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Awaiting the ABCP blame game

U.S. lawsuit that predates the current credit crunch has some firms justifiably on edge

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A lawsuit wending its way through a New York court is making some law firms twitchy, and it's not difficult to see why. **Nomura Asset Capital Corp.**, the U.S. division of Japan's largest securities firm, is suing its New York lawyers in connection with a securitization turned sour.

Sound familiar? Securitizations, or deals where assets are lumped together and used as the basis for issuing commercial paper, are turning sour all over the place these days. And where investments turn sour, lawsuits aren't far behind.

In Canada, with the rescue plan to save the Canadian asset-backed commercial paper market hanging in the balance, it will be months before the extent of any Canadian losses are known. But commercial paper holders have lined up plaintiffs' counsel - so speculation in the legal community is not so much whether there will be lawsuits but how far the blame will extend. The Nomura suit suggests that if it hits the banks and dealers, it could also hit law firms that papered deals.

The 10-year-old Nomura transaction is unrelated to the recent meltdown, but the lawsuit is playing out against the backdrop of the current credit crunch. People are watching.

"If this lawsuit is successful in the States then there's obviously a risk a similar suit would be successful in Canada because the precedential value would be of some significance," says David Wingfield, a litigator at WeirFoulds in Toronto. "A really interesting problem is how the losses would manifest themselves because the people left holding the bag are far removed from the law firms giving the advice. So how would those liabilities get turned into a negligence claim? One way is each person sues the person upstream, until the last person ends up suing the law firm, which is presumably what happened in the Nomura case."

It is what happened. The case started when Nomura was sued by a bank that held a mortgage-backed security it had put together pooling 156 commercial mortgages worth about \$1.8-billion

(U.S.). Nomura settled for \$67-million after losing a key argument on appeal.

Nomura, in turn, sued Cadwalader Wickersham & Taft, the New York law firm that drafted the securitization document, for \$70-million. Nomura alleges malpractice, saying its outside lawyers should not have included warranties that stated each mortgage qualified for special tax treatment and the mortgages were backed by properties worth at least 80 per cent of the mortgage amounts. When several mortgages went into default, some of the representations were not accurate.

Cadwalader wants the suit dismissed arguing, among other things, the warranties were standard language required by the bond rating agencies.

"It looks to me like this was an industry-standard way of doing business and everybody knew or should have known the clause was there," says Christopher Barry, who chairs the Canada practice group at Dorsey & Whitney. "But it's become like that scene from *Casablanca*, where the French police captain says, 'Rick, I'm shocked. There's gambling going on here.' "

Sources say the baskets of frozen commercial paper at the centre of the Canadian ABCP storm contain some boilerplate language as well. If the first ABCP lawsuit, filed last week by Aastra Technologies Ltd. against HSBC Securities (Canada) Inc. and one employee, is any indication, holders who bought the paper without being given access to exactly what was in them may start by going after their dealers.

"We've been very focused on who in this asset-based commercial paper mess might be culpable, but our clients are of the view it makes sense to wait and see where the Crawford committee leads before taking any action," says Jay Hoffman of Miller Thomson in Toronto. "It's not in anybody's interest to pull the whole house of cards down ... but to the extent people suffer losses, they'll be looking to recover those."

Mr. Hoffman says a list could include "certain dealers who may have played different roles in putting the structures together, or in providing liquidity lines or assets to the conduits. To the extent there were conflicts, there are questions about whether they were properly disclosed to investors."

He says there are also questions about whether the rating agencies (DBRS Ltd. is the only one that rated Canadian ABCP) should have rated the paper the way they did, given the market disruption clause that limited conditions under which liquidity support could be triggered. People are also looking at "whether the banks that agreed to provide liquidity and then didn't provide it in some cases, should have provided it under the agreements.

"As far as the law firms go, it's not something that had crossed my mind. But this a very, very messy situation with a lot of different players To the extent people suffer losses, they'll be looking to someone to make them whole."

Mr. Wingfield says if Canadian law firms were to get dragged in, it likely wouldn't happen unless clients - the dealers and the banks - had to make large payouts.

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