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Too Big for Their Britches?

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Just a few years ago, the Abbar family of Saudi Arabia could point to at least \$383 million in investments managed by Citigroup Inc. Patriarch Abdullah Abbar and his son Ghazi had built the family fortune through an array of food import, travel, oil transport, and investment businesses. And beginning in 2006, they entrusted the bulk of their wealth to Citi.

Today the relationship has soured, and the money is almost gone. Both sides have lawyered up—the Abbars hired John Rich of Rich, Intelisano & Katz, and Citi retained Scott Edelman of Milbank, Tweed, Hadley & McCloy—and the legal battle is heating up. In August the Abbars filed a securities arbitration claim with the Financial Industry Regulatory Authority (FINRA), the U.S. securities industry's self-regulator. But while defendants often prefer the privacy arbitration affords, Citigroup wants to move the case into the courtroom.

The Abbar complaint is one of roughly 200 pending FINRA cases with at least \$10 million at stake. The number of cases and the size of potential awards increased significantly after the stock market collapse in 2008. Before then, most FINRA cases involved small investors who were suing their brokers. But after the crash, richer investors flooded FINRA with claims that they were duped by large institutions. "The claims coming in now are substantially larger than what we had a few years ago," says Linda Fienberg, president of FINRA's dispute resolution unit.

The financial institutions, faced with hefty awards that are near impossible to overturn, have taken notice. Lawsuits by banks challenging the arbitrations are increasingly common, often contending that sophisticated investors are trying to twist FINRA's original definition of a brokerage customer to include their claims.

Established in 2007, FINRA is the result of a merger of two sets of self-regulatory organizations, the New York Stock Exchange's enforcement arm and the National Association of Securities Dealers. Cases number in the thousands annually, and currently 7,000 claims are pending, Fienberg says.

For most parties in FINRA cases, arbitration offers a quick and private venue to deal with securities claims. But the arbitration landscape changed when financial service firms began teetering. "There were some very large losses during that period," says Jonathan Harris, a commercial litigation partner at New York's Harris, Cutler & Houghteling.

Harris is counsel to Woodside, California, investment management firm Aurum STS Aggressive Trading LLC. During the fall of 2008, Harris and his cocounsel at Steptoe & Johnson contend that Société Générale breached agreements on warrants the bank issued to Aurum in 2003 and 2004, and unilaterally imposed new terms. Aurum filed an arbitration claim in June 2009 against SocGen, and in October a three-arbitrator panel awarded the company \$61 million—the second-largest award this year. SocGen has said that it disagrees with the decision, but its lawyers at Latham & Watkins have not sought to vacate it.

Big awards like Aurum's have become more common in the wake of the subprime meltdown. Six of the ten largest securities arbitration awards were handed down during the last two years, according to Securities Arbitration Commentator Inc. In February 2009 FINRA awarded \$406.6 million to STMicroelectronics N.V. in a fight with Credit Suisse Group AG, followed by a \$80.8 million award to Kajeet Inc. against UBS AG in August 2010, and a \$54.1 million payout to Colorado patent litigator Gerald Hosier and others in April 2011 over a squabble with Citigroup.

The largest award of 2011 involved options trading firm Rosen Capital Management LLC, which lost \$90 million in fall 2008. Rosen's lawyers at Quinn Emanuel Urquhart & Sullivan blamed its prime broker Merrill Lynch & Co., Inc., which had placed ill-fated margin calls amid a crisis that had just weeks earlier thrown it into a government-brokered \$50 billion sale to Bank of America Corporation. In July a three-arbitrator panel awarded Rosen \$63.7 million. Merrill's lawyers at Wilmer Cutler Pickering Hale and Dorr moved in August to vacate the award.

Courts, though, rarely overturn arbitration awards. The Goldman Sachs Group, Inc. and its lawyers at Schulte Roth & Zabel unsuccessfully fought to vacate a \$20.6 million FINRA award that resulted from the bank's alleged failure to detect fraud at the bankrupt hedge fund Bayou Group LLC. In November 2010 Manhattan federal district court judge Jed Rakoff denied Goldman's petition, saying that "having voluntarily chosen to avail itself of this wondrous alternative to the rule of reason, [Goldman] must suffer the consequences."

Banks are fighting over who is permitted to bring claims to FINRA. UBS's lawyers at Debevoise & Plimpton, with the backing of the Securities Industry and Financial Markets Association, argued that West Virginia University Hospitals, Inc., as an issuer, could not force the bank, as an underwriter, to arbitrate claims of more than \$329 million in auction-rate securities. But in September the U.S. Court of Appeals for the Second Circuit rejected that narrow reading of who FINRA defines as a "customer."

In the Abbar case, Citigroup has similarly filed a lawsuit in Manhattan federal district court seeking to enjoin the arbitration. Milbank's Edelman, Citi's lawyer, declined to comment. But Citi in a statement says the Abbars were not clients of the U.S.-based broker-dealer Citigroup Global Markets Inc., so "their claims should not be subject to FINRA arbitration."

In the meantime, FINRA is adjusting to the bigger cases. In early 2012 it plans to implement a pilot program designed for cases with more than \$5 million at stake, Fienberg says. The program, which will be tested in the Northeast and on the West Coast, will formalize the ways that FINRA allows parties to modify arbitration procedures. For example, parties could pick arbitrators who do not normally handle FINRA cases, such as former judges. Parties could agree to take depositions, which FINRA generally does not allow. And both parties would be able to pay arbitrators more than the \$200 honorarium FINRA typically pays per hearing, a relief to some lawyers who worry about how the low pay might affect the complex cases.

And the Abbars' lawyer? Rich promises more cases from himself as well. "We have other multimillion-dollar cases in the works," he says. "This is not going to be an anomaly."

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Top Five Securities Arbitration Awards

Sanchez et al. v. Enrique Perusquia	\$429.5M
STMicroelectronics N.V. v. Credit Suisse Securities (USA) LLC	406.6M
Kajeet Inc. v. UBS Financial Services Inc.	80.8M
212 Investment Corp. et al. v. Myron Kaplan	74.8M
Rosen Capital Partners LPv. Merrill Lynch Professional Clearing Corp.	63.7M

Source: Securities Arbitration Commentator Inc.

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