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Litigators of the Week: Daniel Slifkin and J. Wesley Earnhardt of Cravath, Swaine & Moore

Daniel Slifkin

J. Wesley Earnhardt

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Since the financial crisis, mortgage-backed securities investors have brought dozens of suits against J.P. Morgan Chase & Co. Those cases have mostly skated through the pleading stage. But summary judgment can be a very different story, as Cravath, Swaine & Moore partners Daniel Slifkin and J. Wesley Earnhardt showed this week when they eviscerated Dexia SA's $774 million fraud case against the bank.

U.S. District Judge Jed Rakoff in Manhattan largely dismissed Dexia's case on Wednesday, ruling that the French-Belgian bank doesn't have standing to bring claims over 60 of the 65 securities at issue in the case. The ruling, if it stands on appeal, may limit Dexia's potential damages to a puny $5.7 million. And it could come back to haunt Dexia and other large investors in the near future.

Between January 2006 and August 2007, a Dexia subsidiary called FSA Asset Management LLC ("FSAM") invested $1.6 billion in 65 MBS certificates issued by JPMorgan and subsidiaries it purchased in the financial crisis, including Bear Stearns and Washington Mutual Inc. Dexia brought suit in January 2012, alleging that the defendants misrepresented the risk profile of the mortgages used to collateralize the MBS. Dexia alleged that, because of those misstatements, it overpaid for the MBS by $774 million.

Judge Rakoff is known for keeping a tight schedule, so the case moved along rapidly. In fact, of the dozens of fraud cases brought against JPMorgan by MBS investors, the Dexia case is just the second to complete discovery. The first was a $10 billion securities class action against JPMorgan subsidiary WaMu Capital Corp. Cravath handled that case and got most of the claims knocked out on standing grounds. Plaintiffs lawyers ended up settling for just $26 million in September 2012.

Earnhardt and Slifkin employed a similar strategy in the Dexia case. During discovery, the Cravath duo learned that all 65 of the MBS certificates at issue were purchased by FSAM, which later sold them to Dexia. According to Earnhardt and Slifkin, FSAM, as the original purchaser of the security, was the only plaintiff with standing. Under New York law, if the original purchaser of a security sells the security to another party, the second party doesn't necessarily inherit the right to sue for fraud. A valid transfer of that right must be explicit and unequivocal. FSAM and Dexia's agreement was far from clear on that point, JPMorgan argued.

You're probably asking yourself why these arguments even matter; since FSAM is a Dexia subsidiary, can't Dexia just bring the case through FSAM as the sole plaintiff? The problem for Dexia was that FSAM transferred 60 of the 65 certificates to the Dexia entities for full price. For the other 5 certificates, the combined difference between what FSAM originally paid and what Dexia eventually paid was a negligible $5.7 million. One could argue, therefore, that FSAM's injury was, at most, $5.7 million.

Earnhardt and Slifkin focused on that standing argument in their motion for summary judgment. Cravath partner Michael Paskin also contributed to the briefing. Slifkin hammered the point home over the course of two lengthy oral arguments before Rakoff earlier this year.

The standing argument seems to have prevailed. In a 2-page order, Rakoff wrote that he's dismissing any claims brought by the Dexia entities and that FSAM can only sue over 5 of the original 65 offerings. While Rakoff's reasoning won't be spelled out until he issues an elaborated opinion, it's pretty obvious from the claims left standing that he adopted Cravath's argument in its entirety.

To make matters worse for MBS investors, Rakoff's ruling could have legs. Dexia, for its part, has a similar fraud case against Deutsche Bank pending before Rakoff over about $1 billion in mortgage-backed securities. In a motion to dismiss Dexia's amended complaint, Deutsche Bank's lawyers at Paul, Weiss, Rifkind, Wharton & Garrison raised parallel arguments last month about FSAM's lack of standing, and they cited discovery in the JPMorgan case.

"It's not a foregone conclusion that plaintiffs will get past summary judgement in complex securities fraud cases," Earnhardt told us on Thursday. "No matter how complex or large the case is, plaintiffs have to come forward with specifics."

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