

Profile

Subprime crisis stirring up new wave of litigation, says Kirkland's Lefkowitz

Jay Lefkowitz is used to pressure. Which is just as well. His 20-year career has spanned two spells in the White House, advising the first President Bush and then the second. One of Lefkowitz's many current roles is acting as President George W Bush's special envoy for human rights to North Korea.

Now Lefkowitz is back at international law firm Kirkland & Ellis, where he worked for most of the 1990s, and the US subprime mortgage crisis is creating a rise in litigation opportunities for him and his colleagues. As a partner in the New York office and a member of the Worldwide Management Committee, Lefkowitz is right in the middle of the storm. Here he gives his views on recent developments in litigation and the way US regulators are going about their work.



Jay Lefkowitz, Kirkland & Ellis

The banks, originators and intermediaries that Kirkland represents are being besieged by all sorts of different law suits prompted by the subprime meltdown and the ensuing credit crunch.

"A lot of this litigation has no merit, but I think we will see a lot of it," says Jay Lefkowitz. "Many plaintiffs's lawyers see the subprime crisis as an opportunity for litigation."

"Everyone is gearing up...banks, lawyers and others" he adds. "However, it's still early in the litigation cycle."

"This is just getting started," he says. "And there is no end to the type of claims that can be brought."

Just in the last month, the US city of Cleveland launched legal action against a variety of originators, banks and institutions. It alleged that the defendants had either originated, funded or purchased mortgages when they knew, or should have known, that these home loans were going to go into foreclosure.

The effects of the subprime meltdown have hit some residential areas particularly hard. Whole neighbourhoods have been boarded up after home owners failed to keep up with their mortgage payments. The point of Cleveland's suit is that it claims it has been unfairly blighted by subprime foreclosures, and the institutions involved are culpable.

Lefkowitz calls suits such as this one baseless: "The banks would

have been criticised for refusing to make the loans in the first place, and now they are being attacked for having made them," he says. "Still, I think we will see a lot of cities, even states, suing financial institutions, and dreaming up all sorts of causes of action."

As one of the US's leading defence practices for such institutions, Kirkland & Ellis is at the centre of the defence against this wave. The litigation practice accounts for roughly a half of the firm's entire fee income, and has over 300 partners. Kirkland has a tough-nosed reputation for taking cases to court, a reputation which Lefkowitz is happy to confirm.

"In the last 18 months we took 30 cases to trial," he says. But this is not a cavalier approach, he adds, or going to court for the sake of it. "We never forget that our clients are business people, who view litigation as a means to an end."

In a recent decision, for instance, Kirkland's client UBS Warburg and ten other Wall Street financial institutions won a motion to dismiss a class-action alleging they had tried to inflate fees charged to short sellers (Electronic Trading Group v. UBS Warburg).

This particular case was not prompted by the subprime crisis, but Kirkland's role in getting it dismissed by the Southern District of New York court gives the firm justified pride in its success.

As does the fact that American Lawyer magazine has just named Kirkland 'Litigation Firm of the Year'.

After all, as Lefkowitz observes, "it's not as if the US is short of good litigation firms."

Profile

The West Wing

Lefkowitz, 45, started his legal career in the late 1980s with the New York law firm Paul, Weiss. He left after three years to work at the White House, advising the first President Bush on domestic policy.

“Working in the West Wing was as intense as the TV series of that name suggests”

His working day started at 6.45 in the morning and continued to well after 9.00 at night. He admits: “I don’t sleep as much as I should.”

One of Lefkowitz’s colleagues goes further: “He doesn’t sleep. I get e-mails from him all the time.”

Lefkowitz went back into private practice after the 1993 election, and spent the next eight years with Kirkland & Ellis in Washington, much of it in securities litigation, and made partner.

From 2001-2003, he left Kirkland to serve in the White House as deputy assistant to President Bush for domestic policy and as general counsel in the Office of Management and Budget.

Lefkowitz provided input on reforming laws in response to the Enron-era mega frauds. This included helping to set up a Corporate Fraud Task Force, as well as working with Congress when it wrote the Sarbanes-Oxley legislation.

Lefkowitz then returned to New York and Kirkland & Ellis.

His present workload includes defending investment banks against securities class-action lawsuits, helping companies and audit committees with internal investigations and advising corporations and hedge funds on dealing with the SEC.

He has also brought several lawsuits against various federal agencies since leaving the government, most of which have been litigated in the federal courts in Washington, DC.

Recently Lefkowitz has been involved in the largest criminal tax fraud prosecution in US history.

The US authorities took action against 19 individuals, mostly former employees of KPMG, accusing them of setting up and marketing sham tax shelters.

He is defending an individual investment manager, David Amir Makov, who was charged alongside the other co-defendants with conspiracy to evade taxes and defraud the Internal Revenue Service (IRS) through allegedly abusive tax shelters (United States of America vs Jeffrey Stein, et al.).

The IRS claims it lost out on a total of US\$11 billion in taxes.

Is the US now over-regulated?

Many US business people believe that regulation has gone too far in response to the Enron-era mega-frauds. The combination of Sarbanes-Oxley and more aggressive enforcement by the SEC and DOJ has increased the cost of doing business in the US and has driven much of it abroad, goes the argument.

Having served at the centre of political power when the new Sarbanes-Oxley framework was being developed, and now as a defender of corporations, Lefkowitz can see the argument from both sides.

He comments: “Generals are always fighting the last war. You tend to have an action, and then an over-reaction.”

“Sarbanes-Oxley was necessary. But parts of it were an over-reaction by Congress,”

You need strong markets, he adds, and you need regulation to be predictable and certain. Whilst he says he has heard from some clients that they have considered taking their businesses private in order to avoid this new regulatory burden, or even abroad, he thinks concerns about this have been over-stated.

As far as regulation goes, he says; “I believe we are in a period of consolidation, although with a change in the White House less than a year away, there are no guarantees.”

The future of regulation

US regulators face many other challenges as well as deciding if they are being too harsh. For instance, should they pursue individuals or corporations? Quite often you can only answer this question in hindsight, several years later, says Lefkowitz. The challenge becomes even more complicated if new stakeholders have taken ownership of the enterprise. Should they be pursued for the sins of the former owners? In what way are they culpable?

While this area is hotly debated, another seems to be set in stone; the rapidly increasing use of the Foreign Corrupt Practices Act (FCPA) against both US and non-US businesses.

Companies like BAE in the UK are currently on the end of FCPA investigations (see page 8-9). “The US is flexing its muscles in this area,” says Lefkowitz.

FCPA work is growing very rapidly and he expects to see more of that growth over the next several years.

Internal investigations

Another recent boom area in the US is the growth of internal investigations. Lefkowitz, who has represented a number of boards, reckons that almost every public company which has a significant securities issue has launched an internal investigation of some kind.

Many more businesses are now pre-empting the regulators and launching their own investigations before even an informal approach by the SEC, for example.

Such investigations have advantages for both the companies concerned and the regulators. The companies get to choose which lawyers and forensic accountants will do the work. They can also drive the process forward so that the business can acquire a clean bill of health as quickly as possible.

And the regulators save huge amounts of money. Companies can put in a lot more resources and staff than the SEC could, says Lefkowitz. Also, the Commission has a comfort level that when some of the top law firms are involved, the activities of the companies will be put under a microscope.

Moreover, Lefkowitz points out, “the regulators often oversee the internal investigation process by getting regular briefings from the lawyers and accountants.”

“It’s not as if these investigations are completed in a vacuum.”

The credit crunch

The subprime-induced credit crunch seems to be spreading out of the financial sector and into the rest of the US economy, threatening recession. Lefkowitz observes that nobody has any sure idea where this credit crunch will lead, but that economic downturns like this are followed by a wave of litigation “as surely as night follows day.”

There have already been law suits against bond issuers and banks. There have been complaints about regulatory statements, claims that CDOs were impaired.

“There is no end to the type of claims that can be brought,” he says.

Plaintiffs might point to underwriting standards, controls, whether appraisals were done properly, whether reserves were set properly against loans, write-off policies and capital deficiencies.

“There will be a lot of plaintiffs,” says Lefkowitz. “But there will be a lot of strong defences.”

And there is where he comes in.