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NEWS ARTICLES

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Options

High Court Says Self-Insurance Group Can Proceed with Claims over Mismanagement of Assets

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by Sherri Okamoto (Legal Editor) *State: Alabama* *Topic: Top*

The Alabama Supreme Court last week revived a workers' compensation self-insurance group's claims against its former investment banker and broker for their alleged mismanagement of the group's assets.

(image via almwcf.org)

The Municipal Workers Compensation Fund, which provides coverage to 624 municipalities and governmental organizations in Alabama, has accused the Morgan Asset Management and Morgan Keegan & Co. of mishandling its money.

The fund said it entrusted the Morgan companies with $50 million in assets, and $15 million of that was lost because the companies decided to buy and hold risky investments connected to the subprime mortgage market.

In 2009, the fund filed a complaint with the Financial Industry Regulatory Authority – a not-for-profit organization authorized by Congress to serve as a watchdog for the securities industry – and demanded arbitration of its claims that the Morgan companies had acted negligently in handling the fund's assets, and then fraudulently concealed their bad investments.

The fund further accused the companies of breaching their contractual and fiduciary obligations and violating state and federal securities laws.

Under FINRA's rules, securities disputes involving more than $100,000 will be decided by a panel of three arbitrators. FINRA gives the parties a list of 30 arbitrators and allows each party to strike up to 12 names from the list. FINRA then assembles a three-member panel from the remaining arbitrators on the list.

Through this process, the Municipal Workers Compensation Fund and the Morgan companies wound up with an arbitration panel comprised of William Julavits, Patricia Dewitt and Eric Kunis.

This panel found in favor of the Morgan companies on all of the fund's claims. Jefferson Circuit Court Judge Nicole Gordon Still entered judgment in accordance with the arbitration decision.

The fund later sought to set that judgment aside, challenging the neutrality of Julavits and Kunis.

The fund asserted that Julavits had failed to disclose his involvement in recent similar litigation during the arbitrator-selection process, and Kunis hadn't revealed his employer's ongoing relationship with Morgan Keegan.

Judge Gordon Still refused to vacate the arbitration decision, finding Kunis and Julavits had failed to make the disclosures required of them under FINRA's rules, but that their failures to disclose did not amount to an "evident partiality" on the part of either.

The Supreme Court disagreed. It ruled Friday that the business connection between Kunis and Morgan Keegan was sufficient to create a "reasonable impression of partiality."

In light of its conclusion as to Kunis, the court said it had no need to decide whether there was a potential

conflict of interest in having Julavits since the arbitration decision could not stand. It then ordered the case, Municipal Workers Compensation Fund v. Morgan Keegan & Co., No. 1120532, remanded for further proceedings.

Morgan Keegan, a subsidiary of Regions Financial, had been one of the largest investment banking firms in the Southeastern United States before being acquired by Raymond James Financial in 2012 for $1.2 billion.

Regions Financial is still the parent of Morgan Asset Management. Regions spokeswoman Evelyn Mitchell said the company had no comment on the Alabama Supreme Court's ruling.

Securities litigation attorney Adam M. Nicolazzo of Malecki Law on Tuesday said the decision is important" because it "puts a spotlight on FINRA's role in investor protection."

Nicolazzo had submitted an amicus brief in support of the fund's request for vacatur on behalf of the Public Investors Arbitration Bar Association, along with Richard Frankowski and Teresa Verges.

PIABA is an international bar association comprised of attorneys who represent investors in securities arbitrations.

Nicolazzo said the group is "very happy with the decision, and believes the Alabama Supreme Court got it right by finding that the arbitrator had constructive knowledge of a conflict that needed to be disclosed, but failed to do so."

William A. Jacobson, a professor and director of the Securities Law Clinic at Cornell Law School, said he too was pleased with the court's decision.

Jacobson had submitted an amicus brief on behalf of the Securities Law Clinic, with the assistance of fellow professor Birgitta K. Siegel and Alabama attorney Charles M. Thompson.

He said the clinic had decided to get involved because they "felt it was important that FINRA's disclosure rules for arbitrators be self-executing."

FINRA requires arbitrators to make extensive discloses regarding their interests, relationships or circumstances that might preclude them from acting in an impartial manner. Before they can sit on any case, they have to complete a 16-page "Oath of Arbitrator" and aver they have made a reasonable effort to learn of potential conflicts of interest which might give rise to the appearance of bias.

Thompson said that many smaller investors rely on the arbitrators' disclosures in deciding who to keep in the pool of potential arbitrators to decide their cases, since they don't have the resources to investigate the background of each person on the list.

"We don't think the burden should be on the investor to do that work," Thompson said. "We took the position that the failure to adhere to the FINRA disclosure rules is grounds to vacate an arbitration award."

Joseph P. Borg, the securities commissioner of Alabama, said he took a similar view.

Borg and the Securities Commission had also been amici in support of the fund. "We want a level playing field, and we want fairness in arbitration proceedings," Borg said.

"Having looked at the allegations of what the arbitrators failed to disclose," he said, "it appeared to us that there was sufficient potential for bias."

When it comes to FINRA arbitration, Borg opined, "the potential for bias is just as bad as bias" since the rules say "you have got to be completely clear from any potential conflicts" to be an arbitrator.

Borg emphasized that "it's not necessary to prove a conflict." Since the grounds for judicial review of arbitration decisions are limited, he said, it's important that the impartiality of decisions be beyond suspicion, and there were just "too many could-be's in this case."

He added that FINRA convened a task force last year to discuss ways to enhance the transparency, impartiality and efficiency of its securities dispute resolution forum for all participants. Borg said he sent them a copy of the Alabama Supreme Court's decision to take into consideration.

The group is supposed to make its recommendations to the National Arbitration and Mediation Committee this fall.

The North American Securities Administrators Association, which holds itself out as the oldest international organization devoted to investor protection, last week sent a letter to the task force complaining that there is inadequate disclosure of arbitrator conflicts under the current system.

NASAA also suggests that arbitration should not be mandatory for securities disputes to begin with.

Jere L. Beasley of Beasley, Allen, Crow, Methvin, Portis & Miles represented the fund before the Alabama Supreme Court, along with Laura S. Dunning, Peter Mougey and Page A. Poerschke of Levin Papantonio Thomas Mitchell Rafferty & Proctor.

Neither the attorneys nor a representative for the fund could be reached for comment on Tuesday.

To read the court's decision, click here.