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Goldman's \$20 Million Consequence

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Goldman Sachs made its bed. Now Judge Jed S. Rakoff says the Wall Street firm has got to lie in it.

In 2008, Goldman chose to fight a case in arbitration rather than court. On Tuesday, in a sharply worded attack on the system, Judge Rakoff of the United States District Court in Manhattan said that Goldman would have to live with the findings of the arbitration panel. In this instance, those consequences could amount more than \$20 million.

“Although arbitration is touted as a quick and cheap alternative to litigation, experience suggests that it can be slow and expensive. But it does have these ‘advantages’; unlike courts, arbitrators do not have to give reasons for their decisions, and their decisions are essentially unappealable.” Judge Rakoff wrote in his opinion. Goldman “having voluntarily chosen to avail itself of this wondrous alternative to the rule of reason, must suffer the consequences.”

The case stems from the collapse of the Bayou Group, whose former chief executive, Samuel Israel III, is now serving 20 years for fraud. Goldman cleared trades for the hedge fund for years. In 2008, unsecured creditors of Connecticut-based Bayou filed a claim against Goldman, arguing the firm ignored signs of wrongdoing at Bayou.

Under the terms of its contract with Bayou, Goldman could have applied to fight the case in bankruptcy court. But instead the firm opted for arbitration.

“Both sides could theoretically have agreed to waive the arbitration clause and litigate in court, but either could have insisted on arbitration,” says a Goldman spokesman, who declined to comment on the decision.

That strategy didn't pan out. Earlier this year, a three-person Financial Industry Regulatory Authority panel ordered the firm to pay \$20.6 million to the unsecured creditors of the Bayou Group.

But Goldman wasn't happy with the findings, and in July it moved to vacate the arbitration award — the largest ever levied against the firm. In taking the matter to court,

the firm argued the panel had “manifestly disregarded the law” and exceeded its authority under the Federal Arbitration Act.

In early November, Judge Rakoff denied the request. On Tuesday, he expounded on the matter in a 13-page opinion, taking jabs at both arbitration and Goldman. Judge Rakoff, known for his sharp wit and blunt talk in big Wall Street cases wrote, “a court, unlike an arbitrator, must state its reasons and subject them to appellate scrutiny.”

The firm is not out of options yet. It can appeal Judge Rakoff’s decision to the Second Circuit Court of Appeals.

If ultimately upheld, the Bayou award could have ramifications across the financial sector. Wall Street firms, which handle billions of dollars in transactions, say that their job is to clear trades, not police clients. This award could raise the standard for clearing businesses.

John G. Rich, a partner at New York law firm Rich & Intelisano who represented the Bayou creditors, said, “The Bayou investors are gratified that the judge gave proper deference to the arbitrators’ findings about Goldman’s conduct.”

[Judge Rakoff’s Ruling on Goldman Sachs Arbitration](#)