

WALL STREET JOURNAL

August 5, 2010

UBS to Pay \$81 Million in Auction-Rate Case

By Randall Smith

UBS AG has been ordered to pay 10 times the amount a Maryland marketer of cellphones originally invested in auction-rate securities, in another sign of the reckoning still dogging Wall Street for its role in investor losses during the meltdown.

UBS was ordered to reimburse Kajeet Inc., which markets cellphones for kids, \$80.8 million for damage to its business when Kajeet's cash was frozen in auction-rate securities in early 2008. Kajeet had invested only \$8 million in the securities through UBS, according to people familiar with the case.

A spokeswoman for Switzerland-based UBS said, "We strongly disagree with the arbitration panel's decision." She said UBS plans to file a motion to overturn it: "We believe the outcome is unwarranted under both the facts and the law."

The award, disclosed late Tuesday, is an unusual example of how Wall Street's bills for the market meltdown are still growing more than three years after the crisis first struck in mid-2007. Investors have filed more than 650 claims to recover auction-rate losses or damages through the end of June,

according to the Financial Industry Regulatory Authority.

The entire \$330 billion market for auction-rate securities froze in February 2008, when Wall Street dealers pulled back from auctions held weekly and monthly to set their interest rates. UBS had more than \$35 billion in such auction-rate investments held by 40,000 customers who suddenly couldn't get access to their money, the Securities and Exchange Commission said in a 2008 complaint. Regulatory settlements eventually required major brokerages to buy back more than \$60 billion from investors.

Investors have had relative success in recovering money for their losses, in part because Wall Street firms represented such investments as safe. Such securities offered rates that were higher than money-market funds, but lower than long-term debt. Regulators later charged that UBS and other firms misled investors to believe they "were equivalent to cash or money market funds," as the SEC put it in its 2008 complaint against UBS.

As part of the settlement by UBS and other brokerages in 2008, a special arbitration procedure was set up for their customers. It allows investors whose funds were frozen to claim "recovery of consequential damages" based on lack of access to their funds. Under the procedure, the firms were barred from contesting liability for claims based on the contention that brokers misrepresented how easy it would be to resell the assets.

"This case sends a shot across the bow for Wall Street firms that if they violate securities laws, they can be held liable for consequential damages," said investors' lawyer Jacob Zamansky.

In the arbitration, Kajeet argued that with the markets frozen, the lack of access to its \$8 million caused a "domino effect," people familiar with the case said. But UBS responded that while Kajeet did run into subsequent financial difficulty, it wasn't entirely related to its inability to access its cash.

Without access to its funds, Bethesda, Md.-based Kajeet had to cut its 60-member work force in half and lost a key distribution deal with a well-known national retail chain, stunting its growth, the same people said. Kajeet currently has 15 employees.

Founded in 2003, Kajeet raised more than \$64 million in venture-capital financing before borrowing \$10 million in January 2008. It ultimately sold \$4 million in auction-rate securities in May 2008 at a 10% loss, which was later made up by UBS. Kajeet sold its remaining \$4 million in January 2009 under a regulator-mandated UBS buyback plan.

"Any company that had its war chest in auction-rate securities was potentially going to suffer catastrophic consequences," said Greg Lawrence, a partner of Conti Fenn & Lawrence LLC in Baltimore, which

represented Kajeet in the arbitration case. "Liquidity crises can kill companies."

"Money is like oxygen," said Daniel Neal, Kajeet's CEO. Merely recovering the original investment, he said, would be like being told, "I want to take all the oxygen out of your office and I'll give it back in a week." The arbitration award, which represented 73% of the \$110 million the company claimed, "will make sure that we'll be healthy" in the future.

Other investors have had similar success in auction-rate cases. Geneva chip maker STMicroelectronics NV won a \$406 million arbitration award against Credit Suisse Group in February 2009 over its purchase of \$415 million in auction-rate securities.

The former Credit Suisse brokers who dealt with STMicro, Eric Butler and Julian Tzolov, were charged with criminal fraud in federal court in Brooklyn. Mr. Butler was convicted in a jury trial in August 2009. Mr. Tzolov testified against him after pleading guilty a month earlier.