintiffs to survive a motion to dismiss a securities class action lawsuit.

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