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Bethesda firm gets $81M ruling

UBS vows to fight FINRA award to Kajeet Inc.

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Regulators have ordered UBS AG to pay nearly $81 million to a children's cell phone firm in Bethesda that suffered when its cash got tied up in student loan auction-rate securities.

The Financial Industry Regulatory Authority, the largest independent regulator for all securities firms doing business in the United States, awarded **Kajeet** Inc. $80.8 million in consequential damages Tuesday in the arbitration case in Baltimore.

UBS, which was represented by New York firm Bingham McCutchen LLP, called the award "unwarranted" and promised to fight it.

"We strongly disagree with the arbitration panel's decision on this legacy auction rate matter, and we will file a motion to overturn that decision," the company said in a statement.

Gregory T. Lawrence, the lead attorney for Kajeet, said the FINRA arbitration resulted from an agreement UBS made to settle a complaint by the Securities and Exchange Commission in October 2008.

"UBS agreed to this process in connection with a settlement with regulators and we believe any court will respect the award that resulted and is supported by overwhelming evidence," said Lawrence, of Baltimore's **Conti Fenn & Lawrence** LLC. He represented Kajeet with co-counsel Daniel McCartin.

Kajeet is a pay-as-you-go cell phone service that the company says is made from the point of view of a child. The company began selling phones in March 2007. Its services include parental controls.

Because FINRA arbitration proceedings are confidential, neither Lawrence nor Kajeet's CEO Daniel Neal would discuss the company's losses in detail. However, the award notes that Kajeet requested consequential damages of $110 million.

"The complaint we filed stemmed from illiquidity from auction-rate securities," Neal said Wednesday. "Illiquidity did result in layoffs at the company in 2008."

Daniel J. Donovan, of Baltimore's **Donovan & Rainie** LLC, who was not involved in this case, said the $81 million award is large by FINRA standards.

"There aren't that many FINRA arbitration awards in that stratosphere, let alone in consequential damages," he said. "I've been a FINRA arbitrator since 1987. I've never sat on a panel that awarded that kind of money."

Donovan said UBS' chances of vacating an arbitration award are "pretty slim" because courts want arbitration to be the alternative to litigation.

UBS would have to show that the arbitrators manifestly disregarded the law, failed to identify their own conflicts of interest, or deprived it of due process.

SEC settlement

In its case against UBS, the SEC said the brokerage firm misled its customers into believing the auction-rate securities were safe, highly liquid investments that were the equivalent of cash or money market accounts. But when the market for those securities seized up, those holding them could not retrieve their money.

Until late 2007, UBS would enter its own bid if there were not enough purchasers to support an auction. However, as demand for the securities was waning, UBS failed to disclose its concerns about continuing to support the auctions. The company decided to let the auctions fail in February 2008, leaving the accounts of more than 40,000 customers, which held $35 billion, basically illiquid.

In the 2008 SEC settlement, UBS agreed to purchase all auction-rate securities from clients with less than $10 million in assets invested with the firm.

In addition, FINRA set up Special Arbitration Procedures for auction-rate securities holders to recover consequential damages — not just the lost value of the securities themselves. Consequential damages can include the loss of product, profit or revenue stemming from the direct loss.

Lawrence said that once auctions began to fail, others quickly followed, because once the market realized that auctions could fail, the security was no longer treated as a short-term investment, but a long-term instrument with no market. That meant that companies that were heavily invested in auction-rate securities could not access their cash.

"Liquidity is just a fancy way of saying available cash," he said, "and a company starved of its cash will likely suffer catastrophic consequences."

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Gregory T. Lawrence (right) and Daniel McCartin represented Kajeet Inc. in the FINRA arbitration proceeding.