

VERDICTS & SETTLEMENTS

FRIDAY, DECEMBER 15, 2017

SECURITIES

BREACH OF FIDUCIARY DUTY

Fraud

ARBITRATION: RESPONDENT

CASE/NUMBER: *Kosti Shirvanian and Marian Shirvanian, individually and as Trustees of the Kosti Shirvanian and Marian Shirvanian Living Trust v. Citigroup Global Markets Inc. (fka Salomon Smith Barney) / 72-168-Y-00005-04 NOLG*

COURT/DATE: American Arbitration Association / Oct. 27, 2017

ARBITRATORS: John K. Hart, Alan Stamm, John Zebrowski

ATTORNEYS:

Plaintiff — Montgomery G. Griffin (Law Office of Montgomery G. Griffin); Theodore S. Avery (Law Office of Theodore S. Avery); James A. McQueen (McQueen Droste LLP)
Defendant — Stacey M. Garrett, Michele R. Underwood, Terry Ross (Keesal, Young & Logan)

EXPERTS:

Plaintiff — Louis L. Straney (securities); Craig McCann (derivative securities).
Defendant — Kjell Ekdahl (derivative securities); Anthony J. Raimondi (securities); John Maine (standard of care)

FACTS:

Claimant Kosti Shirvanian filed suit against Citigroup Global Markets Inc. (referred to during the case as Smith Barney)

CLAIMANT'S CONTENTIONS:

In 2003, the Shirvanians' prior counsel filed the Arbitration with an AAA demand for arbitration form that set forth in very broad terms the nature of the Shirvanians' claims as lost value on securities. No formal causes of actions were included on the 2003 demand for Arbitration and no specific securities (or types of securities) were mentioned. In 2006, the arbitration was placed in the AAA's abeyance by stipulation between

both parties. Three years later, in October 2009, while it continued to sit in abeyance at AAA, claimants' prior counsel withdrew from representing the Shirvanians, leaving them pro se. The case sat in abeyance at AAA for approximately 8 years.

In 2014, Citigroup moved to dismiss the Shirvanians' claims based on alleged failure to prosecute, but the Panel denied the motion without prejudice in April 2015. In March 2015, claimants filed a 29-page First Amended Statement of Claim specifically related to approximately 7,000 stock transactions done at Citigroup in the Shirvanians' accounts (between 1999 and 2002) and Citigroup's alleged inadequate supervision of those transactions. Specifically, such claims as churning, breach of fiduciary duty, and failure to supervise, among others. The Shirvanians' also alleged that Kosti Shirvanian had a close, personal, and storied relationship with Bruce Byers, his longtime Citigroup broker, and that he was known to trust Byers implicitly. Seemingly due to compliance issues, Citigroup placed written employment restrictions on Byers in 1996 that expressly prohibited him indefinitely from engaging in many ordinary broker tasks, such as soliciting securities purchase and sale transactions. The Shirvanians alleged that Citigroup never disclosed this fact to them and further alleged that Byers largely continued to conduct usual business with them and act as their primary contact and trusted broker at Citigroup despite the indefinite employment restrictions on Byers. In 2009, FINRA permanently disbarred Byers from association with any brokerage firm in the securities industry for, among other things, engaging in what FINRA determined to have been fraudulent activity against Shirvanian's widowed and elderly sister while Byers was employed by Citigroup.

The Shirvanians alleged substantial churning and breach of fiduciary duty claims against Citigroup, contending that during some periods, Citigroup so rapidly traded some of their accounts that cost-to-equity ratios (breakeven points) in some of the accounts, including the most-heavily traded account, ranged from between 20 and 50 percent over certain 12-month periods of activity. An

expert witness for the Shirvanians testified that the transactions in their accounts generated millions of dollars of excessive commissions and income for Citigroup. The Shirvanians further alleged that Citigroup failed to adequately supervise Byers and his partner at Citigroup during these periods of alleged excessive trading activity. In the Final Award, the Panel dismissed the stock churning claims on procedural grounds, never reaching their merits. The variable prepaid forward contracts at issue in the arbitration were complex, complicated investments with which the Shirvanians had no prior investment experience. The Shirvanians alleged that Citigroup charged millions of dollars in undisclosed markups in these transactions.

RESPONDENT'S CONTENTIONS:

Claimant Kosti Shirvanian is the former president and chairman of Western Waste, a company that went public under his leadership in 1983 and traded first on the NASDAQ and later on the New York Stock Exchange. He has been an investor in the stock market since 1970, and he has invested through more than 100 securities accounts at a dozen firms on Wall Street. Throughout the late 1990s, Shirvanian constructed a complex portfolio designed to maximize the cash he could invest in high-risk ventures, while simultaneously maintaining ownership of millions of shares of stock in Waste Management Inc., which had a very low cost basis. To accomplish these objectives, Shirvanian over time pledged almost all of his Waste Management shares as collateral for massive margin loans. Citigroup recommended to Shirvanian repeatedly that he sell enough Waste Management stock to pay his margin debt, pay the capital gains taxes, and to invest in stable, tax-free municipal bonds. However, Shirvanian rejected that advice and instead directed aggressive trading and borrowing across the Shirvanians' accounts at many brokerage firms based on his belief that the price of Waste Management stock would continue to increase.

In July 1999, the price of Waste Management shares plummeted 52 percent in three weeks.

Other brokers advising Shirvanian and his wife, Marian, issued margin calls and the Shirvanians were forced to sell massive amounts of securities to meet those calls. These events finally and belatedly caused Shirvanian to consider hedging strategies, a concept that Smith Barney had repeatedly raised with him over the years. In August and September 1999, the Shirvanians entered into several transactions with Smith Barney to pay off the margin debt at other firms, including the calls, protect their Waste Management stock and diminish the risk of additional margin calls. These transactions involved a costless over-the-counter collar and five variable prepaid forward contracts. These strategies helped the Shirvanians at a time when they needed it most. Later, the Shirvanians engaged in additional variable prepaid forward contracts in both Waste Management and another waste company, Republic Services. Smith Barney denied all claims, and contended that the claims added in March 2015 were barred by the statutes of limitation, did not relate back to the original 2003 complaint, and were barred because the Shirvanians failed to prosecute the claims, all of which resulted in actual prejudice to Smith Barney. Citigroup contended that it properly disclosed all material facts and risks associated with the Variable Forward Purchase contracts, and that it fulfilled all duties to claimants. With respect to the other trading activity, Citigroup contended that Kostis controlled

the trading in the accounts, that he was an experienced, sophisticated, active, aggressive trader who had accumulated significant margin debt to purchase assets other than securities, that it neither concealed nor misrepresented material facts to the claimants, that its supervisory systems were consistent with industry standards, and that claimants were not damaged.

Citigroup also contended that claimants' claims were time-barred, their amended claims did not relate back to the original date of filing (in 2003), and the claims should be dismissed as a result of claimants' failure to prosecute and the resulting actual prejudice to Citigroup. The Shirvanians filed this case in 2003. At first, they alleged that Smith Barney had defrauded them in connection with the over-the-counter collar and variable prepaid forward contracts. In March 2015, after allowing the case to lie dormant for seven years, the Shirvanians filed an Amended Statement of Claim.

INJURIES:

Claimants alleged losses on securities transactions.

DAMAGES:

The Shirvanians requested compensatory damages of \$97,932,766 (trebled to \$293,798,298) and punitive damages of \$200,000,000.

Claimants requested compensatory damages of \$97,932,766 (which they argued should

be trebled to \$293,798,298) and punitive damages of \$200,000,000.

RESULT:

The panel found in favor of Smith Barney on all claims and determined that the Shirvanians were not entitled to an award of damages.

OTHER INFORMATION:

After the arbitrators decided in favor of respondent Citigroup Global Markets Inc. on all claims, claimants paid Citigroup \$2 million to settle Citigroup's ancillary claim for attorney fees and costs.

According to claimants, in the Final Award, the Panel barred almost all of the Shirvanians' claims on complicated procedural grounds, and not on the merits. Specifically, the Panel cited and relied on the relation back doctrine and laches to time bar virtually all of the claims filed in March 2015 (e.g., the churning, breach of fiduciary duty, and failure to supervise claims) since, according to the Panel's Final Award, those claims did not relate back to the Lost value on securities demand for arbitration. Moreover, the Panel affirmatively stated in its Final Award that it did not necessarily endorse every action or inaction on the part of Smith Barney or its personnel.

ARBITRATORS:

John K. Hart, Alan Stamm, John Zebrowski.