

## Subprime – Law Firms

# A Bankruptcy Practitioner's View Of The Subprime Mortgage Crisis

The Editor interviews **M. Stephanie Wickouski**, Drinker Biddle & Reath LLP.

**Editor:** Ms. Wickouski, would you tell our readers something about your professional experience?

**Wickouski:** I have been a bankruptcy lawyer for almost 30 years. My career path has been fairly traditional: from law school I went to a federal judicial clerkship, then to a stint in the Justice Department and on to private practice.

Over the course of my career I have represented just about every kind of client in every type of bankruptcy case. Currently my practice is focused on the creditor side, particularly in large bankruptcy cases, but I also represent borrowers and debtors as well as individual and corporate clients.

**Editor:** You are one of the heads of the firm's corporate restructuring practice group. Would you give us an overview of the practice?

**Wickouski:** Drinker Biddle has a very broad-based bankruptcy practice with approximately 20 lawyers. The practice has a presence in all the major bankruptcy venues, including New York, where I reside; Wilmington, Delaware; Chicago; and Washington, DC, as well as practices in northern New Jersey and Philadelphia.

**Editor:** What kinds of background do you look for in your practitioners?

**Wickouski:** Well, like most firms we favor a strong academic background. We look for individuals who are bright, motivated, service-oriented and attuned to producing very high quality work for our clients. Many of them come to us with bankruptcy experience. The group is engaged in both transactional work and litigation, and a few of our partners specialize on the litigation side.

**Editor:** On the transactional side from time to time I am sure you are drawn into securities issues, trusts and estates issues and so on, things that require you to call on people from other areas of expertise.

**Wickouski:** Drinker Biddle has always promoted a very strong interdisciplinary approach to client matters. We frequently call in our colleagues from other practice areas on an as-needed basis, and our people are on call with respect to their projects. We understand client sensitivity to cost, however, so we consult with them whenever it appears that a particular undertaking is going to entail multidisciplinary input. Invariably clients are interested in the most complete result, and we find that they appreciate the job we do in delivering such a result in a coordinated and efficient fashion.

**Editor:** Who are the clients?

**Wickouski:** We provide services across a wide range of industries and industry sectors. I handle a great deal of work for the



M. Stephanie Wickouski

corporate trust departments of major financial institutions, for example. We represent institutional investors and corporations in a variety of industries that may find themselves from time to time as creditors in a bankruptcy case or in a contractual relationship with a debtor in a bankruptcy case. We handle the whole gamut of corporate representation in bankruptcy matters.

**Editor:** Please give us an overview of the kinds of projects the group handles.

**Wickouski:** We frequently represent clients who are prospective purchasers of assets or businesses in Chapter 11. The transaction here consists of the acquisition of a company that is in bankruptcy or of assets of a company in bankruptcy. We also represent creditors' committees serving in bankruptcy cases and representing the interests of creditors collectively. And we often represent the indenture trustees for the bond holders in a bankruptcy case, as well as lenders or investors who are owed money. Our clients include Chapter 11 trustees in their official capacity, where we advise trustees and bring litigation on behalf of the estate. Finally, we defend clients when they are sued for a preference or in connection with other bankruptcy-type issues that come up in this type of case.

**Editor:** Please tell us about the business cycle here. What kinds of work do you find yourself doing when the economy is doing well? And in tough times?

**Wickouski:** As you might expect, our caseload is heavier when times are tough. When the economy is doing well, there are fewer bankruptcies and the cause of bankruptcy tends to be either industry-specific or the result of some act of fraud or mismanagement. When the economy is not doing well, of course, even otherwise healthy businesses can find themselves in financial distress. I would say that both the volume of bankruptcy cases and the composition of those cases change with the business cycle.

**Editor:** You have been following the subprime mortgage crisis for some time. For starters, can you give us an overview of the crisis?

**Wickouski:** The crisis relates to the burst of the housing bubble in the United States – with a worldwide impact – and the dramatic increase in default in subprime mortgages. In other words, default with respect to residential mortgage loans made to borrowers with poor credit, low income, or both. The reason that the impact has been spread so widely has to do with mortgage loan securitization. Mortgage loans were packaged into financial vehicles, such as mortgage stock securities or collateralized debt obligations called CDO's. Those individuals and institutions who invested in these vehicles took a tremendous hit when the housing bubble burst, and this led to a dramatic decline in the stock value of those on the institutional side.

**Editor:** Lenders are supposed to be pretty sophisticated. In an earlier era they would not have made loans to the particular group of borrowers most concerned in the subprime crisis. Why did they run these risks?

**Wickouski:** I think the CDO vehicle – a pooling of risky individual loans – was seen as a way of reducing the risk by spreading it out. These investment vehicles were put together in such a way as to divide the investments into tranches – a senior tranche, a mezzanine tranche and usually an equity tranche – in descending order of risk. The riskier the tranche, the lower its place in the structure. They were rated by the credit rating agencies, Moody's, Fitch Ratings, Standard & Poor's, and so on, and a great deal of criticism has been directed at them for failing to accurately assess the risk. My own reaction is that the blame cannot all be placed at the door of the rating agencies. The root cause of this crisis, in my view, was the shift away from the traditional mortgage arrangement, the 15- or 30-year fixed-rate, fully amortizing loan to new loan products which included a pre-dominance of high-risk adjustable-rate and interest-only loans. These loans dominated the market and contributed to the rapid escalation in housing prices. Needless to say, these products have been the subject of controversy, and many commentators are asking whether they should have been sold to high-risk borrowers in the first place.

**Editor:** You have written about bankruptcy crime for a considerable time. How did this aspect of your career originate?

**Wickouski:** As the old adage says, "when life gives you lemons, make lemonade." A few years ago I found myself on the defense team in a large criminal case involving bankruptcy crimes. It was not a good case, and the clients were very challenging, to put it diplomatically. When it ended, I determined to turn the experience into something positive. In writing this treatise, I intended to cover everything a practitioner would need to know if he or she had a case that involved this body of law. I think there is ambivalence about bankruptcy in our society, and this is dis-

cussed in the book. In the past the failure to pay debt was considered strictly within the realm of the criminal justice system, and even today an element of shame clings to the adjudicated bankrupt. In Europe this is even more pronounced. In any event, over time a number of social reformers – many of whom were spiritual leaders – advanced the idea that it made far more sense for debtors to surrender their assets to their creditors and work toward paying off their debts than be subject to harsh punishment, even imprisonment. Incarceration, they pointed out, was a no-win situation for everyone. Nevertheless, in modern America there are aspects of insolvency that many people regard as morally questionable. I do not see any resolution of this quandary any time soon, and, of course, I find it extremely interesting when a moral undercurrent comes to the surface as it has with the subprime mortgage crisis.

**Editor:** Speaking of the subprime crisis, do you see this as something that is going to pass in time – the pendulum swinging back – or does it represent a permanent aspect of your practice going forward?

**Wickouski:** I do not think the subprime crisis will reoccur in the future, at least not in the way it has at present. The crisis is the result of an unusual combination of events taking place at precisely the same time, a very unusual circumstance. For the future, I see investors approaching CDOs with a great deal of care, both lenders and borrowers skirting around non-traditional financial vehicles with considerable skepticism, and everyone taking a long, hard look at the drivers of a rising residential real estate market. All of this will make it difficult for a crisis like this to happen again, at least in precisely the same way.

Having said this, I think about the only thing we can expect from the future is the unexpected. In time, my practice will move past the effects of the current subprime mortgage crisis, but I certainly expect to be extremely busy with issues that I could not begin to contemplate today.

**Editor:** Is there anything you would like to add?

**Wickouski:** Everyone is aware of the ripple effect that an event such as the subprime mortgage crisis has across the entire economy. Over the next year or so I think many corporate counsel are going to find themselves addressing bankruptcy issues, even where the company is not experiencing financial stress. With an event of this magnitude, everyone not directly impacted is nevertheless going to have some relationship or other – with a vendor, with customers, with landlords or tenants – that is. And that is going to affect the company's business. It is important for corporate counsel to understand what is achievable, and what is not, and recourse to bankruptcy counsel, whether in-house or with an outside firm, is usually a good investment in such circumstances.

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