Morgan Lewis

commercial litigation newsletter

litigation

Introducing Our Financial Institutions Consulting Practice

Morgan Lewis has a seasoned team of lawyers across multiple practices that have spent the last 18 months working as a unit to help some of the nation's largest financial institutions successfully withstand the numerous highly charged regulatory, legislative, and private actions that have been launched since the financial crisis began. To better meet the needs of our clients, we have created a Financial Institutions Consulting Practice composed of a team of attorneys who are able to efficiently review the policies, procedures, practices, and controls of financial institutions and provide meaningful recommendations for proactively reducing the business risks attendant to negative regulatory reviews, media coverage, and lawsuits.

We are one of only a handful of law firms with direct, recent experience interacting with federal and state regulators, the Executive Office for United States Trustees, and attorneys general regarding consumer financial services, lending, and collections practices. Our experiences at the forefront of these actions provide us with insight into the regulatory regime being imposed upon financial institutions as well as an understanding of the basis of the private litigation being supported by the plaintiffs' bar. Our Financial Institutions Consulting Practice specifically tailors each engagement to the needs and budgets of our clients, providing consulting and review services scaled to accommodate institutions of different sizes and requirements.

We work with our clients to help identify and mitigate the elements of regulatory, litigation, and transactional risk in lending and collections practices, including by:

- Reviewing existing operational policies and procedures to identify gaps as well as reputational, regulatory, and litigation risk.
- Evaluating communications and touch points with clients and consumers to identify potential areas for improvement in message, consistency, and compliance.
- Assessing systems and procedures to evaluate the ability to track, record, and respond to contact with clients and consumers.
- Analyzing current practices, including through interviews with employees, to verify consistency between practices and procedures.
- Analyzing form and standardized documents, including content, controls, and execution processes.
- Reviewing the use of third-party vendors to identify risks relating to processes and controls.
- Training of employees at all levels, either on-site or at our training facilities.
- Counseling in connection with interactions with federal and state regulatory and supervisory authorities.
- Preparing employees and representatives for testimony or interviews.
- Monitoring and reporting of amendments to requirements along with related guidance.

For additional information on this practice and how we may be of further assistance, please contact John Goodchild, a partner in our Philadelphia office, at **jgoodchild@morganlewis.com**.

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in this issue

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NEW! Trend Report

Focus on Financial Services

By Romeo Quinto

This is the first of a series of trend reports tailored for our clients and friends to help companies stay a step ahead of legal issues that may affect their businesses. In this issue, we scrutinize financial analyst reports to identify potential litigation trends in the financial services industry. For the most recent three-month period, the following potential trends have been identified:

Further Mortgage Fraud Investigation/Enforcement

On January 27, the Justice Department announced a new task force focused on investigating and prosecuting fraud in connection with the mortgage crisis. Eleven subpoenas have already been served. The focus of the new investigation is on origination conduct — specifically, fraud in packaging and pooling mortgages for securitization purposes — and will also extend to tax-related issues. This investigation could lead to a wide variety of litigation, including class actions, whistleblower proceedings, and commercial litigations among parties to the securitization process for as-yet-undiscovered frauds or other alleged misconduct.

European Debt and Sovereign Stress

The European debt crisis appears far from resolution and has already impacted the financial sector. Despite intervention by the European Central Bank, the growing consensus is that the crisis will only escalate. In that event, there is potential for litigation related to defaults on debt obligations, credit-linked transactions and defaults on currency-linked transactions, general credit risk/default litigation with respect to both banks and commercial borrowers, insolvency/bankruptcy proceedings, and stock-drop class actions or shareholder proceedings.

Bank Failures, Mergers, and Acquisitions

As the stresses from lingering domestic financial weakness and the European/foreign debt crises continue to build, so does the trend of institutional weakness in the banking sector, particularly among smaller or medium-sized banks. This has contributed to the continuing trend of bank failures and merger/acquisition transactions, which could lead to increased litigation activity including, for example, merger break-up litigation.

Municipal Securities

In recent months, the SEC has intensified its institutional focus on the municipal securities market. More recently, the SEC created a new specialization unit to focus on municipal securities and public pensions. The SEC has also started a new whistleblower program, offering significant payments to municipal insiders and others. The SEC's focus encompasses five primary areas: (1) offering and disclosure fraud, (2) tax or arbitrage-driven fraud, (3) pay-to-play practices and public corruption, (4) valuation and pricing fraud, and (5) accounting and associated disclosure violations. This activity raises the specter of whistleblower proceedings, class actions, statutory indemnification actions, municipal insurance coverage actions, and professional and/or fraud liability actions among municipalities, banks, accounting firms, and others.

Feature Story

Importance of Carefully Drafted Provisions Limiting Damages

By Tom Sullivan

Contractual provisions limiting the types of damages that are available in the event of a breach, i.e. "limitation-of-liability provisions," are common in various types of commercial contracts. Such provisions may be useful in shielding a breaching party from significant liability, but their prevalence may cause some lawyers to view them as "mere boilerplate." *Global Crossing Telecomms., Inc. v. CCT Commc'ns*, 46 B. R. 97 (Bankr. S.D.N.Y. 2011), however, underscores that these provisions are not automatically enforced and are subject to certain exceptions. In light of this ruling, attorneys may want to consider several issues when drafting these provisions.

Global Crossing involved a dispute between Global Crossing Telecommunications, Inc. (Global Crossing) and CCT Communications, Inc. (CCT), two common carriers of telecommunication services. *Id.* at 102. The dispute arose out of a closely negotiated contract under which Global Crossing agreed to provide services to CCT; CCT, in turn, resold the services to retail customers. *Id.* Under the terms of the contract, Global Crossing charged CCT a flat monthly fee for calls to some destinations and a per-minute charge for calls to other destinations. Under this arrangement, Global Crossing had to "eat," or absorb, certain costs of international calls on the monthly fee plan that terminated in certain international areas. *Id.* This program became too costly and Global Crossing purported to terminate the agreement. CCT counterclaimed, seeking damages for breach of contract among other claims. *Id.* at 103.

The court began by analyzing whether contractual clauses limiting liability are enforceable. The contract contained the following damages provision:

> **Exclusion of Consequential Loss:** In no circumstances shall either we or you be liable for indirect, consequential, reliance, or special loss or damages *or for lost revenues, lost savings, lost business opportunity or lost profits of any kind.*

Id. at 102 (emphasis added).

The court held that the damages limitation provision was enforceable under New York law and reflected an allocation of risks between sophisticated parties in an arm's-length transaction. *Id.* at 115. Parties may agree to limit their respective damages remedies under New York law (and under many other states' laws), except in the case of gross negligence or willful misconduct. *Id.* The court found that Global Crossing's conduct did not constitute willful misconduct because it was driven by "economically motivated financial self-interest," and CCT failed to identify any evidence of malice, egregious behavior, or gross negligence. *Id.* at 116.

Next, the court examined whether the damages limitation provision was ambiguous. It began this analysis with an overview of the law regarding contract damages. *Id.* at 116. The law divides damages for breach of contract into "general" and "consequential." *Id.* General damages flow naturally and directly from the breach. *Id.* Consequential damages, also called "indirect' damages, are intended to compensate a plaintiff for losses in addition to the value of the promised performance, i.e., the value of the benefits the performance will produce or the losses its failure may cause. *Id.* Lost profits may reflect either general or consequential damages. *Id.* at 117. General damages may be characterized as lost profits when the nonbreaching party would have profited to the extent that its cost of performance was less than the total value of the breaching party's promised payments. *Id.* Lost profits are characterized as consequential damages when, as a result of the breach, the nonbreaching party suffers loss of profits on collateral business arrangements. *Id.*

In light of these rules, the court held that the first clause of the limitation provision was "straightforward" and barred consequential damages, but held that the second clause excluding claims for "lost revenues, lost savings, lost business opportunity, or lost profits of any kind" was ambiguous. *Id.* at 119. The second clause presented an "interpretative problem" because it could be read to bar "lost profits" or "lost revenues" that fall within the category of *general damages*. *Id.* Thus, the court declined to conclude as a matter of law that the provision barred any such general or direct damages, but left open the possibility that extrinsic evidence may explain its meaning. *Id.* at 120.

Global Crossing underscores several important considerations regarding contractual provisions limiting damages:

- There are several exceptions to the enforceability of damage limitations, including gross negligence, willful misconduct, and other public policy exceptions, but such exceptions may be difficult to establish.
- Some statutes and contexts may create special relationships between the parties that preclude the enforceability of the limitations provisions.
- Although courts will often imply the exception for gross negligence or willful misconduct, it is best to explicitly state in contracts that consequential damages will only be available where there is gross negligence or willful misconduct.
- Given the frequent blurring of the distinction between general and consequential damages in practice, it is advisable to define the terms "consequential damages" and "general damages" by listing the specific types of damages included under each category. Because "lost profits" and "lost revenues" can both be interpreted to be categories of general damages, one should list these types of damages as types of consequential damages by using the phrase "including," and the term "lost savings" should generally be avoided or precisely defined.
- Drafting attorneys should consider excluding all consequential damages and also may want to consider a cap on damages.
- The damages limitation provision should appear in its own section and be conspicuously placed.
- Attorneys should consider language that the damages limitation provision reflects the express intent of the parties and reflects a deliberate and bargained for allocation of risk.
- It is generally advisable to include a choice of law provision mandating the applicability of New York law (or the law of another jurisdiction that is clear and favorable on this issue).

Damages limitation provisions may be very helpful, and drafting attorneys may want to consider these issues to increase the likelihood that they will be effective and minimize the risk of ambiguity in such provisions.

Office Highlight

NY Commercial Litigation

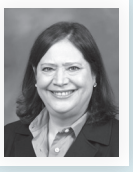
Morgan Lewis's New York office has a strong commercial litigation practice. Our team works together with commercial litigators throughout the firm as well as securities and insurance recovery attorneys in our home office. We represent a diverse group of clients, including a foreign sovereign, chemical manufacturers, a multinational transportation and aerospace company, international shipping and logistics providers, financial services companies, and indenture trustees. Our attorneys are adept at handling

Our attorneys are adept at handling a wide range of matters including contract disputes, class actions, business torts, accounting matters, breach of duty claims, insurance disputes, cross-border disputes, foreign sovereign immunity issues, claims related to mergers and acquisition agreements, art law, and product liability issues.

a wide range of matters including contract disputes, class actions, business torts, accounting matters, breach of duty claims, insurance disputes, cross-border disputes, foreign sovereign immunity issues, claims related to mergers and acquisition agreements, art law, and product liability issues. We routinely appear in state and federal courts at both the trial court and appellate level as well as in domestic and international arbitrations across the country and around the world. One of our attorneys recently served as the Chair of the ABA's International Arbitration Committee, Section of International Law, and is a Fellow of the Chartered Institute of Arbitrators.

We would like your feedback on our Commercial Litigation Newsletter. Please click here to send us your comments.

The Morgan Lewis New York Commercial Litigation Team



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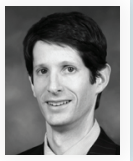

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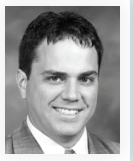

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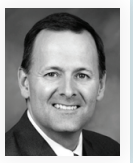

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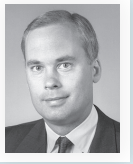

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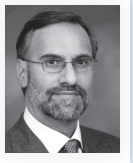

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