

Complaints pile up over auction rate securities

Plaintiff's lawyers 'licking chops' over potential payday

By **Dan Jamieson**

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The plaintiff's bar is hot on the trail of disgruntled investors who can't cash out of auction rate securities.

ARS are long-term municipal bonds, corporate bonds or preferred stocks that are traded at auctions that set the instruments' interest rate and ultimately the price of the security.

Retail buyers can get in with as little as \$25,000.

The market in total is worth somewhere between \$325 billion and \$360 billion, according to the Securities and Exchange Commission.

But with liquidity dried up — especially after the major Wall Street firms stopped bidding in auctions last month — many investors discovered that they couldn't get their cash.

Plaintiff's attorneys say the wealthier individuals and small-business clients who bought ARS were told that the securities were a safe money market alternative with a higher yield. But investors had no idea they faced liquidity risk, lawyers say.

"Our phone has been ringing off the hook" with potential claimants, said lawyer Jeffrey Kaplan, founding shareholder of Dimond Kaplan & Rothstein PA of Miami.

Mr. Kaplan this month filed a \$5.2 million claim against UBS Financial Services Inc. of New York.

He said he has "potentially dozens" of more cases lined up, involving both retail and institutional investors.

Members of the Public Investors Arbitration Bar Association of Norman, Okla., have been getting calls about ARS, said PIABA president Larry Schultz, a partner at Driggers Schultz & Herbst PC in Troy, Mich.

"We should see ... claims filed in large numbers," Mr. Schultz said.

"A lot of claimants' lawyers are licking their chops over these," said Andrew Stoltmann of the Stoltmann Law Offices PC in Chicago.

Mr. Stoltmann said he has five ARS clients signed up and another 15 who might retain him.

"These are extremely good cases," he said.

Meanwhile, several class action firms are soliciting clients through press releases and websites.

Last Wednesday, Erik Sirri, director of the Securities and Exchange Commission's division of trading and markets, told a congressional committee that the agency "has received many requests to address" auction failures in the municipal-ARS market. He estimated the value of recent municipal auction failures to be about \$80 billion.

Mr. Sirri said the SEC will be offering guidance so that municipal issuers may bid in auctions for their securities.

SEC spokesman John Nester declined to elaborate on Mr. Sirri's comments.

WHERE ARE LOSSES?

Merrill Lynch & Co. Inc. of New York says that it warned investors of the risks. Quoting from a brochure given to ARS investors, company spokesman Mark Herr said the first page plainly says investors may obtain a yield advantage "in exchange for forgoing some of the liquidity ... of money market funds."

The brochure "explicitly warns investors that deterioration in market conditions could affect liquidity," he added.

UBS spokesman Kris Kagel said the firm is working to address clients' liquidity needs, as well as market disruptions overall. He declined to comment further.

If liquidity does return to the ARS market, many of the complaints will disappear, plaintiff's attorneys said.

Brokerage firms can always argue that clients haven't suffered losses, because the credits underlying the securities are for the most part still solid and investors are getting interest.

Still, some plaintiff's attorneys said they will sue for rescission of the trades and a return of cash, plus attorney fees, rather than ask for damages.

But investor lawyers also said the market has been rife with questionable practices and that monetary damages could result.

Attorney Joseph Peiffer said one investor who contacted him claims he was sold \$400,000 of ARS by a Smith Barney broker in early February — right before brokerage firms pulled out of the market.

"Someone at the firm knew they weren't going to support auctions," said Mr. Peiffer, a partner at Correro Fishman Haygood Phelps Walmsley & Casteix LLP in New Orleans.

Alex Samuelson, a spokesman with Smith Barney, a unit of New York-based Citigroup Inc., declined to comment.

New York lawyer David Robbins said he got a call last week from a doctor who had gotten nervous about the market and told his Morgan Stanley broker to sell everything and put his \$7 million into a money fund.

But unknown to the doctor, his money was instead put into ARS, said Mr. Robbins, a partner at Kaufmann Feiner Yamin Gildin & Robbins LLP. Mr. Robbins said he expects to see more cases where clients didn't know they had purchased the securities.

While the industry can point to a market that hasn't had liquidity issues for several decades, lawyers for investors said firms won't be helped by a 2006 SEC enforcement action that found various disclosure shortcomings involving auction procedures.

Brokers themselves are upset about what's happened.

"The way all the brokerage firms walked away at the same time, they must have a hotline among themselves," said a Merrill Lynch broker, who asked not to be identified.

"It's been a terrible disservice to clients," he said. ARS were "sold as money market substitutes."

Merrill Lynch's Mr. Herr declined to respond to the broker's comment.

Brokerage firms are now dealing with disclosure issues such as how ARS are shown on statements. At least some of the securities have been shown as cash equivalents and priced at par. Those practices may have to change.

"I heard today from [a Merrill Lynch client] that her investment is still priced at par on the statement," Mr. Stoltmann said last week.

Mr. Herr said Merrill lists ARS as securities.

"We have communicated with clients about [the pricing] issue with [a statement] insert," he said.

Meanwhile, firms have been coming up with other liquidity options, such as offering loans against ARS.

But margin loans involve other risks, such as the possibility of losing securities from a sellout, Mr. Kaplan said.

E-mail Dan Jamieson at djamieson@investmentnews.com.

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