Shifting gears

The large amount of financial litigation that is likely to arise out of the recession will take a different form from previous litigation, creating new challenges for practitioners, say **John McGhee QC** and **Alec McCluskey**

AS BERNIE MADOFF begins a 150-year sentence for fraud, theft and money laundering, the first big criminal trial to arise out of the credit crunch has run its course. The civil litigation which is bound to follow from the recession has barely begun, though. It may take some years for the expected glut of litigation to come to trial. Even once economic recovery is well underway, we can expect to see a long line of cases still working their way through the courts.

Conveyancing solicitors will need no reminder of the fallout from the last recession in the early nineties. Claims by mortgage lenders against conveyancers, valuers and accountants became commonplace. No doubt the credit crunch and fall in the housing market will bring to light further instances of negligence or fraud in these fields, particularly as banks and other lenders look to cut their losses on subprime lending by pursuing advisers who have the benefit of professional indemnity insurance.

This time around, however, the impact of the downturn is not likely to be limited to professionals involved in the housing markets. Given the central role of banks, hedge funds and other financial institutions in bringing about the crunch, it is almost inevitable that these institutions, together with their directors, will become the target of litigation. Just as the losses from the recession are bigger than ever before, so the incentive to cast the net wider in looking for those to blame will be greater.

It is worth bearing in mind that there are two likely sources of claims. First, there are the regulators themselves. There is a widespread public perception that financial regulators have been caught napping by the credit crunch. The FSA, for example, has already shown itself eager to demonstrate that it is looking to 'get tough' on offenders.

At the beginning of July, the FSA announced its intention to impose the sharpest increases in its fines for improper conduct since it was established in 1999. Its new proposals expressly aim to ensure that any profits from misconduct are removed from the wrongdoer.

One of the principal ways in which the FSA and other regulators are likely to seek to demonstrate their determination to punish those deemed guilty of misconduct and counter allegations of lax regulation is through civil litigation.

Tempting targets

Second, those who have suffered financial losses as a result of the recession are likely to look for targets from which to recover some of their losses. The most appealing targets are, of course, professionals backed by indemnity insurance or large financial institutions which can be relied on to satisfy any judgment against them. It seems reasonable to expect that investment and clearing banks, hedge funds, brokers, pension funds, investment managers, and financial advisers will all be the targets of litigation.

It also seems likely that lawyers involved in the drafting of financial instruments will present a tempting target for litigation. Many potential claimants who have suffered losses in the downturn (for example hedge funds) will have deep pockets and are likely to take a fairly hard nosed approach to such litigation.

Just as the financial instruments which are blamed for the credit crunch were complex and sophisticated, much of the litigation arising out of the crunch will be similarly complex. Litigation of this kind will pose challenges and create opportunities for Bar and solicitors alike. It is likely to draw on a range of legal expertise. To take a few examples, questions of banking law and financial

regulation, insolvency, contract and company law, offshore and corporate trusts, property and (in some cases) civil fraud may all arise. Lawyers advising clients contemplating or faced with litigation of this kind will need to be astute to ensure that they have covered all possible bases.

Large-scale financial litigation is nothing new, of course, but we can expect to see a number of common features characterising the forthcoming round of litigation.

An international flavour

Much of the litigation is likely to have an international flavour, something not generally true of the claims that followed the early nineties property recession. Consider, for example, the case of an individual domiciled in the Cayman Islands investing in a London-based hedge fund, which itself invests in assets all over the world. Lawyers instructed to bring proceedings, or acting for clients faced with such proceedings, should consider carefully the impact of jurisdictional and choice of law issues in an attempt to gain the greatest tactical advantage for their clients.

Already we have seen the threat of proceedings in the USA arising out of the partial nationalisation of the Royal Bank of Scotland, and it is reasonable to expect that litigators in foreign jurisdictions may seek to bring proceedings abroad. It is likely that defendants faced with such claims will wish to seek to have the issues litigated in their home jurisdiction.

Electronic disclosure

One of the biggest practical headaches facing those involved in litigation of this kind is likely to be disclosure. The volume and variety of potentially disclosable documents even in relatively small-scale financial litigation will sometimes be of an order of magnitude greater than in comparable cases in the past. Central to this is the growth of email and the profusion of devices used for accessing and generating emails and other documents electronically.

The transactions which are likely to be the subject of future litigation will often have been arranged using a bewildering array of electronic communications. Employees of financial organisations have for some years routinely used Blackberries, PDAs, laptops and other mobile devices for work purposes. Many will use both home and work computers and email accounts for work communications.

Then there are the particular questions posed by backup systems and servers used to distribute information to networked devices. All of these may be potential sources of disclosable documents, and all will need to be considered (no doubt in some cases with the assistance of appropriate experts).

In particularly contentious cases, issues may well arise as to the extent to which it is possible to recover deleted documents from electronic equipment. Each case will pose its own unique difficulties of obsolete software and hardware, missing equipment and (no doubt) arguments and counter-arguments over proportionality and the cost of searches. It seems likely that questions of the scope of parties' disclosure obligations will themselves require consideration by the courts.

Litigation management

So too, the management and procedure of large-scale financial litigation is likely to take a very different form to the past. Prior to the introduction of the CPR, the management of litigation was, of course, effectively in the hands of the parties themselves rather than the court. In the case of large-scale litigation this could lead to proceedings running for many years and any number of costly interlocutory disputes.

Particularly in the case of substantial disputes, the courts continue to be at pains to ensure that the Woolf Reforms' goal of "active case management" becomes a reality. It is hoped that this leads to a streamlining in the largest cases (though individual practitioners will have their own opinions as to the extent to which particular courts have so far succeeded in achieving this).

The Commercial Court is particularly active in this regard, and has recently introduced revised procedures in the light of recommendations from its Long Trials Working Party. The most eye-catching innovation in the commercial guide (and the one which may come as the greatest novelty to those involved in large-scale litigation in the past) is the insistence that statements of case be limited to 25 pages in length, coupled with an increased emphasis on the importance of a judicially approved list of issues.

There is no such requirement in place in the Chancery Division, though it will be interesting to see how practice develops in both courts; as the Long Trials Working Party pointed out in its report, often procedures designed to save time and costs have been honoured mostly in the breach.

There is no space here to consider the Jackson Report on Civil Litigation Costs, potentially the most important and far-reaching review of civil litigation since the introduction of the CPR, but no doubt as time goes by its impact will be felt on financial litigation. The reality, however, is surely that in the very largest and most valuable litigation parties will continue to incur substantial costs in an attempt to gain an edge over their opponents.

All of these issues and more mean that the litigation which follows the recent financial collapse may take a somewhat different shape to the large-scale litigation of the past, but no doubt in substance it will prove just as contentious and hard fought as ever.

Whatever the future holds for the economy, it is clear that the credit crunch and its aftermath will keep the courts, and those who practise in them, occupied for some time to come.

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