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Who's Responsible for Your Investment Losses: The Fallout from the Financial Crisis

By:

Robert R. Marcus
Smith Moore Leatherwood LLP
525 North Tryon Street, Suite 1400
Charlotte, North Carolina 28202
704.384.2630 (telephone)
704.384.2910 (facsimile)
rob.marcus@smithmoorelaw.com

C. Bailey King, Jr.
Smith Moore Leatherwood LLP
525 North Tryon Street, Suite 1400
Charlotte, North Carolina 28202
704.384.2616 (telephone)
704.384.2919 (facsimile)
bailey.king@smithmoorelaw.com

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Who's Responsible for Your Investment Losses:
The Fallout from the Financial Crisis

Robert R. Marcus
Smith Moore Leatherwood LLP
525 North Tryon Street, Suite 1400
Charlotte, North Carolina 28202
704.384.2630 (telephone)
704.384.2910 (facsimile)
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525 North Tryon Street, Suite 1400
Charlotte, North Carolina 28202
704.384.2616 (telephone)
704.384.2919 (facsimile)
bailey.king@smithmoorelaw.com

Rob Marcus is the managing partner at Smith Moore Leatherwood LLP. His practice focuses on complex commercial litigation. He has represented numerous institutional investors, including municipalities and other governmental entities, in matters involving investment losses. Rob has been recognized by Chambers and Partners USA for Commercial Litigation and is listed in Woodward/White's Best Lawyers in America for Commercial Litigation, including the areas of Securities and Banking & Finance. Rob has also been recognized as a North Carolina Super Lawyer in Business Litigation and is listed in Business North Carolina's Legal Elite.

Bailey King is a partner at Smith Moore Leatherwood. Bailey's practice is focused on complex commercial litigation, including claims involving investment losses and securities law violations. Bailey has been named a North Carolina Super Lawyer "Rising Star" in the field of Business Litigation in 2012 and 2013 and was listed in Business North Carolina's Legal Elite, Young Guns in 2011.

In 2012, Rob and Bailey tried a securities lending lawsuit against Wachovia/Wells Fargo arising out of a $10.4 million investment loss in Lehman Brothers on behalf of the City of St. Petersburg, Florida. In addition, over the past three years, Rob and Bailey have represented and advised several other governmental entities on claims arising out of investment losses suffered during the Financial Crisis.

I. Introduction

More than five years after the Financial Crisis of 2008, the effects continue to be felt, and we are only just now beginning to fully comprehend the extent of its impact. Over the course of the past year, scandals from the financial crisis that were previously undetected have begun to make global headlines, and it seems likely that scandals will continue to come to light. Unfortunately, municipalities, counties, and other local governmental entities appear to be some of the biggest victims of these most recent scandals. As the regulatory agencies continue to investigate the fallout from the financial crisis, it is also a good time for municipalities and other institutional investors to review their investment portfolio and attempt to determine who was responsible for their investment losses.

II. Overview of Current Investment Litigation Involving Municipalities[1]

Currently, we are aware of three scandals from the Financial Crisis that impacted municipalities and have led to significant litigation. These scandals include allegations that banks have (1) manipulated the LIBOR rate, (2) engaged in bid-rigging on municipal investment agreements sold in connection with public bond issuances, and (3) made risky investments on behalf of municipality clients in securities lending program. Municipalities and other institutional investors have brought numerous lawsuits against many of the largest financial institutions in the world based on these allegations. The current status of the ongoing litigation over each of these issues is discussed below.

A. The LIBOR Rate-Fixing Scandal

[1] This section has been updated from an article that appeared in the January/February 2013 issue of Municipal Lawyer.

On June 27, 2012, Barclays Bank PLC made international headlines when it announced that it had entered into a $450 million settlement with government regulators for its role in manipulating the London Interbank Offered Rate (LIBOR).

LIBOR is the interest rate banks charge each other to borrow overnight funds. This rate is used as a benchmark for all types of fixed-income investments, including tax-exempt municipal bonds. LIBOR is set and overseen by the British Bankers' Association (BBA), an industry group in London. *See* BBALIBOR – The Basics, http://www.bbalibor.com/bbalibor-explained (last visited Nov. 12, 2012). Each weekday, leading banks around the world submit a figure to the BBA based on the rate at which they estimate they could borrow funds from other banks. The BBA throws out the high and low submissions and averages the remaining submissions into one rate – this is LIBOR. *Id.* Then, LIBOR is calculated for 10 different currencies and 15 borrowing periods (maturity dates). After LIBOR is calculated, it is published on a daily basis by Thomson Reuters.

The magnitude of the LIBOR rate-fixing scandal is enormous, as more than $350 trillion in financial transactions, ranging from complex derivative swaps to simple consumer home loans, were tied to LIBOR during 2011. John Waggoner, *Libor Scandal Explained and What Rate-Rigging Means To You*, USA TODAY, July 18, 2012, http://usatoday30.usatoday.com/money/perfi/credit/story/2012-07-18/libor-interest-rate-scandal/56322230/1. In the last year, government investigations have commenced and a frenzy of private antitrust lawsuits have been filed on behalf of various institutional investors. In late 2012, UBS became the second large bank to settle with government regulators for its role in manipulating LIBOR. UBS settled for $1.5 billion, more than three times the amount of the Barclays PLC settlement. Silla Brush & Phil Mattingly, *UBS $1.5 Billion Libor Settlement*

Signals More to Come, BLOOMBERG, Dec. 20, 2012, http://www.bloomberg.com/news/2012-12-19/ubs-1-5-billion-libor-settlement-signals-more-to-come.html. In sum, governmental investigators and private litigants have accused at least 12 international banks of colluding to manipulate LIBOR.

LIBOR is an important number because it is used by the financial industry to set interest rates in trillions of dollars worth of loans and investments. LIBOR is often used to price financial instruments such as interest rate swap transactions and futures contracts. As a consequence, if banks kept LIBOR artificially low during the financial crisis and its immediate aftermath, investors would have been robbed of billions of dollars in returns on investments.

U.S. cities and other local governmental entities are likely to be some of the biggest victims of the LIBOR rate-fixing scandal. Stephen Gandel, *Wall Street's Latest Sucker: Your Hometown*, CNNMONEY, July 11, 2012, http://finance.fortune.cnn.com /2012/07/11/libor-sucker-hometowns/. This is because the municipal bond market relies heavily on LIBOR. In addition, state and local governments are significantly exposed to investment losses through the purchase of interest rate swaps, which are oftentimes also tied to LIBOR. State and local governments use swaps when they want to issue a bond at a floating interest rate but protect themselves from future swings in rates. In a standard swap, the investor exchanges the floating interest rate promised to bond investors for a fixed rate, making future budgets more predictable. The problem for many municipalities is that while they paid fixed rates to their banks, the floating rates they received in return were tied to LIBOR. Thus, if LIBOR was suppressed by the banks, investment returns for these swap transactions would be diminished. Various institutional investors, including state and local governments, are still calculating the losses they suffered as a result of investments tied to LIBOR, which in many cases will be

significant. For example, the North Carolina Department of State Treasurer, which oversees the state's public pension plans, reportedly made two major swaps tied to $1.3 billion of bonds at a time LIBOR was suspected of being manipulated. Nathaniel Popper, *Banks Face Suits as States Weigh Libor Losses*, N.Y. TIMES, Sept. 4, 2012, http://www.nytimes.com /2012/09/05/business/banks-facing-suits-as-states-weigh-their-libor-losses.html. By one calculation, that could have meant losses for North Carolina of around $10 million on those two swaps. *Id.*

Currently, antitrust class actions arising out of various investment losses are the leading type of lawsuit in LIBOR litigation. According to the complaints filed in these actions, the banks participating in the LIBOR manipulation conspired together to suppress the LIBOR interest rate. *See In re LIBOR-Based Financial Instruments Litigation*, No. 1:11-md-2262 (S.D.N.Y., Consolidated Amended Complaint filed Apr. 30, 2012). They did this by collectively submitting low rates to the BBA when they knew their own borrowing costs were higher during the financial crisis and immediate aftermath. For investors whose investments were based on LIBOR, the return on their investment was lower than it would have been if the banks had not suppressed the LIBOR rate. A host of municipalities, pension funds, and other institutional investors have filed lawsuits for these losses, which have been consolidated for multi-district litigation in the United States District Court, Southern District of New York. *Id.* Charles Schwab and related entities have filed a separate complaint, alleging losses to their money market and ultra-short term bond mutual funds, which has also been consolidated. *See In re LIBOR-Based Financial Instruments Litigation*, No. 1:11-md-2262 (S.D.N.Y., Charles Schwab Amended Complaint filed Apr. 30, 2012). A number of community banks have also filed similar suits, claiming they have been harmed by the BBA-member banks that conspired to suppress

LIBOR; these cases were recently consolidated. *See Berkshire Bank v. Bank of America Corp.*, No. 12-cv-5723 (S.D.N.Y., filed July 25, 2012). *Community Bank & Trust v. Bank of America Corp.*, No. 12-cv-4205 (S.D.N.Y., filed May 25, 2012).

Most recently, a number of California cities and municipalities filed suit against more than a dozen banks for investment losses related to LIBOR manipulation. The counties of San Diego and San Mateo, the cities of Richmond and Riverside, the East Bay Municipal Utility District and the Los Angeles County Employees Retirement Association lodged separate suits in three California federal courts. *Cf. County of San Diego v. Bank of America Corp. et al.*, No. 13-00048 (S.D. Cal.); *County of San Mateo et al v. Bank of America Corp. et al.*, No. 13-00108 (C.D. Cal.); *City of Riverside et al. v. Bank of America Corp. et al.*, No. 13-00062 (C.D. Cal.); *City of Richmond et al. v. Bank of America Corp. et al.*, No. 13-00106 (N.D. Cal.); *East Bay Municipal Utility District v. Bank of America Corp. et al.*, No. 13-00109 (N.D. Cal.); *Log Angeles County Employees Retirement Ass'n v. Bank of America Corp. et al.*, No. 12-10903 (C.D. Cal.). The municipalities all accuse the banks of violations state and federal antitrust laws, as well as engaging in fraud and other related torts. In early 2013, those California lawsuits were transferred to the multi-district litigation pending in the Southern District of New York. *See In re LIBOR-Based Financial Instruments Litigation*, No. 1:11-md-2262 (S.D.N.Y.).

All of these lawsuits allege that the BBA banks responsible for setting LIBOR engaged in a price-fixing conspiracy under Section 1 of the Sherman Act. 15 U.S.C. § 1. Some complaints also assert claims for violations of the Racketeer Influenced and Corrupt Organizations Act (RICO). 18 U.S.C. § 1961. The defendant banks are some of the largest financial institutions in the world, including Bank of America Corporation; Barclays Bank PLC; Citibank, N.A.; JPMorgan Chase & Co.; HSBC Holdings PLC; UBS AG; and various other international banks

that contribute to set the LIBOR rates. The putative classes include investors that (a) purchased financial instruments from defendants that were indexed to U.S. LIBOR, including but not limited to interest rate swaps, or (b) owned a U.S. dollar-denominated debt security on which interest was payable based on the U.S. LIBOR rate. *See, e.g.*, *In re LIBOR-Based Financial Instruments Litigation*, No. 1:11-md-2262 (S.D.N.Y., Consolidated Amended Complaint filed Apr. 30, 2012). The complaints allege a claim under Section 1 of the Sherman Act by asserting that the bank defendants joined in a conspiracy to restrain competition in the marketplace by fixing the LIBOR rate at below-market levels. As a result, the investor-plaintiffs allege that they suffered a direct antitrust injury by receiving diminished returns on LIBOR-based financial instruments purchased, held, or traded from bank defendants.

The bank defendants have filed motions to dismiss the antitrust claims, contending that: (a) there is no evidence of joint, as opposed to independent action; (b) there is no restraint on trade because the U.S. LIBOR is an index rate, not a price or product, and member banks remained free to negotiate interest rates and other pricing for their financial instruments; (c) plaintiffs lack antitrust standing because many investors benefitted equally, or more, from lowered interest rates; and (d) to the extent that the class includes indirect purchasers, the claims are barred by the *Illinois Brick* doctrine. This latter point is noteworthy because the *Illinois Brick* doctrine says that indirect purchasers of goods or services cannot assert antitrust claims. *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 730-31 (1977). Many claimants may have purchased financial instruments from banks not associated with the LIBOR manipulation. Consequently, such claimants have no direct commercial relationship with the banks that were involved in the LIBOR manipulation and may, therefore, find it difficult to prevail on antitrust claims against them. On March 5, 2013, Judge Buchwald heard oral argument on the motions to dismiss.

LIBOR-related antitrust litigation is rapidly evolving and presents significant risk to the accused banks as governmental investigations progress and continue to expose the scandal. In order to prevail, however, the putative class will need to overcome several significant obstacles. Most importantly, damages will be extremely difficult to prove and will make class certification difficult. Whether investors lost money on certain investments depends on whether they were on the winning or losing side of the specific transaction. For example, most investor-plaintiffs both paid interest and collected interest at rates determined by LIBOR. To further complicate matters, each investor likely has a unique, individualized loss, depending on how LIBOR manipulation might have affected various transactions or securities held at different times over different periods of time. In sum, calculating a loss on one transaction for one plaintiff will be complex. Calculating a loss for a class on a universe of transactions will be even more challenging.

Given the difficulties associated with antitrust class actions, LIBOR-related litigation is likely to grow as institutional investors with potentially large claims decide to opt out of the classes and file individual claims. Those types of lawsuits may have a greater chance of success as compared to the class action antitrust litigation because it is easier to calculate damages arising from one or two large transactions for a single plaintiff, such as an interest rate swap. Institutional investors who choose to opt out of the class actions and bring individual claims may also find it easier to allege claims for fraud and unfair and deceptive trade practices based on representations that the defendant banks may have made to the plaintiff as its client.

Given the size of the market for investments tied to LIBOR, the LIBOR scandal could prove to be the most significant type of litigation arising out of the financial crisis. Many investors, however, may not even recognize the damages they have suffered as a result.

B. The Municipal Bond Big-Rigging Scandal

Municipalities and other local governmental entities may have also lost money as a result of an alleged bid-rigging scandal in the municipal bond market. Municipalities often raise capital to finance long-term projects through the issuance of tax-exempt bonds. When a city issues these tax-exempt bonds, the bond proceeds are typically invested in various investment products sold by major financial institutions until the bond proceeds are needed to complete the project. These products, which are referred to generally as municipal derivatives, are tailored to meet the bond issuers' specific collateral and spend-down needs, and include products such as guaranteed investment agreements (GICs), repurchase agreements (repos), and forward purchase agreements (FPAs). To ensure bond proceeds are invested at fair market value, most issuers submit their bond issuances to a competitive auction of at least three banks that compete to sell these investment products. It appears, however, that some of the banks may have been rigging the public bid process in order to pay municipalities a lower rate on these investments.

In these cases, banks allegedly bribed the auctioneers/brokers who arranged the auction. Matt Taibbi, *The Scam Wall Street Learned From the Mafia: How America's Biggest Banks Took Part in a Nationwide Bid-Rigging Conspiracy – Until They Were Caught on Tape*, ROLLING STONE, July 5, 2012. In return, the middleman broker would tell the prearranged winner what the other bids were, allowing the bank to lower its offer and come in with an interest rate just high enough to "beat" the supposed competitors. The winning bank then provided the middleman broker with a reward disguised as a fee. This process has been termed the "last look." Similarly, in other cases, banks conspired to deliberately submit non-winning bids in order to allow other banks to win the bid. This practice is known as a "set-up." By shaving even fractions of a percent off the winning bid, banks have allegedly pocketed large sums of money over the lives of multimillion-dollar bond deals. *Id.* Meanwhile, bond issuers

have incurred significant losses as a result of receiving lower returns on these municipal derivative investments than they would have received in a free market.

Several bank executives have already been convicted on fraud and conspiracy counts for their involvement in the bid-rigging scandal. For example, on May 11, 2012 three former GE Capital executives were found guilty on charges of participating in several rigged bids on municipal investment contracts. *United States v. Carollo et al*., No. 10-cr-654 (S.D.N.Y.). Further, on August 31, 2012 three former UBS AG executives were found guilty on charges arising from similar conduct. *United States v. Ghavami et al.*, No. 1:10-cr-1217 (S.D.N.Y.). Former executives from other major banks, including Bank of America and Wachovia, have also been implicated in the bid-rigging scandal. *See* Max Stendahl, *Former BofA Exec Testifies He Bribed UBS For Rigged Bid*, LAW360, Aug. 14, 2012, http://www.law360.com/whitecollar/articles/369478/former-bofa-exec-testifies-he-bribed-ubs-for-rigged-bid; Keith Goldberg, *Ex-BofA Exec Indicated In Municipal Bond Bid-Rigging Scheme*, LAW360, July 23, 2012, http://www.law360.com/banking/articles/362499/ex-bofa-exec-indicted-in-municipal-bond-bid-rigging-scheme; Press Release, U.S. Securities and Exchange Commission, "SEC Charges Wachovia With Fraudulent Bid Rigging in Municipal Bond Proceeds," Dec. 11, 2011.

The SEC (along with the Attorneys General of 25 states) has been prosecuting these types of cases against financial institutions, which have now paid in excess of $673 million in settlements resulting from the ongoing investigations. For example, J.P. Morgan Securities LLC settled for $228 million on July 7, 2011; UBS Financial Services Inc. settled for $160 million on May 4, 2011; Banc of America Securities LLC settled for $137 million on December 7, 2010;

and Wachovia Bank N.A. (now Wells Fargo), settled for $148 million on December 8, 2011. Proceeds from these settlements are being returned to affected municipalities.

In addition, several state and local governmental entities, including the State of Mississippi and Fairfax County, Virginia, have filed a nationwide class action lawsuit against more than 40 leading banks, insurance companies, and brokers allegedly involved in the bid-rigging of municipal derivatives. Among other things, the lawsuits allege that all the defendants conspired to rig bids, limit competition, and fix prices in the municipal derivatives market in violation of Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1. *In re Municipal Derivatives Antitrust Litigation*, No. 1:08-md-1950 (S.D.N.Y.). The lawsuits have been consolidated for multi-district litigation in the United States District Court, Southern District of New York. While certain bank defendants have settled (JPMorgan Chase & Co. has agreed to settle for $44.6 million), the multidistrict litigation is currently pending against the remaining defendants.

In the last year, municipalities in the multi-district litigation have faced a difficult choice of opting to receive proceeds from the above-mentioned regulatory settlements, pursuing their claims in the multi-district litigation, or bringing an individual lawsuit. As a condition of opting to receive the regulatory settlement funds, plaintiffs are required to waive and relinquish their claims in both the multi-district litigation and any individual lawsuit.

For municipalities with significant and identifiable losses tied to the bid-rigging scandal, it may be beneficial to opt out of both the multi-district litigation and the regulatory settlements and instead pursue individual claims. The statute of limitations on these types of claims may be an issue because this scandal was exposed in national media around 2008 and 2009. Institutions with potentially large losses as a result of tax-exempt bond issuances, however, should consult

with counsel before deciding whether to opt out of the multi-district litigation or any regulatory settlement.

C. Securities Lending Litigation

Securities lending is a service that is offered by financial institutions to their large custodial clients, which oftentimes includes municipalities and other local governmental entities and their pension funds. In a securities lending program, the financial institution lends its client's securities (i.e., stocks, bonds, and other investments) to broker/dealers (such as hedge funds) in order to cover short sales and other trading activities. In exchange, the borrower of the security provides collateral, usually in the form of cash. The financial institution then invests the cash collateral on its client's behalf. When the borrower returns the security, the financial institution sells the investment, returns the cash collateral to the borrower, and any return on the investment is split between the financial institution and its client.

In the past, securities lending programs were typically sold as "low-risk" programs where the client could make a small amount of additional return on investments that were otherwise simply being held in a custodial account in order to offset the bank's custodial fees. The primary objectives for most securities lending programs were safety of principal and liquidity. During the financial crisis of 2008, though, it became apparent that many financial institutions had made risky investments in highly complex and risky financial products such as "structured investment vehicles." When investors attempted to get out of their securities lending programs, they were unable to do so because these investments were illiquid. Ultimately, many clients lost millions of dollars.

Since the financial crisis of 2008, at least a dozen lawsuits have been filed on behalf of local governmental entities, hospitals, pension plans, and other institutional investors against their custodial banks arising out of losses suffered in their securities lending programs. The banks that have been sued include some of the largest financial institutions in the world, such as Wells Fargo, Wachovia, JPMorgan Chase, BNY Mellon, and Northern Trust.

To date, two of these cases have tried. In *Workers' Compensation Reinsurance Association v. Wells Fargo Bank, N.A.*, four non-profit institutions in Minnesota obtained a $41 million verdict against Wells Fargo for securities lending losses suffered in investments in Lehman Brothers and in structured investment vehicles Cheyne Finance and Stanfield Victoria, which was upheld by the Minnesota Court of Appeals. *Workers' Comp. Reinsurance Ass'n v. Wells Fargo Bank, N.A.*, No. A11-1260, 2012 WL 1253094 (Minn. Ct. App. Apr. 16, 2012). Similarly, on April 3, 2012, a jury awarded the City of St. Petersburg, Florida approximately $10.4 million dollars for losses it suffered in its securities lending portfolio as a result of an investment that Wachovia made on its behalf in Lehman Brothers. Michael Van Sickler, *City of St. Petersburg Wins $10.4 Million Verdict Against Big Bank*, TAMPA BAY TIMES, Apr. 4, 2012, http://www.tampabay.com /news/localgovernment/city-of-st-petersburg-wins-104-million-verdict-against-big-bank/1223271. The case is currently on appeal. Finally, several of these cases have been settled. In particular, Sarasota County recently settled its lawsuit against Wachovia arising out of a $34 million dollar loss it suffered in a Lehman Brothers investment and an investment vehicle called Altius for $24 million dollars. Zac Anderson, *Wells Fargo to Pay $24 Million in Sarasota County Settlement*, HERALD TRIBUNE, Dec. 5, 2012,

http://www.heraldtribune.com/article/20121205/ARCHIVES/212051062/-1/opinion09?p=1&tc=pg.

The securities lending lawsuits generally assert claims for breach of contract, breach of fiduciary duty, and other various securities law violations. Because these claims arise out of the relationship between banks and their institutional customers, the viability of each potential claim is highly fact-specific. Most securities lending programs are governed by a set of investment guidelines that set out the obligations of the bank and the client. Municipalities and other governmental entities that participated in securities lending programs should review these investment guidelines to determine whether the investments made on their behalf were appropriate.

III. Common Obstacles Municipalities Face in Investment Litigation

In evaluating and litigating claims related to investment losses (whether in the context of the ongoing litigation discussed above or otherwise), municipalities face common issues that must be taken into account. Indeed, in all three of the types of lawsuits discussed above and in any other type of investment litigation, an investor should assume that the financial institution's strategy for defending the case will be aimed at shifting blame away from itself and toward the municipality's finance department. These arguments include variations of the following themes: (1) the municipality was a "sophisticated investor" with a large portfolio and a professional staff; (2) it understood the risks associated with the investments at issue; and (3) the losses suffered were a result of a turbulent and unprecedented economic times, not the fault of the financial institution.

The first step in assessing the strength of these arguments is to conduct a thorough review of the investment advisor contract, which will set out the responsibilities of both parties.

Ordinarily in investment litigation, an individual investor sues an advisor for acting negligently. In the context of an institutional investor, though, it is extremely important to instead attempt to tie the alleged "negligent" act to the express terms of the contract. By doing so, the municipality can limit the investment advisor's ability to hide behind the agreement and argue that it did "what it agreed to do." Investment advisor agreements generally have provisions related to the types of permissible investments, certain reporting requirements, sometimes including downgrade notification requirements, and notice provisions. There may even be a contractual provision that states that the investment advisor will not be liable for any losses unless it was "negligent" or "grossly negligent."

If a municipality finds that its investment advisor has breached one of the provisions of its agreement, the municipality must still be prepared to respond to the argument that it was a "sophisticated investor" and should have been aware of the risks associated with the investment. In order to respond to this argument, a municipality is well-served to conduct a thorough review of their own performance before bringing suit. In short, the question to ask is whether city staff did what they were supposed to do in overseeing and managing the investment advisor.

With respect to the expertise of the municipality's finance department, it is important to know what types of investment the staff actively manages. For example, if a finance department manages a government-backed bond portfolio on its own but hires an outside investment advisor to manage a derivative portfolio, it would tend to show that the city hired the investment advisor because managing a derivative portfolio was relying on the investment advisor's expertise in managing the portfolio. Similarly, it is also important to paint a clear picture of the breadth of the finance department's responsibilities. Oftentimes, in addition to the oversight of the municipality's investment portfolio, a finance department may also be responsible for

accounting, payroll, bond issuances, and various other functions. Finally, to the same end, it is important to put the size and number of the particular investments at issue in context. If an institutional investory has over 5,000 holdings in its portfolio with several outside investment advisors responsible for different types of holdings, it stands to reason that the investor would monitor its investment advisors on a portfolio basis rather than reviewing specific holdings.

If a municipality or other institutional investor can point to specific contractual provisions that the investment advisor violated and also show the degree to which the municipality's finance department relied on its outside investment advisors (either due to under-staffing or lack of expertise), a municipality can begin to put together a strong case that the investment advisor violated its duties. A municipality seeking to recover investment losses, though, must still show that the investment advisor's acts caused the loss. The most common defense to this is that the financial crisis was "unprecedented" and that "no one could have predicted what was going to happen in that market."

There are responses to this argument. First, the investment advisor was likely in a better position than the municipality and had access to more information. Second, the investment advisor was likely aware of the municipality's risk profile and should have recognized that the risk was getting too high, even if it could not have predicted the actual loss. Finally, financial institutions often had conflicting interests among themselves and their clients. If the investment advisor chose to limit its own exposure to an investment while continuing to hold the investment for its clients or if it gave conflicting advice to a larger customer, a municipality can develop an argument that its investment advisor was not acting in its best interest, which is oftentimes the strongest argument one can make against an investment advisor in these types of cases.

Each of these issues requires extensive discovery of the investment advisor's internal assessment of the risks associated with a particular investment. Financial institutions will typically work hard, however, to keep this information out of discovery by arguing that it is confidential because it relates to other clients. This type of information is essential, though, in building a case. As a result, an institutional investor that chooses to bring an investment loss case will likely be involved in prolonged and difficult discovery fights. As a result, the cost of investment litigation can be high. Of course, the losses suffered by municipalities and other institutional investors during the financial crisis are as well. Accordingly, in evaluating whether to bring a claim, a municipality should carefully consider (1) whether the investment advisor has violated its duties, (2) whether the municipality's investment staff adequately performed its oversight function, and (3) whether the size of the investment loss and the potential for recovery justifies the expense of litigation.

IV. Practical Tips for Handling Investment Litigation

Assuming a municipality elects to go forward with a claim over its investment losses, it will have to handle the same unique issues that governmental entities face in all litigation. In litigation involving a large investment loss, where there will likely be public scrutiny, these issues can be critical. The two issues which we believe distinguish litigation on behalf of cities and other local governmental entities from traditional commercial litigation are (1) public records laws, and (2) governmental decision-making through public bodies. In ordinary circumstances, both of these issues promote and open and fair government. In the context of litigation, however, they provide an adversary with virtually unfettered access to the city's internal workings. The city, on the other hand, will not be able to gain this type of access through the normal discovery procedures.

In order to effectively litigate in this type of setting, we have found that the following tips can be helpful:

- Instruct elected officials not to comment on pending litigation. Elected officials will oftentimes want to publicly comment on these types of issues in order to let the public know their position. They should know what they say may be used in the litigation, and that they likely do not have all of the information at that time.

- Review as much of the publicly available information as possible, including recordings and minutes of all public meetings.

- Use public records laws to your benefit. It is likely that other governmental entities are facing similar issues to you. Oftentimes, it is much easier to get records from a financial institution's customer than it is from the financial institution itself.

The other area where public scrutiny can have a major impact is settlement negotiations. Ordinarily, a municipality will have to have any settlement approved by an elected body. This causes two issues: (1) the settlement must be accepted by a vote as opposed to a single decision maker, and (2) the settlement cannot be confidential. The first of these issues causes logistical difficulties; the second can make it difficult to settle a case at all.

V. Conclusion

Nearly all institutional investors have significant losses arising out of the Financial Crisis of 2008. Attempting to determine who is at fault for these investments is not easy. In light of the LIBOR rate-fixing scandal, the municipal bond bid-rigging scandal, and the numerous securities lending lawsuits, however, municipalities and other local governmental entities should not simply assume that these losses were caused by a decline in the market or were unavoidable. Instead, municipalities should review their portfolio to determine the cause of their investment losses and assess whether litigation is a viable strategy for recovering some portion of them.