COMING HOME TO ROOST?

Law firms have evaded blame from companies harmed during the financial crisis. But that may be changing.

THE GAME OF WHO'S TO blame for the complex financial instruments that helped create the global financial crisis has been under way for just over four years now. Banks, regulators, rating agencies, and individuals have all taken their turns on the hot seat. Law firms, on the other hand, have largely escaped scrutiny.

But that could be changing. During the last week of January, two law firms found themselves on the receiving end of complaints over their involvement in financial transactions that unraveled during the recession. On January 25 Orrick, Herrington & Sutcliffe was slapped with a malpratice suit by a Dallas-based investment company over losses from a collapsed loan deal. And five days later Greenberg Traurig was sued by an investor in a now-bankrupt private mortgage broker and real estate loan provider.

In the Orrick lawsuit, which was filed in Texas state court, Highland Financial Partners and its affiliates allege that the firm acted negligently in a 2008 multimillion-dollar collateralized debt obligation (CDO) transaction between Highland and The Royal Bank of Scotland. (Full disclosure: RBS is an investor in the parent company of *The American Lawyer*.) Highland had hired Orrick to review two amendments that were supposed to extend the deadline to close the CDO transaction. Highland alleges in its complaint that Orrick failed to tell the company about a provision of the deal that allowed RBS to cancel the agreement at any time. Highland claims that it had paid nearly $65 million to extend the negotiations of the deal, but RBS terminated the agreement in October 2008. Orrick denies any wrongdoing.

Greenberg Traurig is being sued for fraud and breach of fiduciary duty in California state court in a class action suit brought by David Nolan, who, along with other investors, lost a collective $700 million through now-defunct mortgage broker RE Loans, LLC. The complaint alleges that Greenberg Traurig helped secure a loan from codefendant Wells Fargo Capital Finance that would hide RE Loans's losses from a portfolio of loans that fell into default and foreclosure, even though the firm knew that RE Loans's agreement with its investors barred the broker from taking on third-party debt. Nolan further alleges that the defendants advanced the alleged cover-up by forming a new investment vehicle that was used to solicit new capital from existing investors to conceal the broker's cash flow problems. Greenberg Traurig says it "acted properly and in no way wrongfully."

While it's too soon for the Orrick and Greenberg Traurig suits to have gained traction, the suits are not without precedent. In New York state court, Nomura Asset Capital Corporation, a Japanese securities company, has been waging a five-year malpractice battle against Cadwalader, Wickersham & Taft. Nomura sued Cadwalader in 2006, accusing the firm of botching a 1997 assignment to advise Nomura on the origination and securitization of 156 commercial loans in a fund worth $1.8 billion. (Cadwalader signed a tolling agreement that prolonged the statute of limitations.) The most significant claims stem from a $50 million loan made to a hospital that fell into default in 2000. Cadwalader, acting as Nomura's counsel, had asserted in documents that this loan qualified for special tax treatment as a Real Estate Mortgage Investment Conduit (REMIC). Nomura later discovered that the loan didn't meet the REMIC requirements. When the hospital defaulted, the fund trustee sued Nomura over the loan's REMIC qualification. After settling with the trustee, Nomura then sued to recover the money from Cadwalader. The suit has survived a motion to dismiss and a motion for summary judgment filed by Cadwalader's counsel at Cravath, Swaine & Moore.

In the end, however, it may turn out that the plaintiffs in these suits have little legal ground to stand on. While the laws governing securities fraud can vary from state to state, it's tough to hold law firms liable for soured financial products and transactions because firms base their opinions on facts they receive from their clients, says Jonathan Macey, a corporate and securities law professor at Yale Law School. "If the facts on a document are wrong, that's the client's fault," Macey says. "What has to be shown is that the law firm is doing more than just papering the transaction. It has to be directly involved in piecing the deal together." —CLAIRE ZILLMAN

CITATIONS

"One is a practicing polygamist, and he's not even the Mormon."
—Retired U.S. Supreme Court justice **SANDRA DAY O'CONNOR** joking about the difference between Republican presidential candidates Mitt Romney and Newt Gingrich in a speech at the Alfalfa Club. *Above The Law*, February 3.

"Abandoned by counsel, Maples was left unrepresented at a critical time for his postconviction petition . . . no just system would lay the default at Maples's death-cell door."
—**JUSTICE RUTH GINSBURG**, in a Supreme Court ruling about a death row inmate who had been represented by lawyers from Sullivan & Cromwell. *The National Law Journal*, January 18.

"Picture a law written by James Joyce and edited by e.e. cummings. Such is the Medicare statute, which has been described as 'among the most completely impenetrable texts within human experience.'"
—A memorandum opinion, issued by the U.S. district court for the District of Columbia in *Catholic Health Initiatives v. Kathleen Sebelius*, January 30.