

# ECONOMIC MELTDOWN AND LITIGATION

As a result of the economic meltdown of 2008, a large percentage of the investment community will consider whether the adverse financial climate and resulting losses are the legal responsibility of others. This will lead investors sustaining losses to deliberate on whether litigation or arbitration is appropriate.

While no one person or organization bears exclusive responsibility for the financial catastrophe of the second half of 2008, there are a number of prospective defendants who may have responsibility for a particular loss. Such persons include investment advisors, stockbrokers, accountants and credit rating agencies.

Investment advisors and stockbrokers often act as fiduciaries for their customers. As such, they are obligated to be knowledgeable regarding their customers and management of their money. Above all, they have a responsibility to promptly inform clients about their investments, particularly regarding risks affecting those investments. Many investment advisors and stockbrokers failed to assess risk to their clients' investment portfolios and to timely communicate the risks that should have been explained to their clients. Clearly, there was a high degree of risk and volatility leading to the collapse of the market during 2008. Trillions of dollars of investments were at risk. The question now is, what did an investment advisor or stockbroker know, and when did he or she know it? And if he or she did not know there was risk, why not?

Those who reviewed and relied upon financial statements as part of making investments may have claims against accountants who audited and certified financial statements of U.S. companies. It is now clear that by their so-called "clean opinions" accounting firms understated risks attendant to many issuers' balance sheets. In particular, there seems to have been a nearly systemic overstatement of the value of bonds and other securities underlying many investments – and in particular "collateralized" investments. The questions will be not only about the actual valuations the accounting firms endorsed, but also the standards they applied to determine value.

Credit rating agencies failed to accurately evaluate collateralized debt obligations – and in particular those backed by sub-prime mortgages. Often "Triple-A" ratings were given without serious study. Inaccurate and improper ratings created a fragile and fractured financial community. As the mortgages that were the

basis of the CDOs went unpaid, the CDOs dropped in value. This created a domino effect throughout the world financial system.

The key to determining whether the meltdown will cause a spike in litigation and arbitration will likely be the time of its duration. As time passes, and concomitantly the depth of the meltdown increases, people's tolerance of the circumstances will decline. They will be forced to prosecute claims for their personal losses.

While there is no evidence that recent events were the result of deliberate machinations by market players, there seems little doubt that the conduct of some important persons and entities involved in the U.S. financial markets bordered on recklessness. It will be up to the legal system to sort out the issue of ultimate financial responsibility. <sup>1</sup>



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