DERIVATIVE LITIGATION AND DISPUTE RESOLUTION

PROF. FELSENFELD: The next, and the longest, portion of our program has to do with derivatives litigation. I am very proud to introduce the next speaker, who will manage this afternoon's program. He is one of the acknowledged stars of the field of derivatives, helped create it in the 1970s, and now stands at its head.

Denis Forster, a New York lawyer, has been involved in some of the major derivative lawsuits. He served as lead counsel to the Kingdom of Belgium Ministry of Finance in its dispute with Merrill Lynch and advised Procter & Gamble in its highly publicized litigation with Bankers Trust.

He participated in the drafting and development of the 1987 and 1992 ISDA Master Agreements, and coordinated the amendment in 1994 of the New York Statute of Frauds making oral derivative trades enforceable. He established a practice in New York in which he largely consults and advises derivative end-users in resolving their disputes with dealers.

Denis, we are very happy to have you here and I turn the afternoon session over to you.

DENIS M. FORSTER:* Thank you very much, Carl. As you can see from your program, after my comments we are going to have the benefit of three different panels. We are very fortunate to have leading attorneys from the top firms here in New York who worked on recent derivative litigation cases, and they will be able to share with all of us their insights.

Just to keep them honest, we have Carolyn Jackson, who spent a number of years in the industry—in fact, I have known Carolyn for about twelve to thirteen years. After rising to the heights of being Executive Director of the International Swaps and Derivatives Association, Carolyn got religion and is now going to law school, as you may know. The real good news for Carolyn is that she has already landed a job with the prestigious firm of Allen & Overy over in London, so she is going to carry on her career.

And then, what is really going to be unique about this program is that we are going to have the benefit of hearing from the people who

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really count, the judges—Justice Ramos and Judge Hellerstein.

After my remarks, Martin Bienenstock and his panel will discuss unique issues of OTC derivative disputes. Then John Lovi and his panel will delve into litigation surrounding the sale of derivatives to funds. Finally the judges will share their perspectives.

I appreciate that there may be some here who do not have a whole lot of familiarity with derivatives, and it might be helpful if I start by identifying what part of the derivative world we will be speaking about this afternoon.

I guess, if you are going to divide up the universe, one way of doing it is to look at those instruments that are exchange-traded compared to those that are traded over-the-counter. Examples of exchange traded instruments are futures and options. In the United States, that is principally in Chicago. These are basically standardized contracts with margin requirements, a clearinghouse, and thus a lot less credit risk—almost no credit risk.

In sharp contrast with that, we have the over-the-counter ("OTC") derivatives. These would be swaps and options on a variety of different things, such as interest rates, currencies, commodities, equities, and now credit derivatives and others. These products are individually tailored and very, very innovative. There is no clearinghouse and often no security. They have the potential for a lot of risk, and therefore a lot of loss. Their trade association is the International Swaps and Derivatives Association that I just mentioned with respect to Carolyn.

We will be talking about OTC derivatives. In that context, the world can be divided with respect to participants into two different groups. On the one hand, we have those top-tier banks around the world, both commercial and investment banks, with a few affiliates of top-tier insurance companies, who have created a market in these products. We call them, as you may well know, in industry parlance "dealers." They sell products to those who can use them for purposes of risk and asset management. This might be corporations or it could be other banks, regional and community banks, pension funds, perhaps a whole host of other types of entities, including now individuals. We call them "end-users." So just to keep it clear, I will try to use that terminology throughout.

By the way, as Carl in his generous comments at the outset mentioned, and I should mention to you up-front so that you can properly discount whatever I have to say because of my biases, I do exclusively represent end-users. I appreciate that there may be some out there in the dealer community that basically equate any lawyer who represents an end-user as equivalent to the lawyer who might represent a child molester—or maybe even worse, the child molester himself. I appreciate that, because a lot of times these issues are real hot-button types. It's the one thing that I have seen people, particularly on the dealer side, actually get quite emotional about. We are going to try to keep it real dispassionate here, of course.

I should mention in this regard two things. I am not going to try to say that even end-users deserve legal representation, because I am sure you all would agree with that. But what I want to say is that there are indeed end-users out there who, with their eyes wide open, go out and bet on black and it comes up red; then they go groping around trying to find a legal excuse to wiggle off the hook, a legal loophole. Since this is what I do exclusively, I do get calls from those types of end-users, and they are usually not those that have been in the market for a long time. I think that I know the right questions to ask and I am pretty well able to screen them out quickly. I decline much more business than I accept. Believe it or not, there are some end-users out there that have a meritorious case, and that is what I want to talk about today.

But also, as a second point, I want to mention that it is difficult in many respects to represent the end-user. In a sense, the deck is stacked against you. I have been trying to remember that expression that John McCain has been using—and over-using—which has to do with "Star Wars" and he is battling against all these "known evils." Anyway, it is some figure from "Star Wars."

I am not going to suggest to you that representing the end-user is that difficult, but there are a lot of forces that you have to reckon with. The main one is that we are a Johnny-come-lately. When as a lawyer you get involved in a dispute, the die has already been cast, in a sense. The deal has been done, the documentation has been done, the end-user has signed on the dotted line, and the documentation may be very disadvantageous, and there may be a number of other things that are going against you. I will talk later about how one could help balance the playing field, an opportunity that counsel for the end-user does have to balance the playing field. But starting off, it is definitely tilting against you.

In terms of putting some kind of perspective on this thing, we have the end-users and the dealers, and I am very, very happy to say that, in general, they live in harmony. When you look at it, it is only a small fraction of one percent of the deals that end up being disputed. Usually, however, the amounts are so enormous, the losses so huge, that it overshadows the positive contribution being made by dealers with these instruments. But it is a reality that in fact it is a very, very small fraction. It is that fraction of deals that go awry that have given the industry some pretty tough times.

What I would like to do is talk about a couple of cases that were high profile, and try to put them into some kind of perspective. What impact have they had on the industry and the industry's way of thinking? Then I would like to go through a number of causes of action, or theories of recovery, that end-users' counsel should have on their checklist. Perhaps counsel representing the dealers will want to have on their checklist in terms of structuring deals properly and documenting them properly at the outset. Finally, I would like to talk about some strategic considerations that end-users' counsel should use.

Now, the date was September 12, 1994. That was a date that an event occurred that rocked the OTC derivative markets, and things have really never been the same since. On that day, a lawyer named Cliff Craig, of the Cincinnati law firm of Taft, Stettinius & Hollister, walked into Federal Court in Cincinnati and filed a complaint against Bankers Trust on behalf of his client, Gibson Greeting Cards.[1]

I remember the date quite well and the immediate aftermath. The reaction of the industry was furious. The basic thought was, "How can they do this? How can people who enter into a trade seek to unwind it by getting lawyers involved using legal loopholes?" Gibson Greetings was asking to basically void a number of trades with a marked-to-market value of $23 million.

Then the all-important facts started to seep out. The SEC got involved, they investigated, and they got hold of some tapes. The pattern and the facts that emerged were that Bankers Trust had gone in and entered into a series of increasingly sophisticated, increasingly complex, increasingly risky transactions with Gibson Greetings, culminating in a LIBOR-squared swap. Nobody had ever heard of a LIBOR-squared swap before.

1. In re BT Securities Corp., Securities Act Release No. 33-7124, Exchange Act Release No. 34-35136 (Dec. 22, 1994) (concerning a "Treasury-Linked Swap" between Gibson Greetings and BT Securities Corporation).

When you looked at it, really what had happened was that Gibson Greetings, a gift-wrap and greeting cards maker, in Cincinnati, Ohio, had written an option in favor of Bankers Trust to pay Bankers Trust LIBOR-squared times the notional principal amount if LIBOR breached a certain barrier. Again, I have never heard anybody who could economically justify such a trade, except perhaps to earn premium income for Bankers Trust.

And then there were the tapes. It became quite clear from the tapes that Bankers Trust had identified a pigeon at Gibson Greetings and were feeding him some erroneous information with regard to value.

The reaction of the industry was, "Well, maybe in this particular instance one of our own crossed the line. Maybe Bankers Trust shouldn't have sold a LIBOR-squared swap to this greeting cards maker in Ohio." That was on September 12th.

Meanwhile, back in Cincinnati, cross-town swap loser Procter & Gamble finds that it is sitting on top of trades which amount to $200 million marked-to-market engaged in with the same crowd from Bankers Trust. As you might imagine, the *Cincinnati Inquirer* and all other papers had headlines about what happened to Gibson Greetings, so Procter & Gamble filed its suit in Federal Court in Cincinnati, Ohio.[2]

Gibson Greetings alleged a number of counts, including breach of fiduciary duty, fraud, and Procter & Gamble did essentially the same thing. Later they also alleged a RICO count. There were some sixteen different counts that Procter & Gamble alleged in that particular case.

The case eventually settled about eighteen months later, in May of 1996, and simultaneously two things happened. First, Judge Feikens issued an order and a reasoned decision dealing with a whole host of counts raised by Procter & Gamble. But, before that order had been delivered by Federal Express to the parties, the parties settled the case, and they settled the case in a manner very favorable to Procter & Gamble. Basically, the $200 million liability, more or less, to Bankers Trust was reduced to $35 million and there were some adjustments made on swaps. In other words, a very, very positive settlement for Procter & Gamble.

What was important there was that Judge Feikens went through and he slammed the door shut on about thirteen different counts that Procter

2. Procter & Gamble Co. v. Bankers Trust Co., 925 F. Supp. 1270 (S.D. Ohio 1996).

& Gamble was trying to get to the jury. But he left one door open, and all you need is one door. That door was the concept that if one party has superior knowledge not readily available to the other party and the first party knows that the second party is acting on a mistaken belief, then that first party—read that Bankers Trust—has a duty to disclose material facts, and a failure to do so with intent and the other elements necessary for fraud, constitute a fraudulent omission. I wrote an article which goes through the decision by Judge Feikens and focuses on a number of the different things that he said that may be of some interest to you at some point in time.[3]

Now, what was different about these two cases? Why did I say that this rocked the OTC derivatives world? Well, before this happened, most of the cases involving OTC derivatives involved an insolvency. In fact, people that talked about derivative litigation didn't have too much to talk about; you could get it done in about a half-hour.

There were two cases involving California thrifts, there were a couple of cases involving Drexel, and then there was the *Hammersmith and Fulham* case in England that I will talk about shortly. However, in each of those cases the common denominator was that you were dealing with an insolvency, or if the trades were upheld, you would have had an insolvency.

People at that point in time looked at the two major risks in derivatives. First, let's say we enter into a trade and the market moves against us. The market is either going to move for us or against us, and the market moves against us. Well, we call that market risk.

But what if the market moves in our favor? That is the good news. But what's the bad news? The bad news is our counter-party doesn't pay us. So we had counter-party risk. Prior to 1994, most people in this business equated counter-party risk with credit risk, credit risk being the financial inability of your counter-party to perform, because it is insolvent for instance, or near insolvent. That makes sense. That is credit risk.

But people really didn't focus on this other thing, called legal risk. When Gibson Greetings and Procter & Gamble filed, what they were saying is, "We've got the financial ability to pay, but we are mad as hell

3. DENIS M. FORSTER, AN ANALYSIS OF THE HOLDINGS IN *PROCTER & GAMBLE V. BANKERS TRUST* (2000) (on file with the *Fordham Journal of Corporate & Financial Law*).

and we've got a legal reason not to pay, so we are not going to pay." And there is the difference. Now people started to say, "Hey, you know, there is this thing out there called legal risk. We really never focused on it, but maybe we should start focusing on it."

Now there is so much derivative litigation out there that Andrews even has a *Derivative Litigation Reporter*.[4] You know that your field has arrived when Andrews trots out a Litigation Reporter. So there is a lot of litigation. We have people here appearing on the panel dealing with these issues, but some years ago people really didn't focus on these points.

I would like to take a brief trip through the different causes of action that have been used, alleged, and talk about the legal risks associated with those. I think they ought to be on a checklist for end-users' counsel, and even for counsel representing the dealers.

The first, in terms of a logical sequence, would be to deal with capacity, because after all, what we are usually talking about here is trying to enforce a contract. In basic Contracts 101, we learned in the first day that the party with whom we are contracting has to have the capacity to contract. For instance, a minor does not have the capacity to contract except for necessities.

We know that, in the United States at least, when we are talking about corporations, the idea that they can turn around and claim lack of capacity has pretty much gone by the wayside. In fact, under Delaware General Corporation Law, there is a specific provision that says that a corporation cannot use lack of capacity as a defense except in certain very limited circumstances not relevant here.

So if you are dealing with a U.S. corporation, you generally do not have to worry about this one. But there are others you do have to worry about—particularly, municipalities, pension funds, and regulated industries. Also if you are dealing with an offshore entity you may have to worry, because what applies here in the good old U.S.A. may not apply offshore.

Perhaps the most famous case here was *Hazell v. Hammersmith and*

4. In 1970, Andrews Publications created the first Litigation Reporter and revolutionized the delivery of timely and accurate litigation information. Currently, Andrews publishes over 50 Reporters covering key legal niches, including the Andrews Derivatives Litigation Reporter. The Derivatives Litigation Reporter, published in 24 issues per year, provides summaries of over-the-counter derivative controversies in cutting-edge cases. See generally <http://www.andrewspub.com>.

Fulham,[5] a borough in London. There, from 1983–1989, the borough went out and dealt with some eighty different commercial banks and put on literally hundreds of trades all betting that Sterling short-term interest rates would remain low. They were right until 1989, when Sterling short-term rates spiked. When they spiked, the borough's auditor took a look and said, "You know, I'm not so sure that these contracts are enforceable because I'm not sure we have capacity here." Of course, they had been accepting the money for some six years.

The long and the short of it is that the case went to the House of Lords and, in a unanimous decision (5–0) in 1991, the House of Lords looked at the authorizing statute, which dated back to 1845, was amended in 1972, and said, "You know, we can't find anything in here that says that this borough can do swaps and furthermore, these were not incidental to their borrowing powers; therefore, commercial banks, these contracts amounting to over $500 million are void." That got a lot of people's attention. So we had the capacity issue there. The first thing to do is to check capacity.

Also, the same issue of *ultra vires* was raised in the Orange County case with regard to the reverse repurchase agreements. Arguably these agreements exceeded the restrictions imposed by the California Business Code. If so, they would have been rendered them void.

Then there is the related but distinct issue of authority. In addition to *ultra vires* and capacity, we have the issue of authority. The issue is that the entity has the capacity, but does the particular individual signing have the authority. In the United States and other common law jurisdictions, what usually bails us out here as a failsafe is the doctrine of apparent and ostensible authority. We have had a lot of rogue traders around the world, such as Nick Leeson[6] and the like. But until recently, I hadn't heard of a bank or a counterparty or anybody turning around and saying, "You know, the doctrine of apparent authority doesn't work

5. Hazell v. Hammersmith & Fulham London Borough Council, 2 All Cas. 1 (1991) (on appeal from Q.B.).

6. Nick Leeson is a former derivatives trader with Barings Bank, Britain's oldest financial institution, who caused its collapse by making certain trades that exposed Barings to excessive risk. *See* Richard W. Stevenson, *The Collapse of Barings: The Overview, Young Traders' $ 29 Billion Bet Brings Down a Venerable Firm*, N.Y. TIMES, Feb. 28, 1995, at A1. *See generally* BANK OF ENGLAND, REPORT OF THE BOARD OF BANKING SUPERVISION INQUIRY INTO THE CIRCUMSTANCES OF THE COLLAPSE OF BARINGS PP 1.33-1.70 (1995).

because you knew our guy didn't have the authority"—until recently, in the *Sumitomo Copper* cases.[7] That is now being alleged by Sumitomo Copper.

In other words, the idea here is—and this is important in this business, which is basically done by telephone—that if the company arms an individual with a telephone and puts him in a position of ostensible authority, then that entity is going to be bound regardless of the fact that maybe he or she does not in fact have authority.

Where this can come up overseas, when you move away from the common law jurisdictions to civil law jurisdictions, is you have to fall back on express authority. There can be some pretty bizarre things out there. In some countries, a person is authorized only if their name appears on the registry, and the registry may only be open between 10:00 and 2:00 on Tuesdays, and it is very difficult to know whether or not you are in fact dealing with someone who is authorized. I guess, in a couple of instances, counterparties have raised that as a defense. It seems like arguably a low blow, but there it is, and it is something that people have to be alert to if they are dealing offshore.

The next issue I would want to bring to your attention is the Statute of Frauds. Again, we are going back to Contracts 101. Hopefully, nobody skipped Contracts 101, because there is a lot in it. You may recall that at the time of Charles II, in order to avoid a variety of different frauds that were then being perpetrated in England after the so-called civil war over there, they passed the Statute of Frauds.

One of the provisions was that an oral contract which by its terms cannot be performed within one year—sort of archaic language, which we picked up and have in our statutes today—is void. So you take a look at a trade, let's say, a swap that goes out thirteen months that is done orally over the telephone. Do you have a deal? Well, not unless you have done something about the Statute of Frauds.

And again, what makes this so important for historical reasons and for practical reasons in this business is basically "trade now, document later." The vast majority of these trades are done orally over the telephone with the expectation, at least by the dealer, that it's a done deal when they hang up the telephone. Now, in 1994, New York changed the Statute of Frauds with regard to the one-year rule.[8]

7. *In re Sumitomo Copper Litigation*, 74 F. Supp. 2d 393 (S.D.N.Y. 1999).

8. In 1994, the NY Legislature added a new subdivision (b) to General

Also, I forgot to mention that we have had two cases here in New York, *Intershoe v. Bankers Trust*[9] and also *In re Koreag*,[10] where courts here in New York took the view, supported by the official commentary in Article 2 of the Uniform Commercial Code, that foreign exchange and foreign currency are goods; therefore, a sale of a foreign exchange contract is a sale of goods subject to Article 2. If you follow that and take it just one step further, that means that any foreign exchange contract for over $500—meaning 99.9 percent of them all—is subject to the Statute of Frauds. In 1994, New York changed that, as well.[11]

But what I think people need to be alert to is that although New York has changed the application of Article 2, other states have not. Therefore if, for instance, you have General Re or AIG up in Connecticut dealing with someone in Texas, or even someone here in New York dealing with someone in Texas, what is the applicable law?

There may be a Master Agreement in place—and this sort of gets intricate—and there are provisions of Master Agreements that say all agreements have to be in writing. If you follow that, you sort of block the protection of the Statute of Frauds. In any event, it is something that I think people need to be alert to.

Moving on, another count frequently raised in these cases is misrepresentation. This is a fact-intensive inquiry. Basically it is whether or not the facts of the particular case match up with the elements for misrepresentation under New York law.

And then, there is the one that has drawn an awful lot of attention, as I alluded to earlier, which is fraudulent omission, also known as fraudulent concealment. Here, Judge Feikens in the Procter & Gamble

Obligations Law 5-701. This subdivision provides that a qualified financial contract, defined in subsection (b)(2), would not be subject to requirements that a writing (as defined in the statute) be present, so long as there was sufficient evidence of a contract or if the parties agreed by a written contract (before or after the contract in issues) to be bound by telephonic or electronic messages or other means of agreement. Generally, the 1994 amendment sought to release large broker-dealers from the NY Statute of Frauds writing requirement when they conduct certain types of transactions with qualified institutional investors. *See* N.Y. Gen. Oblig. Law 5-701(b) (McKinney Supp. 1997).

9. 77 N.Y.2d 517 (1991).

10. Koreag Controle et Revision S.A. v. Refco F/X Associates, Inc. (In re Koreag, Controle et Revision S.A.), 961 F.2d 341 (2d Cir. 1992) *cert. denied*, 506 U.S. 865 (1992).

11. *See* N.Y. Gen. Oblig. Law 5-701(b) (McKinney Supp. 1997).

case**,** as a Michigan judge sitting by designation in Ohio in a case in diversity, but applying New York law, looked at New York law, and said that under New York law there is a duty to disclose if any of those three conditions that I earlier mentioned occurred. That is to say that if Bankers Trust had superior knowledge as to material information not readily available to Proctor & Gamble and knew that Procter & Gamble was acting on a mistaken belief about that information, there is a duty to disclose the information.

If those things come together and coalesce, then a duty to disclose occurs and the failure to disclose can constitute fraud. The benefit from the standpoint of an end-user here is, with either misrepresentation or fraud, it could lay the basis for entitlement to punitive damages.

Next is fiduciary duty. That is, admittedly, a difficult one to establish. In fact, basically Judge Feikens said in *P&G*, "Hey, you guys don't need fiduciary duty. Quit coming at me with that one. You've got superior knowledge and that should get you home." That is basically what he said, reading between the lines.

But under fiduciary duty what one would have to establish is that: 1) the dealer invited the trust and confidence of the end-user; 2) the end-user placed his trust and confidence in the dealer; and 3) because of that trust and confidence being placed, the dealer had a position of superiority and influence.

When you use the word "fiduciary" it is like using RICO**.**[12] Sometimes the titles just don't match. We talk about RICO, and RICO seems to be used against everybody except racketeers. We are sort of hampered, in a sense, by the label "fiduciary duty" because it sounds so awesome. But if you ask a dealer and a salesman, "How do you get the business away from your competition? How is it that you were able to sell this product and all the competition trying to get at that end-user couldn't do it?" They might very well say, "Well, I got the trust of that customer."

A lot of times when you are dealing with explosive products, such as derivatives, like nitroglycerin, the person buying the product wants to be able to trust the other party. So whereas at first blush it sounds like a far stretch to say that the dealer has a fiduciary duty, when you look at the facts, and you find a great disparity in knowledge and sophistication between the parties, then it becomes, I think, much more acceptable.

12. 18 U.S.C. §§ 1961-68 (1994 & Supp. II 1995).

There are a number of others; I will just mention them:

1) Federal securities laws, in particular, Rule 10b-5.[13] The threshold issue there is, whether this particular instrument constitutes a security for purposes of the federal securities laws.

2) The anti-fraud provisions of the Commodity Exchange Act.[14] There, the threshold question is, whether the instrument is a futures contract or a commodity option, so as to bring into play the protection of the Commodity Exchange Act.

3) You might also want to take a look at state securities laws. In a particular state, there may well be protection, again if your instrument constitutes a security.

4) I almost hate to mention this one, and would never run a case based on this alone, but you might use the gambling and gaming statutes, particularly offshore. We have pretty much resolved that problem here in this country, but you may find that there is some merit there. Again, I would use this as an add-on. I would never try to use this as the sole basis for a defense of an end-user.

5) There is, as I mentioned, the RICO Act[15], which some people use, and I think should be used very, very sparingly and only if the facts scream out for such a thing, but in some cases maybe they would.

6) Last but not least, what I suggest should be on people's checklist are the anti-tying provisions of the Bank Holding Company Act[16], which were adopted in 1970. The provisions are almost counter-intuitive,

13. See 17 C.F.R. 240.10b-5 (1999). Rule 10b-5 under the Securities Exchange Act of 1934, first promulgated in 1942, was adopted in order to prohibit any person from using or employing any manipulative or deceptive device in connection with the purchase or sale of a security.

> It now reads: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact in order to make the statement made, in light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

14. 7 U.S.C. § 1 et seq. (1994).

15. 18 U.S.C. §§ 1961-1968 (1994).

16. 12 U.S.C. §§ 1841-1841 (1994).

basically saying that one cannot tie one product to another product in a sale. But an aggressive salesman, the same person who is selling that derivative, may very well overstep the boundaries here and tie the two products together. You can also theoretically make out a case under the Sherman Act, but that is a near-impossible task with the requirements for affecting interstate commerce. But the Bank Holding Company Act is really fairly easy and streamlined if you have the facts and if you are dealing with a commercial bank or one of its affiliates.

There may be some others, such as the Unfair Trade Practices Acts under the states, but those are the major ones.

Now, what do we do about this? I talked earlier about how the end-user is in this inferior position because of his knowledge of the product—and by the way, the products we are talking about are not "plain vanilla." The ones that blow up and cause problems are the ones that are very, very complex. Marketers do not make a lot of money by selling "plain vanilla" swaps. They are like commodities with very, very narrow margins. Where they make the money is with the complex products, which are difficult to value, difficult to price, or at least difficult for the end-user to determine the appropriate price and the actual risk level.

To start off, you are going to find that your client pretty much has no idea as to the workings of the product, how to model it, how to price it, what the alternatives were in terms of market practice. Further, the client will have signed some documentation without really having even read ISDA.

How many people are out there in, for instance, the oil patch down in Texas, doing these trades, signing ISDA agreements that never read those ISDA agreements, much less understand them? I think you could take 100 and you wouldn't find one.

Now, I have the good fortune of having only one client for transactional work and I try to reserve the rest of my time for representing end-users in disputes. That client is Microsoft Corporation. They are a wonderful client in many, many respects. They are not a triple-A-rated entity. Despite all of the problems they are facing right now in terms of legal challenges, they are nevertheless a very, very attractive counterparty for dealers. Dealers are very anxious to do business with them, even though they don't have a triple-A debt rating. The reason they don't have a triple-A debt rating is they don't have any debt. In fact, they are sitting on $19 billion of cash. Now, that makes it pretty easy in dealing with dealers and negotiating with dealers' documentation. At the end of the day, I think we get some very protective documentation from dealers.

Now, the irony of this is that Microsoft's treasury is staffed with a number of very bright people who probably don't need the protection that I negotiate for them. But the people that really need the protection are the ones that are maybe doing one or two deals. They often do not have the protection.

I am going to turn next to what we do about these things. What do you do about such a situation? We all look at the world through a different knothole, and because we stand in different places we see different things. Here in New York, quite understandably, finance and commerce is king. To us, the sanctity of the contract is very, very important. We frequently say, "If you sign it, you should have read it; if you read it, you should have understood it; if you didn't understand it, you should have gotten a lawyer." That makes a lot of sense right here in Manhattan, and we can understand why the law is the way it is in New York.

But I suggest that if you take that same scenario down to Texas and ask a judge to look at the situation and say, "Did it really make sense in this fast-moving environment to ask this assistant treasurer to go up to New York to try and find somebody that knows this stuff, that has the time to work on it and figure it all out and negotiate it and pay him those New York rates that the lawyers charge up there before doing the deal; or, alternatively, just accept what the dealer said was standard documentation?" I think you might find that the Texas judge says, "You know, you are right. I think I can find an ambiguity in this twenty-four-page document which will help you out." So it is just a difference in viewpoint.

So the question here is, how do we balance the playing field? I think it is through the choice of forum. In the ISDA Agreement Section 13-b, it basically says that if you select New York law, you get New York jurisdiction. Nobody ever changes that, or they very rarely change that. So you can have the emphasis on non-exclusive jurisdiction.

The alternative—and you look around and you say, "Well, under the facts of the case, would I have jurisdiction in our home state?"—let's just use Texas as an example. Then you look at the long-arm statute in Texas, you find that perhaps the dealer came down and made calls in Texas and did a number of other things to satisfy the minimal requirements of the due process clause and the long-arm statute. Now you say, "Well, I can sue them in either Texas or New York." Which way are you going to go on that one?

And if there is any question about it, you might want to think back to what happened in the *Pennzoil v. Texaco*[17] case back in the 1980s. In that case, Pennzoil did not come up to White Plains to sue Texaco in New York. They sued them in Houston, in Harris County. There the jury got hold of this one and came back with a $10.2 billion judgment against Texaco. Texaco felt it had some strong grounds for appeal—but guess what? They could not appeal. The reason they could not appeal is they had to file an appeal bond. The appeal bond was twice the amount of the judgment. They could not get anybody to come up with an appeal bond for $20.4 billion. So what happened? They had to settle. They actually went into bankruptcy. They were driven into bankruptcy and eventually settled. As sort of a footnote to that, plaintiff's counsel down there, Joe Jamail, according to *Forbes*,[18] was compensated for his efforts in that case to the tune of $345 million and is now one of the wealthiest people in America. But getting back to the forum issue, the interesting point is that initially somebody from Pennzoil filed up in Delaware. Then they realized their mistake and, before Texaco responded, they were able to get a dismissal without prejudice and get it back down into Harris County.

It is not only the juries that people should give some thought to. I would like to share with you one story about the late Carl Rubin, who was the presiding judge in the *Procter & Gamble* case in Cincinnati, who very unfortunately died in the midst of that case. He was a very highly regarded individual. I understand that he had a canned speech that he would pull out every time a New York lawyer walked into his court. The thrust of that speech was he was going to raise that New York lawyer up to the level of a Cincinnati lawyer. So it is not only the jury, but also maybe the judge is a bit different and creates a different environment.

So in terms of which way to go, it is hard to imagine, at least domestically, if you are representing somebody in the United States and you have a choice to sue in Texas versus New York, why you would

17. 626 F. Supp. 250 (S.D.N.Y. 1986).

18. *The Forbes 400: America's Richest People Renegades*, FORBES, Oct. 11, 1999, at 362.

ever sue in New York. Now, never say never, and there may be a reason I just haven't thought of.

Of course, people feel much more comfortable in their own jurisdiction. Procter & Gamble, as an example, didn't file in New York. I don't think the thought ever occurred to them. In 1840, when Cincinnati was just a cow town, two guys named Procter and Gamble went down to the slaughter yards and took the fat off the carcasses of the cows, started making soap, and now you have a $31 billion-a-year company. Along the way, they had given a lot of money to local orphanages and universities and the like, and they are known as a model corporate citizen. Where are they going to go? Are they going to look for a jury in New York or in Cincinnati? That should be pretty easy.

In representing the end-user, I think one should make sure that they guard and protect the ability to sue in the local forum. If there is money due under the contract, you want to make absolutely certain that you don't breach it. You don't want to say anything that would constitute an anticipatory breach so that you can retain that.

Now, wanting to close on a positive note, what makes sense in these cases? Carl and I were talking earlier about all of these cases settling. These are not about great principles, like abortion and things like that. This is about money. Also, the reality is that the dealers are good companies with good culture. A lot of times, what happened is that a bonus-oriented salesman got off the reservation and did something that maybe senior management isn't too happy about. So there should be an opportunity to settle, and there will be at some point in time.

The question is, when do you settle the case? The time that seems to make the most sense in these cases is before filing the complaint. I say that because there is settlement value to be extracted. The dealer does not want the complaint to be filed for two reasons:

• One, negative publicity, if indeed you do have a case that involves negative publicity—and I am assuming all along that we've got a meritorious case. Publicity is important particularly if there are tapes and sound bites and things that the press would get hold of. It is what the federal regulators call reputational risk. So the dealer is not going to want that to happen.

• And also, there is the concern in some cases by the dealers of copy-cat cases. For instance, when Gibson Greetings started with their case, then you had Procter & Gamble and Air Products and Federal Fiberboard and Sandoz AG, and everybody is coming out of the woodwork. So dealers know filing can have that effect, and this can get worked into the settlement amount that is provided.

On that happy note, I would like to close.