

Court Rejects Goldman's Appeal of \$20.6M Arbitration Award

By Lorie Konish
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A U.S. appeals court struck down Goldman Sachs' appeal of a \$20.6-million arbitration award decision on Tuesday, upholding the original decision in favor of creditors of the Bayou Group.

Goldman was ordered to pay the \$20.58 million arbitration award on June 24, 2010 by a three-member Financial Industry Regulatory Authority panel. The firm subsequently petitioned the U.S. District Court for the Southern District of New York, which denied Goldman's request and confirmed the award through a cross-petition. Goldman then appealed the decision at the U.S. Court of Appeals for the Second Circuit, which affirmed the ruling on Tuesday.

Goldman declined to comment on the court's decision through a spokeswoman on Thursday.

The case stems from Goldman's role as a clearing broker and prime broker for hedge funds associated with the Bayou Funds, an alleged Ponzi scheme that ultimately collapsed in 2005 and entered bankruptcy in 2006.

The subsequent 2010 award decision considered Goldman an "initial transferee" of two sets of deposits in question, rather than simply a conduit without control over the funds, according to court documents. In its appeal, Goldman argued that the arbitration decision was in "manifest disregard of the law."

But the verdict handed down on Tuesday rejected Goldman's argument that \$6.7 million transferred from outside accounts to Bayou funds from June 2004 to June 2005 was not an initial transferee, and therefore not recoverable from Goldman Sachs. It also rejected the firm's argument that \$13.9 million transferred from one Bayou fund to four new Bayou funds in March 2003 was not a conveyance because it represented one fund.

"The manifest disregard standard is, by design, exceedingly difficult to satisfy, and Goldman has not satisfied it in this case," the U.S. Court of Appeals for the Second Circuit ruled Tuesday.

"The Bayou case signals that bankruptcy fraudulent conveyance claims against broker-dealers are best brought in arbitration rather than court," Ross B. Intellisano, a lawyer at Rich, Intellisano & Katz, LLP, counsel for the Bayou Creditors' Committee, said in a statement.

The decision comes as FINRA arbitration panels are "becoming more sophisticated and experienced in hearing large and complex cases," Intellisano said. Earlier this week, FINRA announced that it has launched a pilot program aimed at enabling more flexibility for a growing number of arbitration cases of \$10 million or more.

A ruling against Goldman Sachs has potential far-reaching implications for all clearing brokers, the Securities Industry and Financial Markets Association, or SIFMA, argued in documents it filed in the case in October 2011.

"By implicitly characterizing a clearing broker as an 'initial transferee' under the Bankruptcy Code, places substantial economic and quasi-regulatory burdens on all clearing brokers, burdens which the SEC and industry regulations as well as the courts have specifically rejected," SIFMA's filing stated.

Under SEC rules, broker-dealers are currently prohibited from having "dominion and control" over the customer funds they have in possession, SIFMA stated. Putting more responsibility on those broker-dealers to investigate customer funds would drive them away from quickly clearing and executing transactions, SIFMA said.

SIFMA did not respond to a request for comment on Thursday.