Banks Face Billions in Liability Exposure

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In June, Barclays Bank agreed to pay $453 million to settle charges that its conduct resulted in manipulation of the Libor interest rate. Although lawsuits involving potential Libor manipulation had been pending for nearly two years prior to the settlement, ?Libor Litigation? soon became a buzzword. Now, some believe that Libor lawsuits will begin pouring into the courts. Just last Tuesday, the New York Times reported that the State of North Carolina is investigating theories for suing over losses incurred by its state pension fund.[1]

Perhaps Libor litigation is the next tsunami of lawsuits. Perhaps not. But the legal issues springing from Libor manipulation are significant, the liability exposure of the world?s largest banks has been estimated in the billions, and no one can predict the full impact on potentially harmed parties and the banks that might have been involved.

Overview of the Litigation: Types of Plaintiffs and Types of Suits

The potential plaintiffs and types of lawsuits resulting from Libor manipulation seem to span the legal landscape. One of the leading types of suits is an antitrust class action by individual bond holders suing for bond investment losses. Under this theory, the banks participating in Libor rigged the market by artificially depressing the interest rate. For bond holders and other investors whose investments were tied to Libor, this means that their return on investment was lower than it would have been had the rate not been artificially depressed.

Fixed-income investment losses based upon an artificially depressed Libor also have the attention of state pension funds. As mentioned above, the State of North Carolina is studying potential losses from Libor manipulation, focused chiefly on investments directly tied to Libor and on interest rate swaps. In addition to North Carolina, states looking into potential recovery for Libor manipulation include Connecticut, Maryland, Massachusetts, and New York. This area of litigation could be huge because of the aggregate size of state pension holdings. At least one state treasurer believes that the Libor manipulation cases could be as big as the mortgage crisis settlement.[2]

Suits have not been limited to investment losses. A number of shareholder derivative actions and securities fraud cases have been filed against banks that might have been involved in Libor manipulation. In these suits, classes of plaintiffs claim that officers and directors of the banks failed to exercise appropriate oversight, leading to shareholder losses, or that the banks themselves defrauded investors through their participation in Libor manipulation.

There also has been some inter-bank litigation resulting from Libor manipulation. In one such suit, a class of plaintiffs made up of New York banks alleges that the artificially depressed Libor resulted in lower interest payments on the banks? loans.

This is just an overview of a few of the pending and threatened lawsuits involving Libor manipulation. The fact is that Libor is tied to trillions of dollars of financial activity, and litigation could arise from almost anywhere. We anticipate that unforeseen suits involving all kinds of financial products and contracts will be filed in the coming months and years.

<u>The Problem with Damages</u>

Regardless of the wide range of lawsuits, a key issue in Libor litigation is and will remain how a plaintiff measures the loss allegedly suffered. Under a traditional ?measure of damages? for breach of contract, fraud, and other causes of action, courts require fairly rigorous proof. A plaintiff?s case cannot go forward if damages are ?speculative.? Moreover, many a case has ended simply because the plaintiff could not quantify damages and thereby meet the standard of proof. Often, such cases have ended before trial, giving the defendant a victory and providing the plaintiff no recovery at all.

In Libor cases, speculative damages might be the order of the day. As we review the cases that are pending or have been threatened, we see attempts to determine when the rate might have been manipulated, over how long a time period the supposed manipulation occurred, by how much the rate was artificially manipulated, how the manipulation might have affected a security held by an investor, and how all this resulted in a monetary loss that can be accurately measured. This is no easy task, and there is a serious question whether a plaintiff could quantify damages enough to be entitled to recover.

Another problem with damages in these cases is the fact that, for many investors, the damages will be very small, and litigating over such amounts would be difficult to justify economically. Take the example of an individual investor with $10,000 in a fixed-income investment that was affected by Libor manipulation. If we assume the Libor rate was manipulated by 30 basis points for a period of three years (the estimate currently suggested by some pending lawsuits) and the investor held her $10,000 investment for those three years, her damages would only be $90.

Because these losses are relatively small, we anticipate that most Libor litigation will have one of two aspects. First, we likely will see very large invested amounts at issue, usually via class actions or plaintiffs who are institutional investors, state pension funds and the like. We also will likely see some theory of recovery that allows an award of attorney fees. For example, North Carolina has an unfair and deceptive trade practices statute that allows recovery of attorney fees and treble damages. Any suit in North Carolina will likely allege this as a cause of action.

The Future

The world?s largest banks have already been the target of Libor litigation, and they will be dealing with those issues for several years. On the other hand, while the aggregate potential losses are large, plaintiffs will have difficulty finding viable legal theories, presenting evidence to prove the rate manipulation, and quantifying their damages. The latter category, damages, could prove to be plaintiffs? biggest hurdle and the banks? best defense.

Libor litigation could prove to be one of the most wide-ranging types of litigation coming out of the financial crisis. After all, the banks have been accused of purposefully manipulating what has been called ?the world?s most important number.? However, if the litigation springing from Libor

manipulation becomes too much of a strain on the system, there could be an industry-wide settlement similar to the mortgage settlement, essentially ending private causes of action. This does not, however, account for government investigations and potential criminal liability, which will be the topic of our next article.

[1] ?Banks Face Suits as States Weigh Libor Losses,? The New York Times, September 4, 2012.

[2] Id.

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