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### Auction-Rate Anger Turns into Arbitration

By Daisy Maxey

The legal battle lines are being drawn over the auction-rate securities mess.

The first handful of arbitration claims have been filed by investors who can't sell securities for which auctions have failed. Large brokerage firms typically include binding arbitration clauses in agreements when clients open accounts with them. Arbitration claims go through the Financial Industry Regulatory Authority, which oversees the brokerage industry.

Arbitration claims involving auction-rate securities may face a number of hurdles, including disclosure documents and arguments that some of their investors were sophisticated. In addition, some issuers, including Eaton Vance Corp. (EV) and Nuveen Investments, have announced at least partial solutions to address the current liquidity issues with outstanding preferred shares.

Plaintiff attorneys are pressing on.

Jacob Zamansky, a partner at Zamansky & Associates in New York, has filed an arbitration claim on behalf of a client of UBS Financial Services. In his view, "brokers misrepresented the risk and liquidity of these

auction-rate securities and pitched them as 'cash equivalents,'" Zamansky said. "In fact, the monthly statements of many of these clients reflected that it's a cash equivalent."

Karina Byrne, a spokeswoman at UBS AG (UBS), said the firm "is committed to addressing our clients' concerns about the market events that caused the breakdown of liquidity for auction-rate securities." UBS is working with clients on a case-by-case basis, offering such solutions as margin loans and lines of credit at preferred lending rates, Byrne said. In addition, it's working with peers and industry groups on solutions, she said.

Zamansky and other attorneys will seek to prove that the broker-dealers who sold auction-rate securities and for many years supported the auctions at which they were sold misrepresented them as liquid investments, failed to let investors know the extent to which they supported the auctions and then backed out, leaving investors high and dry.

Andrew Stoltmann, an attorney with Stoltmann Law Offices PC in Chicago, said he'll seek to prove that broker-dealers misrepresented or omitted mention of the risks.

"I think the liability is pretty clear-cut," he said. "Advisors misrepresented the level of risk or completely omitted any of the risks that were inherent in these securities."

A potential issue is the role of the banks that arranged the auctions.

In the auction-rate securities market, municipalities, student loan authorities, closed-end fund companies and others issued debt with interest rates that were reset every week to 35 days in bank-arranged auctions. Investors were stunned last month when big banks like Citigroup Inc. (C) and Goldman Sachs Group Inc. (GS) decided to stop buying the securities that failed to sell. The \$330 billion market locked up after auctions failed for the first time in some 20 years.

Stoltmann said the pattern established by investment banks over many years of stepping in to buy auction-rate securities that failed to sell at auction could mean that they had a legal obligation to continue doing so.

"There's a legal concept called course of conduct," he said. "If a defendant consistently acts a certain way and clients begin to rely on that or investors begin to rely on that conduct, they can be liable."

Said Zamansky: "My information is that in the last year or so a lot of these auctions were failing and the only reasons they went off is that the firms were buying. That's a material fact that should have been disclosed to investors. Many investors wouldn't have gone in if they knew that the only successful auctions were the ones at which the broker-dealers were buying."

#### Waiting Game

One legal scholar said plaintiffs have a tough case to make.

James Cox, a professor specializing in corporate and securities law at Duke University, said such a case could face two headwinds. A defense might be made that many of the investors in these securities have experience investing, and should have understood that market conditions can change and that the unforeseen can occur, he said. Any claim that such investors simply relied upon representations made to them could be met with skepticism, he said.

In addition, most of those who sold the securities likely had contract provisions stipulating that no representations are made except those in the document provided, Cox said. In cases where such provisions do exist, courts tend to say there is no course-of-conduct issue, he said.

Certainly, many investors in the securities are angry at being unable to access their money.

Investor Harry Newton said he is frustrated at having \$4.5 million locked up in auction-rate preferred shares issued by Nuveen Investments' tax-free closed-end funds.

Nuveen on Wednesday said it has provided new financing for a portion of its taxable closed-end funds' preferred shares and is pursuing solutions for shareholders of preferreds issued by its municipal closed-end funds.

Newton said he now feels "relatively confident" about getting his money back. "The only problem now is the timing; when are you going to get your money back? Is it going to be several months or a year or what?"

Newton, a former publisher, writes a blog, In Search of the Perfect Investment, at [www.technologyinvestor.com](http://www.technologyinvestor.com), which he has converted into a hub for information on the auction-rate crisis at [www.auctionratepreferreds.org](http://www.auctionratepreferreds.org).

He said he pulled money out of equities in November and placed it through Deutsche Bank AG (DB) in the preferred shares, which a Nuveen marketing brochure said were an attractive alternative to money market funds, commercial paper, certificates of deposit or U.S. Treasury bills. He said he didn't receive any documentation from his brokers, though he said he later found Nuveen brochures on the Web saying the investment "provides (but does not guarantee) liquidity at par through auctions."

Deutsche Bank officials didn't have any immediate comment.

Newton said he's been unable to sell any of his securities for about a month: "There's no indication in these brochures that you might end up with a security that lasts 100 years or more."

