Credit Crunch – The Impending Litigation Wave

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CREDIT CRUNCH – THE IMPENDING LITIGATION WAVE

When a client hears from a corporate or financial services partner the words "You need to talk to a litigation partner", shivers usually are sent up their spines. For a long number of years that sense of unease was caused by the client getting involved in a process which they felt was foreign to them, took up too much time, was governed by, in their mind, arcane rules and was financially onerous. It was perceived to be a rollercoaster ride that one could not get off until the end.

The ten years up until August 2007 witnessed unprecedented economic growth and accumulation of wealth in Ireland. This growth has brought an increased confidence in Irish business and financial institutions. The curve was forever upwards. In that period, the need to call on litigation partners in law firms lessened. Entrepreneurs were too busy moving on to the next deal and profit to worry about breaches of agreements and disputes. These problems were bought off. To stand and fight only stalled the process to doubling and trebling your money. It was always onwards and upwards.

Then suddenly the markets wobbled. Market turmoil in August 2007 led to changes in funding terms and costs. People began to talk of lack of liquidity, subprime contamination, rating reviews for lenders, banks not lending to each other and, suddenly, we had the "credit crunch". Allied to this slowing in economic growth and higher inflation, both domestically and internationally, has led to a less optimistic view of the future. Now everyone is scrutinising their contracts, their financial instruments and their business relationships. So could the litigators be back?

There is no doubt that litigation is the great countercyclical discipline in law firms. History has shown that where large loses are suffered, litigation usually follows. In boom times no one wants so sue but in poorer times litigation not just becomes an option but perhaps an essential. We have already seen the effects of the "credit crunch" in the Courts. Last August *Structured Credit Corporation* went into examinership with substantial debts incurred in a very short time space and caused by market volatility. In February of this year *International Securities Trading Corporation* was the victim of similar market difficulties and subsequently went into examinership. Whilst no litigation as such has arisen out of these two examinerships yet, they did keep litigators and insolvency practitioners busy. There certainly weren't enough seats in the High Court to accommodate every lawyer, and roll calls by judges were not unusual. Unfortunately the downturn in the economy will lead to more similar situations and not just in the burgeoning financial sector.

Indeed, the number of cases currently being processed through the Commercial Court is indicative of the current state of the market. Recent figures released by the Courts Services show that in 2004 when the Commercial Court was set up 45 cases were entered into the Commercial Court List. This rose to 106 cases in 2005, 113 in 2006 and 196 cases in 2007. The Commercial Court has been an innovation ensuring a speedy and well managed forum for dealing with disputes. Anecdotal evidence from litigation practitioners indicates increased activity which inevitably will manifest itself in an even busier Commercial Court over the coming months and years. So where are the areas for potential?

Valuations in funds will always be an area of concern and a potential target for disgruntled investors. From experience, a significant volume of litigation revolves around valuations. As alternative investments funds, hedge funds and other derivative based trading techniques have become increasingly popular, so to has the complexity and risk profile of assets. The more complex the financial structure the greater potential for lack of transparency masking riskier assets.

The growth of the financial services industry and regulatory requirements for Irish resident directors, has lead to an industry in directorships. The increasing regulation of companies has brought into sharp focus the importance of the duties and responsibilities owed by directors to their company and in essence places even more burdens on directors to carry out their duties to the highest possible standards. If losses occur investors and their advisers will seek to ascertain how the interests of shareholders could have been protected more securely. Valuations, supervision of delegates and risk management are areas for potential litigation for directors. Liquidators and Receivers will certainly scrutinise director performance. This leaves directors vulnerable. Directors can be held personally liable and no doubt will ultimately the subject of claims for contribution as defendants seek to spread the pain.

The increasing number and readiness of activist shareholders has resulted in significantly greater investor scrutiny. No longer are these activists merely rogue shareholders with small share holdings turning up once a year at the annual general meeting to embarrass the board about some trifling issue. They are now composed groups of institutional shareholders banding together. Groups of this nature have already been active in class actions suits in the United States of America and Europe. Indeed, the case against Royal Dutch Shell in Holland is illustrative of this trend in Europe. Activist shareholders may target the decisions made relating to mergers and acquisitions in particular. In a buoyant market certain views may have been taken to get the deal done. In a stagnant market when deals look less attractive, questions will be asked by powerful investors. Joint ventures are always a boon

for litigation as the joint venture partners begin to realise that they were never really a good fit in any event.

Of course the professional advisers are always prey to attack in a turning market. Allegations of poor advice, failure to explain risks and conflict of interest will be the crux of such investor driven litigation. Some of these claims will be unfounded and usually arise out of a professional adviser's decision to sue for outstanding fees. However there may be situations where a client will have a legitimate cause for complaint. Professional advisers, with personal liability and insurance backing, are always a mark for damages and an easy target for litigation.

One final issue from a litigation stand point is worth considering. The financial landscape in Dublin has changed immeasurably in the past fifteen years with the arrival of all the major global financial players used to the hurly burly of other more litigious jurisdictions, especially the United States. Dublin is no longer the home of a few domestic financial heavyweights. In recent good times relationships have not been really tested. The arrival of less certain times in terms of economic growth may put strains on business relations and it is difficult to predict how the various parties will react. A hedge fund manager sitting in his office in New York who has lost a considerable sum of money will not care about cosy business relationships that have gone on for years. He will want someone to blame, and sue if he has a case.

In London at the moment law firms gearing up for litigation arising from their "credit crunch" are marketing themselves as being prepared to act against the major banks. Needless to say these firms would not act for those banks in normal course but they are substantial legal outfits. The banks are concerned about this development and are now considering allowing law firms, who would be normal ports of call for their banking work, to act against them in litigation. In other words waiving conflict of interest issues on the basis of the devil you know.

So like death and taxes another certainty can be added. When a credit crunch arrives litigation increases. So when you hear the words mentioned in the first few lines of this article, you may be getting back on that rollercoaster.

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