MED-ARB WORKED IN U.S. FOR REAL ESTATE PARTNERSHIP CLAIMS

By Philip S. Cottone

Abuses in syndicated real estate limited partnerships, very popular in the U.S. in the late nineteen seventies and early eighties prior to the Tax Reform Act of 1986, caused Prudential Securities to be sanctioned by the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD, predecessor to FINRA) in the early nineteen nineties. Prudential was the sponsor of these partnerships and an affiliate usually served as a general partner. In a global settlement with both regulatory bodies, Prudential was required to establish a $500 million settlement fund, and Irv Pollack, a former SEC commissioner, who was at the time Chair of the NASD National Arbitration Committee, was designated Claims Administrator and empowered to design and implement a procedure whereby aggrieved investors could apply for payment from the Fund.

A med-arb process was developed and neutrals around the country were selected to hear the cases, initially as mediator. If the parties did not reach agreement, the same neutral was empowered to act as an arbitrator to decide the matter. Consent of the parties to this procedure was required to obtain a payment from the Fund. The author of this article was a neutral who presided over more than sixty cases in Pennsylvania and New Jersey, both by phone and in person. The claimants had to establish that they were affected by one of the violations cited by the regulatory bodies (causality), and had to prove damages as a result of those abuses.

The Claims Administrator reported that 300,000 claim forms were distributed and about 160,000 claims paid, of which a little more than 2000 were referred for mediation-arbitration. The Fund grew to over $1 billion because Prudential had to post additional deposits, but total payout was just under $1 billion, and the process was completed in two years. The experience of the author was that about 95% of the cases settled in mediation. In those few cases where a decision had to be made as an arbitrator, an abbreviated hearing was conducted and an award was rendered. By and large the parties and their counsel felt the process was fair, that their arguments were heard and considered, and that the result was acceptable, and few, if any, complaints were received.

Med-arb worked effectively in these cases where liability was clear-cut if causality could be established based on the violations found by the regulators, and if resulting damages could be proved. The neutrals selected were experienced arbitrators and mediators who were required to hear the matter in an expeditious fashion and to report the results promptly to the Office of the Claims Administrator so checks could be drawn and sent out without delay. The process worked exceedingly well.

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