The P I A B A Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

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Editor's Notes

In this issue of the Quarterly, member Reagan Pratt discuss the *Claimant's Objection to Consideration of Motion* (excerpt from brief).

The deadline for receiving submissions for the June, 2001 issue of the *Quarterly* is June 10, 2001. All submissions, regardless of length, should be accompanied by a computer disk of the submitted materials in either word perfect or as a text file.

Please send change of address information to Robin Ringo at 2241 W. Lindsey St., Ste. 500, Norman, OK 73069. Toll Free: (888) 621-7484; Fax: (405) 360-2063; E-Mail: ***rsringo@piaba.org***; Website: ***www.piaba.org***.

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LETTER FROM THE PRESIDENT

Seth E. Lipner
Garden City, New York

Sometimes it seems like PIABA exists only in cyberspace, but the incredible response to the announcement of our upcoming Annual Meeting shows that actual human contact remains important to all of us. It is heartening. This year's Meeting, our tenth, promises to be the biggest and best yet, and I am pleased so many of you plan to attend.

I am certain that a good portion of the upsurge in Annual Meeting attendance, and in our membership as well (we now have nearly 400 members) is the product of increased losses in the stock market. But that increase must also be attributed to the good work of our organization in its fight for investor causes. Now, under the incredible guidance and hard work of Robin Ringo, we have produced a new website and interactive forum for our members, as well as an incredible research tool and network for our members. Now, with increasing access to our archives, and the addition (soon) of new data bases, will make PIABA an even better resource for every attorney representing investors in arbitration.

The upsurge in membership, and the costs associated with development of our website and archiving system, and these new data bases, has caused our budget to expand beyond what we anticipated even a year ago. With these new services, and the increasing demands on our members (we intend to add an additional staff person) comes the need for more revenue. At our March Board Meeting, we considered the budget matter carefully, and considered all our options. In the end, the Board of Directors voted unanimously to raise member dues by $100.00, to $295.00 per year, for the year 2001, as of July 1, 2001. That means that each of the members will be asked to pay another $50.00 this year, and $100.00 in the coming years, to assure our organization of financial security. We hope you will see the value of PIABA membership, and continue to support our organization by promptly paying these dues when you receive the notice.

Of course the website and the Annual Meeting are not PIABA's only activities. In the last two months, PIABA has continued to fight for, inter alia, changes in CRD expungement, better training for NASD and NYSE arbitrators, a ban on non-attorney representatives in arbitration, changes in the NASD's expertise function of NLSS, and an arbitrator definition which would shift quasi-industry arbitrators back into the industry pool. Each of these tasks takes time and effort, and I commend each and everyone of you who serves on these committees, participates in meetings both telephonic and on list-serves, and contributes to our fight to level the playing field. I also encourage all our new members to become involved in PIABA actively.

I look forward to seeing you all at the Annual Meeting in Florida in October.

Seth

Successor Broker Dealer Liability

Reagan D. Pratt, Esq.
Clements, O'Neill, Pierce & Nickens, L.L.P.
Houston, TX

[This article is a portion of a brief submitted by Mr. Pratt in response to a motion to dismiss by a successor broker dealer. The text has been edited for inclusion in this publication.]

Claimant's Objection to Consideration of Motion

As set forth in great detail in Claimant's Motion to Strike, Respondent's Motion to Dismiss is not a procedural devise allowed under the NASD Code of Arbitration Procedures. Indeed, Respondent's "motion to dismiss," based on two pages of asserted "undisputed facts," would not be considered by any court of law which even theoretically permits such pre-discovery dispositive motions. *See, e.g., Old Republic Ins. Co. v. Hansa World Cargo Serv., Inc.*, 51 F.Supp.2d 457,476 (S.D.N.Y. 1999) (rejecting challenge to successor liability theory, where defendant had given no discovery). For these reasons, Claimant asserts that its Motion to Strike is the only "response" this Panel need consider, and the Panel should not even address the merits of Respondent's motion.

The PIABA QUARTERLY is published quarterly in the interest of the members of the Public Investors Arbitration Bar Association. Editor-in-Chief - L. Jerome Stanley; Associate Editor - Seth Lipner. The PIABA QUARTERLY welcomes information on cases or articles that would be of interest to PIABA members.

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Nonetheless, in case Respondent has piqued the Panel's curiosity on the merits of this claim, Claimant offers the panel a brief summary of the facts and law which overwhelmingly establish Respondent's liability in this action.

Summary

After accumulating $2.5 million in adverse arbitration awards in just two years of doing business, the original broker dealer ("BD No. 1") merged ***all*** of it assets and business into Respondent. BD No.1 publicly announced this move to all of its customers, explicitly referring to the move as a "merger" of the two corporations. BD No. 1's sole shareholder, then moved all of the corporations accounts and employees to Respondent, forming a new division. Respondent paid BD No. 1's sole shareholder for these corporate assets (and not BD No.1, the corporation), and Respondent's new division retained a profit interest in all of the operations of Respondent's division formerly known as BD No.1. In sum, Respondent maintains the same business as BD No.1, with the same employees doing the same jobs, under the same supervisor, producing the same product for the same customers. Under both federal and state law of successor liability, Respondent is liable for the debts of BD No.1.

Facts

Respondent has yet to disclose a single document responsive to the Discovery Guide lists or Claimant's First Request for Production. Respondent has possession of all of BD No.1's corporate records, and continues to stand in defiance of this Panel's Order compelling production of those Documents. Respondent also has not produced a single document responsive to Claimant's recent requests addressing the successor issues.

Respondent nonetheless claims that its list of "facts" are undisputed, based on three pages it printed off the Internet. Discovery will prove, however, that:

- BD No. 1's President bought BD No.1 at the end of 1996.
- BD No.1's President was the sole shareholder and Chief Executive Officer of BD No.1until the Fall of 1999.
- In those two and a half years, BD No.1racked up over $2.5 million in unsatisfied arbitration awards which it owed to defrauded customers.
- In an effort to further defraud those creditors, BD No.1's President and Respondent agreed to merge all of BD No.1's business into Respondent's operation.
- BD No.1included a merger announcement in its final customer statements issued under that name, advising all of its customers that it would be merging with Respondent and that Respondent would continue BD No.1's service of the accounts.
- Respondent took over all of BD No.1's customer accounts, including approximately $20 million under management, and hired all of BD No.1's brokers.
- Respondent paid all fees and expenses associated with transferring BD No.1's business to Respondent.
- At the time of this merger, Respondent knew of BD No.1's pattern and practice of fraudulent sales practices. Respondent consciously decided that BD No.1's type of bucket-shop operation would meld well with Respondent's.
- BD No.1 ceased doing business after this merger. It immediately thereafter began reporting zero revenues to the SEC, and its broker-dealer license has been withdrawn.
- BD No. 1's President maintained personal possession of all of BD No.1's business records after the merger.
- Respondent employed BD No.1's President as its registered principal and Senior Vice President. BD No.1 President's duty at Respondent is as the person "in charge of" the former BD No.1 brokers, now formed into a new division of Respondent (the "New Division").
- Respondent's merger agreement with BD No.1's President provides that he Ashall, in his sole discretion, make all decisions regarding the management and termination of employment with [Respondent] with respect to any member of the New Division.
- As consideration for the sale of BD No.1to Respondent, Respondent gave BD No.1's President a profit interest in the New Division consisting of 10% of the gross commissions generated by this division, as well as a fee of up to $450,000 based on the gross performance of the New Division.

Argument

In light of these facts, it should be clear that Respondent and BD No.1 intentionally, as publicly stated to their customers, merged their two companies into one. Under both state and

Facts

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Argument

In light of these facts, it should be clear that Respondent and BD No.1 intentionally, as publicly stated to their customers, merged their two companies into one. Under both state and federal law of successor liability, Respondent is liable for BD No.1's debts as its successor in interest.

A. Respondent is BD No.1's successor under federal law, which requires a showing of only a "substantial continuity" of the business from one entity to the other.

Respondent asserts, without any citation to authority, that New York state law governs the question of its liability in this matter. This is not correct. Claimant has made claims under the federal securities laws. The law is well settled that the substantive aspects of liability under Rule 10b-5 are established by uniform federal law, rather than by adoption of analogous state law. *See Singer v. Olympia Brewing Co.*, 878 F.2d 596, 599-600 (2nd Cir. 1989) (federal law of setoff applies to 10b-5 actions, not the state rule), *cert. denied*, 493 U.S. 1024 (1990); *Wolf v. Frank*, 477 F.2d 467, 479 (5th Cir.) (federal law determines the availability of prejudgment interest), *cert. denied*, 414 U.S. 975 (1973); *Drachman v. Harvey*, 453 F.2d 722, 726-27 (2nd Ci. 1971) (federal law determines the definition of a "shareholder" entitled to bring suit), *rev'd on other grounds*, 453 F.2d 736 (2nd Cir. 1972) (en banc).

The Second Circuit has also made clear that, in order to advance the goals of federal remedial statutes, the federal law of successor liability adopts the "continuity of enterprise" approach, also known as the "substantial continuity" rule. *B.F. Goodrich v. Betkoski*, 99 F.3d 505, 509 (2nd Cir. 1996) (adopting this federal rule of successor liability in the CERCLA context). The court specifically ***rejected*** the less flexible "identity rule" urged by Respondent in this case. *Id.* Under the "substantial continuity" test, the court (or panel, in this instance) considers whether "the successor maintains the same production processes, and produces the same products

business, with the same employees doing the same jobs, under the same supervisors, working conditions, and for the same customers." *Id.*; *see also Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27, 43, 107 S.Ct. 2224, 2236 (1987) (adopting this federal test for successor liability in the labor law context); *Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168, 175 (5th Cir. 1985) (listing eight factors to consider under this test); *New York v. Westwood-Squibb Pharmaceutical Co.*, 62 F.Supp.2d 1035, 1039 (W.D. N.Y. 1999) (same).[1]

There can be no serious dispute that Respondent satisfies this test for whether it is substantially continuing the business of BD No.1. Respondent:

1. maintains the same business (retail securities brokerage[2]),
2. with the same employees (BD No. 1's President and the New Division),
3. doing the same jobs (selling securities),
4. under the same supervisor (BD No.1's President), working conditions (boiler room), and production processes (cold calls, fraudulent sales pitches, phenomenal turnover rates),
5. selling the same products (securities),
6. to the same customers (whose accounts were all transferred from the defunct BD No.1).

The fact that Respondent and BD No.1 held themselves out to their customers as merging, in order to induce the transfer of all customer accounts, is merely the nail in Respondent's coffin of liability. *See Mozingo*, 752 F.2d at 175 (listing "whether the successor holds itself out as the continuation of the previous enterprise" as a factor to consider under the continuing enterprise theory of liability).

B. *Respondent is BD No.1's successor even under New York law.*

Even if the panel strictly applied the "identity" tests of successor liability, Respondent would be found responsible for the debts of BD No.1. Successor liability under New York law is found when: (1) there is an express or implied agreement to assume the other company's debts and obligations; (2) the transaction is entered into fraudulently to escape such obligations; (3) there was a de facto merger or consolidation of the companies; or (4) the purchasing company was a mere continuation of the selling company. *Old Republic Ins. Co. v. Hansa World Cargo Serv., Inc.*, 51 F.Supp.2d 457,475 (S.D.N.Y. 1999). Respondent is liable for BD No.1's obligations under *all four* of these theories of liability.

Implied Agreement: Respondent can be found liable under an implied agreement theory based solely on the facts that (1) the merger left BD No.1with no assets with which to pay its creditors, and (2) Respondent and BD No.1described the combination to their customers as a "merger." The court found these two factors alone sufficient to impose successor liability in the case upon which Respondent principally relies, *Ladjevardain v. Laidlaw-Coggeshall, Inc.*, 431 F.Supp. 834 (S.D.N.Y. 1977). In considering the transfer of a brokerage business much like here, where the predecessor broker became a mere "shell" after the transaction, the court first focused upon the effect of the transfer on creditors of the predecessor corporation. The court held that, where the first broker-dealer had no continuing business following its transfer of all of its accounts and brokers to another broker-dealer, and "there is a real possibility that the creditors of [the first broker] have been left without a remedy, ... a finding of an implied assumption is more likely than in a case where the predecessor corporation continues as a viable corporate entity." *Id.* at 839-40.

Second, the *Ladjevardain* court focused on the fact that the parties represented to the old firms' customers that the transaction would act as a merger. The firms sent letters to customers of the old firm stating that "upon completion of the proposed combination, all accounts of [old firm] customers will be serviced by [new firm]," and that accounts would be automatically transferred if no objection were received "by the effective date of the combination of the two firms." *Id.* at 840. On information and belief, Madison Capital and Dalton Kent sent virtually identical correspondence to Madison's customers, and even described the combination as a "merger." Accordingly, in light of BD No. 1's many creditors left without a remedy, Respondent may be held liable as a successor based on its holding itself out as the successor in order to assume a business advantage.

Fraudulent Transfer: BD No.1 owed defrauded customers an estimated $2.5 million in unpaid arbitration awards when BD No.1's President simply moved its operation to Respondent. He left BD No.1 with no assets or business. The Panel would be entitled to conclude that Respondent and BD No.1 undertook this arrangement in order to defraud BD No.1's creditors, and therefore can be held responsible for those debts.

[1] While Respondent cites a securities case applying state law to this issue, that district court opinion never addressed the question of applicable law. *See Ladjevardain v. Laidlaw-Coggeshall, Inc.*, 431 F.Supp. 834 (S.D.N.Y. 1977). Since the case pre-dates the Second Circuit's analyses in *B.F. Goodrich* and *Singer*, it has been implicitly overruled to the extent that it would stand for any different proposition.

[2] Claimant expect the evidence to further show that Respondent is continuing BD No.1's speciality in *fraudulent* retail brokerage operation.

De Facto Merger: A de facto merger occurs when one corporation is absorbed by another, without complying with the statutory requirements for a merger. *Arnold Graphics Industries, Inc. v. Independent Agency Center, Inc.*, 775 F.2d 38, 42 (2nd Cir. 1985). A de facto merger will be found when there has been (1) a continuity of ownership; (2) a cessation of ordinary business and dissolution of the selling corporation; (3) assumption by the successor of liabilities ordinarily necessary for the uninterrupted continuation of the business of the predecessor; and (4) a continuity of management, personnel, assets, physical location and general business operations. *Old Republic*, 51 F.Supp.2d at 476-77. Not all of these factors are needed to demonstrate a merger, however; they are merely indicators that a de facto merger has occurred. *Id.* (citing *Lumbard v. Maglia, Inc.,* 621 F.Supp. 1529, 1535 (S.D.N.Y. 1985)). "It is the continuity [of the corporation], not uniformity, that is the important variable." *Lumbard,* 621 F.Supp. at 1535 (finding that allegations that the successor corporation had the same management, employees, and assets as the predecessor corporation, leaving the predecessor corporation a mere "shell," were sufficient to support a de facto merger claim).

These factors strongly support a finding of de facto merger in this case. (1) While Respondent claims that BD No. 1's President is not an "owner" of Respondent, he certainly owns a profit interest in Respondent's New Division. A share of the profits is the principle benefit of ownership. Moreover, Respondent's payments for BD No.1's operations went *solely* to BD No.1's President, not to BD No.1(as would be expected in a mere asset sale). (2) BD No.1 has ceased conducting ordinary business and, if not already dissolved, soon will be. There is no requirement that all of the "de facto merger" indicators occur at the same time. *Arnold Graphics Industries, Inc.*, 775 F.2d at 42. (citing *Knapp v. North American Rockwell Corp.*, 506 F.2d 361, 367 (3d Cir. 1974)(finding a de facto merger even though the selling corporation was not dissolved until eighteen months after the sale and still possessed valuable assets in the meantime)). (3) Respondent expressly agreed to pay all of BD No.1's expenses incurred in smoothly transferring its business to Respondent. And (4) Respondent's New Division has continued BD No.1's management, personnel, assets, and general business operations, even describing the transaction to its customers as a "merger."[3]

Mere Continuation: Finally, Respondent should be held liable as a "mere continuation" of BD No.1. Contrary to Respondent's allegations, the "BD No.1 Group" has not continued any business of BD No.1 or, apparently, any business at all. There is not a single known asset belonging to the shell formerly known as BD No.1. Moreover, there is no strict requirement under the "mere continuation" doctrine that the predecessor corporation be extinguished. Indeed, the rules of successor liability apply regardless of the form of organization at issue. *Grahan v. James*, 144 F.3d 229, 240 (2nd Cir. 1998). Hence, for example, the *Graham* court held that "mere continuation" might be found where an individual transferred all of his business assets, including customer lists, from his sole proprietorship to a new corporation he formed. *Id.* The court mentioned no requirement that the individual actually be dead or otherwise "extinguished" for "mere continuation" liability to attach.

Finally, the *Ladjevardain* case cited by Respondent denied a "mere continuation" claim only because the predecessor "continued to exist after the sale ***and*** apparently received fair consideration for its assets." 431 F.Supp. at 839 (emphasis added). BD No.1 has not continued to exist (except, perhaps, temporarily on paper), and it received ***no*** consideration for its business. Respondent paid BD No.1's President to move all of BD No.1's business to Respondent. Under these circumstances, Respondent is both intuitively and legally the "mere continuation" of BD No.1.

C. *Respondent can be liable as an aider and abetter under the Texas Securities Act.*

Finally, Respondent seeks to dismiss Claimant's "aider and abettor" claim on the grounds that there is no such cause of action under ' 10(b) of the federal Exchange Act. Respondent is apparently unfamiliar with the Texas Securities Act, which explicitly provides for the liability of, and a private right of action against, a person who, with intent to deceive, "materially aids a seller" of securities. Tex. Rev. Civ. Stat. art. 581-33(F)(2). The aider is liable jointly and severally with the seller, and to the same extent as if he were the seller. *Id.* Hence Claimant plainly stated a claim against Respondent as an "aider" under the Texas Securities Act.

Conclusion

Respondent's motion is procedurally improper and substantively without any merit whatsoever. It should be summarily denied.

[3]The allegation that BD No.1physically moved the location of its business to the premises of Respondent should carry very little weight in this analysis, since all of the business of both entities is conducted by telephone.

Recent Court Decisions

California U.S. District Court Holds That A Petition to Vacate Does Not Present A Federal Question and That the Amount in Controversy is the Amount of the Arbitration Award, not the Amount of the Underlying Claim

In *Goodman v. CIBC Oppenheimer & Co.* , 131 F. Supp. 2d 1180 (C.D. Ca. 2/12/01), Plaintiff , a customer of CIBC Oppenheimer & Co., arbitrated a variety of securities fraud claims against Oppenheimer before an NASD arbitration panel. Having sought $3,000,000 in damages, but achieving an award of only $74,030.75, Goodman petitioned the Court to vacate the award under Section 10 of the Federal Arbitration Act on the ground that the arbitrators manifestly disregarded the law. The Court held that it need not reach the merits of Goodman's claim because the Court lacked subject matter jurisdiction over the dispute; that although the parties were diverse, the amount in controversy did not meet the jurisdictional minimum; and that, though the parties are proceeding under the Federal Arbitration Act, that act does not confer federal question jurisdiction over the dispute, nor was there a federal question raised in the substantive dispute presented in the proceeding.

The Plaintiff argued that the petition to vacate presented a federal question on two separate grounds. First, he claimed that the case arose under federal law because it is brought under the Federal Arbitration Act, 9 United States Code Sections 10. Second, he claimed that his petition arose under federal law because the arbitrators resolved questions based on the federal securities laws.

The Court held that neither claim was meritorious because the Federal Arbitration Act does not confer subject matter jurisdiction on the federal courts (*Southland Corp. v. Keating, 465 U.S. 1, 16, 79 L. Ed. 2d 1, 104 S. Ct. 852 (1984)*) and that there was no federal question involved because the question was not whether federal laws were violated, but whether the arbitrators acted in manifest disregard of the law. The Court noted that Appellate Courts have unanimously held that judicial review of an arbitrator's decision "is both limited and highly deferential." *Barnes v. Logan, 122 F.3d 820, 821 (9th Cir. 1997),* and, when making this inference, the reviewing court must search for "even a barely colorable justification for the outcome reached," and if one is found, the arbitration award must be confirmed. *Id. at 13.* This search, however, does not involve a federal question, but rather an analysis of the conduct of the arbitrators.

Since there was no federal question jurisdiction, the Court looked at diversity and the amount in dispute. The Court noted that other federal courts had crafted at least four different ways of analyzing the amount in controversy in petitions to vacate or confirm arbitration awards. The Court found that the approach of the Sixth and Eleventh Circuits to be the most widely followed. The case law from those circuits holds that the amount in controversy is equal to the amount of arbitration award regardless of the amount sought in the underlying arbitration. See *Baltin v. Alaron Trading Corp., 128 F.3d 1466 (11th Cir. 1997).*

Since the case did not meet the amount in controversy threshold, the Court declined jurisdiction and dismissed the case.

Oregon U.S. District Court Affirms Arbitration Award Which Held Clearing Firm Liable for Wrongful Actions of Introducing Broker Dealer

In *Koruga V. Fiserv Correspondent Services*, 2001 U.S. Dist. LEXIS 2417 (D.C. Or. February 7, 2001), the Court was asked to confirm an arbitration award which held a clearing firm liable for the actions of an introducing broker under Washington and California law.

Plaintiffs maintained brokerage accounts at Duke & Company, Inc. Duke was an "introducing broker" and cleared its securities sales through Hanifen Imhoff Clearing Corp., and later, Hanifen's successor, Fiserv Correspondent Services, Inc. The account agreements between Plaintiffs and Fiserv called for final, binding arbitration over any dispute that might arise between the parties.

After a hearing on the merits, the arbitration panel found that under the plain meaning of the Washington and California Securities Acts, respectively RCW 21.20.430(3) and Cal.Corp.Code § 25504, Fiserv was jointly and severally liable to Plaintiffs for the full amount of damages, plus interest, costs, and fees. Fiserv sought to have the arbitration award vacated, claiming that the arbitration award manifestly disregarded applicable law.

RCW 21.20.430(3) provides: "every broker-dealer...who materially aids in the transaction is also liable jointly and severally with and to the same extent as the seller or buyer..." Similarly, Cal. Corp. Code § 25504 provides: "every broker-dealer or agent who materially aids in the act or transaction constituting the violation, are also liable jointly and severally with and to the same extent as such person..."

Fiserv argued that the panel improperly disregarded *Carlson v. Bear, Stearns, 906 F.2d 315 (7th Cir. 1990).* However, the Court held that Carlson did not interpret the Washington or California Securities Acts, and the Illinois Securities Act discussed in Carlson differed from the Washington and California Acts, and that the Seventh Circuit's decision in *Carlson* was premised upon the particular facts in that case. The Carlson Court found that the defendant performed only ministerial duties in its role as a clearing house for the disputed securities transactions. The Court noted that, unlike Carlson, the arbitration panel made specific factual findings

that Fiserv was directly involved in the challenged transactions and materially participated in the wrongdoing. Applying the plain language of the California and Washington statutes, the panel determined that Fiserv was liable under the Washington and California Securities Acts as a direct participant in the wrongdoing.

The Court went on to say that a review of the factual determinations was beyond the scope of the Court's jurisdiction in reviewing an arbitration award. Accepting these factual findings, the Court held that the panel's application of the Washington and California statutes appeared to be consistent with the overall intent and scope of those statutes' statutory schemes, and that it therefore could not find that the panel's application of the statutes was contrary to the plain meaning of the statutes, nor contrary to any other applicable source of law.

Fiserv also argued that the panel improperly disregarded *Cacciola v. Kochcapital Inc.,* 1997 Wash. App. LEXIS 1122, 1997 WL 407867 (Wash.App.Div.1). The Court held that *Cacciola* was not applicable to the facts of the instant case because the Washington Court of Appeals in *Cacciola* applied RCW 21.20.430(1), as opposed to RCW 21.20.430(3), and held that the clearing firm was not a "seller" under that section because the clearing firm's participation was not a substantial factor in causing the transaction. The arbitration panel had distinguished that case in award, based upon the fact that the *Cacciola* Court applied a different section of the applicable statute and made a factual finding that the clearing firm was not liable as a "seller. The Court concluded that "even if *Cacciola* held precedential value, the panel's disregard of this case was not a manifest disregard for law".

U.S. District Court in Louisiana Affirms $1.00 Compensatory, $250,000.00 Punitive Damage Arbitration Award

In *Morgan Keegan v. Lalonde*, 2001 U.S. Dist. LEXIS 598 (E.D. La. January 16, 2001), Morgan Keegan had filed a petition to vacate an arbitration award which included punitive damages. The District Court denied Morgan Keegan's motion to vacate.

Ms. Lalonde had filed an NASD arbitration claim against Morgan Keegan, the broker LeBlanc, and the branch manager Freiberg, contending that LeBlanc churned her account to generate commissions, made unsuitable trades considering her investment objectives, and made numerous unauthorized trades by allowing LeBlanc to trade the account without written authorization. Lalonde also claimed that Morgan Keegan and Freiberg inadequately supervised LeBlanc's activities with respect to this account. She sought over $1 million dollars in compensatory damages, punitive damages, costs and fees.

The arbitration panel conducted an eleven-day long hearing and subsequently awarded Lalonde $ 1.00 in compensatory damages and $ 250,000.00 in punitive damages, the maximum allowed by Georgia law. Morgan Keegan sought seek to vacate the punitive damages award on the basis that it was grossly excessive and in manifest disregard of current case law, and that it exceeded the scope of the arbitrators' authority.

In contending that the award was grossly excessive, Morgan Keegan pointed to *BMW of North America, Inc. v. Gore,* 517 U.S. 559, 134 L. Ed. 2d 809, 116 S. Ct. 1589 (1996) which, in awarding punitive damages, set forth three factors for consideration: 1) the degree of reprehensibility of the conduct, 2) the disparity between the harm suffered and the punitive damage award, and 3) the punitive damage awards in similar cases. Morgan Keegan suggested that the Court should review the case in light of these factors. However, the *Lalonde* Court held that the *Gore* case did not involve review of an arbitration award and that the extremely narrow standard of review required in arbitration cases did not invite the type of analysis suggested by Morgan Keegan.

Morgan Keegan also claimed that the punitive damage award was in manifest disregard of current case law and that it exceeded the scope of the arbitrators' authority. The Court noted that, except in cases involving federal employment rights statutes, the U.S. Fifth Circuit Court of Appeals had not yet approved of the "manifest disregard" standard and has limited a district court's review of an arbitration award in a commercial contract case to those grounds explicitly set forth in Section 10 of the Federal Arbitration Act. *McIlroy v. Painewebber, Inc.,* 989 F.2d 817, 820 (5th Cir.1993). The Court then noted that Morgan Keegan's only alleged Section 10 violation was to the effect that the award exceeded the authority of the arbitrators, but that, in securities arbitration cases, an award of punitive damages was permitted unless expressly excluded from the agreement. *Mastrobuono v. Shearson Lehman Hutton,* 514 U.S. 52, 131 L. Ed. 2d 76, 115 S. Ct. 1212 (1995). In addition, the Court noted that the panel awarded the punitive damages pursuant to Georgia statutory law, OCGA §51-12-5.1, which provides for a maximum punitive damage award of $ 250,000.00 for tort actions, and concluded that the arbitration panel was clearly within the scope of its authority in fashioning the award.

Lastly, the Court stated that:

> even if this Court were to apply the "manifest disregard of the law" standard to this commercial contract case, the award must stand because there

is no evidence that the arbitrators acted contrary to applicable law. Plaintiffs' notion that the ratio of punitive to compensatory damages is contrary to law is, itself, contrary to law. In addition, for this Court to engage in the punitive damages analysis set forth in Gore v. BMW, which is not an arbitration case, would disregard the standard of review required in this case. Finally, a review of the transcript of the proceedings supports the conclusion that a colorable basis for the decision is present, a further indication that the panel acted within its scope of authority in fashioning the award.

New York U.S. District Court Gives a Primer on New York Securities Law In its Consideration of a Wrongful Liquidation Claim Involving CMOs

In *Primavera Familienstifung v. ABF Capital Management, et al.*, 130 F. Supp. 2d 50; (S.D.N.Y. February 5, 2001), the Court was called upon to decide several complex issues underlying the sale of certain Collateralized Mortgage Obligations in a motion for summary judgment context.

The investors, who included both individuals and institutional investors, were shareholders and/or limited partners in hedge funds. The Funds primarily acquired their CMOs pursuant to repurchase agreements or "repos." The brokers loaned the hedge funds most of the purchase price for each CMO and took possession of the CMOs as collateral for the hedge funds' performing their obligations to repurchase the CMOs, i.e., repay the loan, with interest, on the repo buy-back date. If the value of the securities in a repo account fell below an amount agreed upon by the parties, the "margin amount," then there was a "margin deficit" and the broker had the right to make a "margin call," and to demand money or additional securities as collateral for the loan. If a proper margin call was not met, the broker had the right to liquidate the securities in the repo account.

Between March 28 and March 31, 1994, the various brokers with which the Funds had entered into repo transactions issued a "blizzard" of margin calls on the hedge funds. All told, the margin demands amounted to more than $131 million. In response to the margin calls, the hedge funds transferred approximately $49 million in cash or unencumbered collateral to the various brokers, leaving a shortfall of almost $82 million. By March 30, 1994, the hedge funds' short-term obligations exceeded their cash and unencumbered securities by approximately $60.4 million. As the hedge funds were unable to meet the margin calls, the brokers liquidated the hedge funds' portfolios. The hedge funds collapsed and filed for bankruptcy under Chapter 11 on April 7, 1994. The investors in the hedge funds allegedly lost approximately $230 million in investments.

The investors alleged misrepresentations in two categories, namely, the "valuations fraud" and the "operations fraud." The valuations fraud pertained to representations concerning the process by which the hedge funds' securities were valued, and, specifically, whether valuations were based on broker marks, and representations regarding the performance of the hedge funds' securities. The operations fraud pertains to representations regarding the use of computer modeling to manage the hedge funds' investments.

The Court discussed New York law on common law fraud. Under New York law, a cause of action for common law fraud can arise out of a contractual relationship where the "fraudulent misrepresentation [is] collateral or extraneous to the contract." *Bridgestone/Firestone, Inc. v. Recovery Credit Serv., Inc.,* 98 F.3d 13, 20 (2d Cir. 1996). It is also "elementary" that a false representation that induces one to enter into a contract supports a fraud claim. *Stewart v. Jackson & Nash,* 976 F.2d 86, 88-89 (2d Cir. 1992) (citing cases); see *Waltree Ltd. v. ING Furman Selz LLC,* 97 F. Supp. 2d 464, 470 (S.D.N.Y. 2000) (allegation of fraudulent inducement to invest through material misrepresentations was not breach of contract claim disguised as tort).

The Court went on to say that although "a mere conclusory allegation that the defendant did not intend to carry out a promise is insufficient to state a fraud claim," such a claim is viable where there are specific facts supporting "an inference that [the defendant] never intended to carry out its alleged promise." *Dornberger v. Metropolitan Life Ins. Co.,* 961 F. Supp. 506, 542 (S.D.N.Y. 1997) (*citing Brown v. Lockwood*, 76 A.D.2d 721, 732, 432 N.Y.S.2d 186 (N.Y. 1980). The Court concluded that the collateral misrepresentation doctrine applies under the circumstances of the instant case because there is a "representation of present fact, not of future intent . . . collateral to, but which was the inducement for the contract." *Deerfield Communications,* 68 N.Y.2d at 956.

The Court also discussed common law investment fraud cases which involve plaintiffs who claim to have been induced both to make and to retain their investment. *Marbury Management, Inc. v. Kohn,* 629 F.2d 705, 708-09 (2d Cir. N.Y. 1980). In *Marbury*, the Second Circuit, in determining whether or not damages could be obtained for the period during which a plaintiff was induced to retain his investment, discussed interchangeably cases where the plaintiffs were induced both to make and retain their investments, and cases where the plaintiffs were induced only to retain them. 629 F.2d at 708-09 (citing inter alia *David v. Belmont,* 291 Mass. 450, 454, 197 N.E. 83, 85 (1935) (retention of securities) and *Continental Ins. Co. v. Mercadante,* 222 A.D. 181, 183, 186, 225 N.Y.S. 488 (N.Y. App. Div. 1927) (retention of securities)). The Court also noted that the Second Circuit also cited "to the same effect"

a New York case which did not involve investment fraud but which held that "'fraud which induces non-action where action would otherwise have been taken is as culpable as fraud which induces action which would otherwise have been withheld'" *Marbury,* 629 F.2d at 709 (quoting *Stern Bros. v. New York Edison Co.,* 251 A.D. 379, 381, 296 N.Y.S. 857 (N.Y. App. Div. 1937)), and that another district court within its circuit had concluded that "it is sufficient that the misrepresentation induced plaintiff to purchase or retain his investment." *Alvin S. Schwartz, M.D., P.A. v. O'Grady, 1990 U.S. Dist. LEXIS 13465, No. 86 Civ. 4243, 1990 WL 156274* (S.D.N.Y. Oct. 12, 1990) and also *Freschi,* 551 F. Supp. at 1230 (common law fraud claim exists where "ongoing concealment" causes the retention of a investment), and that the New York State Appellate Division has also recognized that a common law fraud may be "based on inducement to retain" an investment. *Kaufmann v. Delafield,* 224 A.D. 29, 229 N.Y.S. 545, 546-47 (N.Y. App. Div. 1928).

The Court also discussed New York law and the prospectus defense and reasonable reliance. It noted that under New York law, reliance on statements that are contradicted by a writing is not justifiable. *Hunt, IRA v. Alliance North American Gov't Income Trust, Inc.,* 159 F.3d 723, 729 (2d Cir. 1998) (reliance unreasonable where "prospectuses warned investors of exactly the risk [they] claimed were not disclosed"); *Republic Nat'l Bank v. Hales,* 75 F. Supp. 2d 300, 315 (S.D.N.Y. 1999) (borrower could not reasonably rely on alleged oral misrepresentations by bank where express provisions of written contract contradicted those misrepresentations). The Court also noted that the rule applies to written as well as oral statements contradicted by a writing. *Hunt,* 159 F.3d at 730 (plaintiffs could not have been misled by written "advertisements when read in conjunction with the prospectuses and related offering materials"). Lastly, the Court noted, however, that cautionary language in a prospectus does not bar a fraud claim where is does not "precisely address the substance of the specific statement or omission that is challenged." *In re Prudential Secs. Inc. Ltd. Partnerships Lit.,* 930 F. Supp. 68, 72 (S.D.N.Y. 1996). Nor does "cautionary language . . . protect material misrepresentations or omissions when Defendants knew they were false when made."

Since the Court found that the misrepresentations alleged by the investors were not specifically refuted by language in the Private Placement Memorandum (the "PPM"), the PPM risk disclosures did not immunize against a primary fraud claim based on representations made outside of the PPMs. *In re First Amer. Ctr. Secs. Litig.,* 807 F. Supp. 326, 333 (S.D.N.Y. 1992) ; Hunt, 159 F.3d at 728-29 (sustaining fraud claim by hedge fund investors where prospectuses promised fund would attempt to use hedging but in fact fund could not do so).

The Court also considered the defendant's claim that the investors waived any right to rely on any representations outside of the PPMs because of the disclaimer in each PPM that "no representations or warranties" had been made, and the Investor was "not relying upon any information other than that contained in the Offering Memorandum [i.e., the PPM] and the results of [the Investor's] own independent investigation." In its consideration, the Court noted that a fraud plaintiff is bound by a specific disclaimer of reliance on prior statements (*Belin v. Weissler,* 1998 U.S. Dist. LEXIS 10492, No. 97 Civ. 8787, 1998 WL 39114, at *7 (S.D.N.Y. July 14, 1998) (investor could not claim reliance on representations outside partnership agreement where according to subscription agreement he "relied solely . . . on the information contained in the Partnership Agreement"), but also noted that, in the instant case, the PPM acknowledged that each Investor would rely not only on the PPM but also on "the results of [the Investor's] own independent investigation", and that the PPM further confirmed that, as part of an investor's independent investigation, there was the opportunity to ask questions of ACM and receive responses -- responses which would include, by implication, representations outside of those contained in the PPM.

The Court was also called upon to assess the defendant's contention that the losses sustained by the hedge funds were caused by market forces rather than any alleged fraud. The Court referred to *AUSA Life Ins. Co. v. Ernst and Young,* 206 F.3d 202 (2d Cir. 2000), wherein the Second Circuit analyzed the issue of causation in the context of both federal securities fraud and common law fraud claims, and noted that the *AUSA Life* Court explained that in the securities context causation has two elements, transaction causation and loss causation. Loss causation is equivalent to the traditional "proximate cause" concept, and pertains to whether the fraudulent conduct caused the economic harm, while transaction causation is analogous to reliance, and pertains to whether the fraudulent conduct caused the plaintiff to engage in the transaction in question. The *AUSA Life* Court held that loss causation is established when "the damage complained of [was] one of the foreseeable consequences" of the fraud. The Court emphasized that the *AUSA Life* Court held that issue of foreseeability is crucial to the loss causation inquiry, as it is with proximate cause, and elaborated that "foreseeability finding turns on fairness, policy, and ... 'a rough sense of justice,'" and concluded that it would not be unjust to hold liable a party who misrepresented the financial condition of a company, thus inducing investors to refrain from selling their securities. Moreover, the Court observed that the *USA Life* Court considered the issue of external causal factors, including, specifically, a market crash, as being relevant to the loss causation analysis, but stressed that it "did not intend to bar a plaintiff from successfully pleading proximate cause when the claim follows a market collapse."

The Court next considered the liability of the brokers based on aiding and abetting. The Court noted that the Brokers may be held liable for aiding and abetting the primary fraud if they knew of the fraud and rendered substantial assistance to its achievement. *Tribune Co. v. Purcigliotti,* 869 F. Supp. 1076, 1100 (S.D.N.Y. 1994), but that in order to establish the scienter or knowledge element, the investors will have to prove, by clear and convincing evidence, sufficient facts to support a "strong inference" of fraudulent intent. *Beck v. Manufacturers Hanover Trust Co.,* 820 F.2d 46, 50 (2d Cir. 1987). Such an inference may be established by (1) showing a motive for participating in a fraudulent scheme and a clear opportunity to do so, or (2) identifying circumstances indicative of conscious behavior. *Dreieck Finanz AG v. Sun,* 1990 U.S. Dist. LEXIS 1438, No. 89 Civ. 4347, 1990 WL 11537, at *12 (S.D.N.Y. Feb. 9, 1990).

The Court rejected the investors contention that scienter could be established by a showing of recklessness and their reliance on *Rolf v. Blyth, Eastman Dillon & Co.,* 570 F.2d 38, 44 (2d Cir. 1978) since *Rolf* arose in the context of an aider and abettor that owed a fiduciary duty to the fraud victim. The Court held that, absent a fiduciary duty, there must be a showing of actual intent to establish liability. *Ross v. Bolton,* 904 F.2d 819, 823 (2d Cir. 1990) ("Assuming . . . recklessness has been adequately pleaded -- absent a fiduciary duty ... there is no aiding and abetting liability ... [plaintiffs] need to show ... actual intent").

The Court further noted that in order to establish liability for aiding and abetting, the investors also had to prove substantial assistance by the brokers. The substantial assistance element has been construed as a causation concept, requiring that the acts of the aider and abettor proximately caused the harm upon which the primary liability is predicated. *Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.,* 602 F.2d 478, 484 (2d Cir. 1979) (substantial assistance is proximate causation concept); *Northwestern Nat'l Ins. Co. v. Alberts,* 769 F. Supp. 498, 511 (S.D.N.Y. 1991) ("[A] plaintiff alleging substantial assistance by the aider and abettor must allege that the acts of the aider and abettor proximately caused the harm upon which the primary liability is predicated."). However, the Court noted that executing transactions, even ordinary course transactions, can constitute substantial assistance under some circumstances, such as where there is an extraordinary economic motivation to aid in the fraud. *Armstrong v. McAlpin,* 699 F.2d 79, 91 (2d Cir. 1983) (broker's processing of transactions with knowledge of fraudulent nature to generate commissions); *IIT v. Cornfeld,* 619 F.2d 909, 921-22, 926-27 (2d Cir. 1980) (performing challenged transaction knowing it violated client's policy, with heightened economic motive to do so); *Rolf v. Blyth, Easton Dillon & Co.,* 570 F.2d at 48 ("Substantial assistance might include . . . executing transactions or investing proceeds, or perhaps . . . financing transactions."). And that, participation in financing the fraudulent scheme, particularly where the financing was not routine, is another. *Monsen v. Consolidated Dressed Beef Co.,* 579 F.2d 793, 800-04 (atypical financing transactions).

[Ed. Note: This is an epic of a decision consisting of some 111 pages which considers virtually every aspect of a securities claim under New York law. In addition to the topics covered above, the case has an excellent primer on CMOs, discusses appropriate damages in cases of fraud and in contract, considers the admissibility of expert testimony in general and expert testimony that makes legal conclusions in specific, discusses margin liquidations and the requirement under U.C.C. §9-504(3) that any such liquidation be commercially reasonable, and lastly, contains a discussion of various state statutes of limitations (as a result of the New York borrowing statute).

New York U.S. District Court Denies Bear Stearns' Motion For Judgment As a Matter of Law After an Adverse Jury Verdict

In *Kwiatkowski v. Bear Stearns & Co., Inc.;*126 F. Supp. 2d 672 (S.D.N.Y. December 29, 2000), the District Court considered Bear Stearns' motion for judgment as a matter of law and, in the alternative, for a new trial after a jury rendered a verdict in favor of Kwiatkowski on the negligence claim in an amount of $111.5 million, on which he was entitled as of right to statutory pre-judgment interest of approximately $60 million that was then added by the Court.

Kwiatkowski was an exceptionally wealthy individual who, through accounts he maintained at Bear Stearns under his own management and control, in late 1994 purchased a position in foreign currency futures contracts worth approximately $6.5 billion. In this venture, a form of investment considered inherently risky, he lost an estimated $215 million in a space of a few weeks in early 1995. Kwiatkowski alleged two legal theories for recovery against Bear Stearns -- breach of fiduciary duty and negligence. The jury found Bear Stearns liable on the negligence claim but not for breach of fiduciary duty. The basic question to be answered was whether, assuming Kwiatkowski's accounts at Bear Stearns were nondiscretionary, did Bear Stearns owe Kwiatkowski a legal duty to furnish him with any investment advice. The Judge found that, even if Kwiatkowski's accounts were nondiscretionary, on the basis of the business relationship and course of dealings the record demonstrated he had established with Bear Stearns, there was sufficient evidence to raise a triable issue as to whether, in connection with Bear Stearns's handling of Kwiatkowski's investments, Kwiatkowski had entrusted matters and Bear Stearns had provided services that exceeded the bounds ordinarily associated with nondiscretionary accounts. Accordingly, as regards the negligence claim, the dispositive factual issue

was not so much what type of accounts Kwiatkowski maintained, but rather the manner in which Bear Stearns actually dealt with them. The Judge held that Kwiatkowski's pleadings of negligence and the claims placed at issue by the evidence at trial asserted generically a breach of the duty of reasonable care in Bear Stearns's dealings with Kwiatkowski, and then specified the related particular actions alleged to constitute the lack of due care. These included: failing to make daily margin calls; failing to safeguard the security account he held for his children; waiting for weeks until Kwiatkowski's losses had reached the value of the securities accounts and then rapidly liquidating his positions in a deteriorating market; causing one-half of Kwiatkowski's foreign currency positions to be transferred to the OTC market; and engaging in transactions with Kwiatkowski on the OTC market as an interested party. The Judge relied on "evidence of a substantial advisory function undertaken by the defendants" and of a "substantial advisory relationship" in the course of which "the defendants were entrusted with matters and owed the plaintiff duties which exceeded those of simply executing trades in a normal broker-client relationship in a nondiscretionary account."

The instructions that the trial judge gave the jury informed the jury that "[a] defendant breaches a duty of care if his conduct is not that of a reasonably prudent person under similar circumstances." In giving context to what the jury could take into account as some evidence of reasonable conduct related to a trade or business, the Court referred the jury to documents and to sharply divergent testimony of expert witnesses admitted in evidence regarding the applicability of certain general industry standards and practices, as well as Bear Stearns's own internal procedures. The Court permitted the jury, in reaching a verdict, to consider whether or not Bear Stearns adhered to these standards in handling Kwiatkowski's accounts.

In making its determination as to the potential basis for the jury's verdict, the Court went thorough an exhaustive discussion of the relevant legal issues: the broker as agent; the broker as a fiduciary; the duty of due care owed by a broker; negligence and contract negligence; breach of fiduciary duty; and the applicable standards of due care.

In denying Bear Stearns' motions and affirming the jury verdict, the Court held that there were three separate legal bases to support a jury determination that Bear Stearns breached its duty to exercise reasonable care in the firm's relations with Kwiatkowski. First, sufficient evidence was presented indicating that, notwithstanding that Kwiatkowski's accounts with Bear Stearns were nondiscretionary, Bear Stearns assumed and performed substantial advisory functions in connection with the affairs Kwiatkowski entrusted to the firm during the course of their relationship. Second, even absent any obligation to perform enhanced advisory responsibilities, in several critical respects, the firm's performance could be found short of fulfilling its duties to inform of important matters falling within the scope of the broker/client relationship that had developed between the parties. And third, even if Bear Stearns had had no standing obligation to render any information or advisory service to Kwiatkowski, under the conditions that prevailed in the case, with Kwiatkowski caught in a position fraught with financial peril, Bear Stearns undertook efforts to respond by providing assistance.

[Ed. Note: This case serves as a starting point for the proposition that a cause of action exists when a broker is negligent, i.e., breaches the applicable standard of care.]

Recent Arbitration Awards

***Bridges v. Bear Stearns & Company, Inc., et al.*, NASD Case No. 98-2897;** *2001 NASD Arb. LEXIS 369;* March 1, 2001.

Claimants asserted the following causes of action: violation of Section 10(b) and Rule 10b-5; violation of § 8-6-17 and § 8-6-19, Code of Alabama (1975); common law fraud and conspiracy to defraud; violation of the NASD Rules of Fair Practice; breach of fiduciary duty; breach of contract; wantonness and negligence. The causes of action relate to recommended purchases in common stocks and warrants for highly speculative, under-capitalized small companies in initial public offerings, which resulted in substantial losses to Bridges. Claimants requested compensatory damages of $550,000.00, plus punitive damages, interest, costs, and attorneys fees.

Bear Stearns denied the allegations made in the Statement of Claim and asserted the following defenses: Claimants failed to state a claim upon which relief can be granted; Claimants did not rely on any statement or action made by Bear Stearns or its agents; Claimants failed to mitigate the damages sought in the action; the claims are barred by the doctrines of waiver, ratification and estoppel; any alleged oral contract is not enforceable based upon the Statute of Frauds; Claimants and Bear Stearns have entered into a written agreement and any alleged modification fails for lack of consideration; any damages incurred were the result of decisions made by the Claimants independent of Bear Stearns; and Bear Stearns' conduct does not warrant an award of punitive damages and any such award would be in contravention of the Constitution of the United States.

The arbitration panel awarded as follows:

1. Respondents Bear Stearns Securities Corp., First Cambridge Securities Corp., Kenneth Orr and Seth Peter Margoshes are jointly and severally liable for and shall pay to Claimants Terrell Bridges and Francis Bridges the sum of $186,757.20 in compensatory damages, plus interest at the rate of 10% per annum accruing from August 11, 1998 until the sum is paid in full;

2. In addition, Respondents First Cambridge Securities Corp., Kenneth Orr and Seth Peter Margoshes are jointly and severally liable for and shall pay to Claimants Terrell Bridges and Francis Bridges the sum of $356,242.80 in compensatory damages, plus interest at the rate of 10% per annum accruing from August 11, 1998 until the sum is paid in full;

3. Furthermore, Respondents Bear Stearns Securities Corp., First Cambridge Securities Corp., Kenneth Orr and Seth Peter Margoshes are jointly and severally liable for and shall pay to Claimants Terrell Bridges and Francis Bridges the sum of $30,000.00 in attorneys' fees.

Claimants were represented by J. Timothy Francis, Esq. of the Law Offices of James L. North, located in Birmingham, Alabama. Respondent Bear Stearns & Co., Inc. was represented by A. Inge Selden III, Esq., of Maynard, Cooper & Gale, P.C., located in Birmingham, Alabama.

***Carney v. First Montauk Securities Corp., et al.*, NASD Case Number: 98-04758,** *2001 NASD Arb. LEXIS 384;* February 28, 2001

Claimants asserted the following causes of action: breach of contract; violations of Federal Securities Laws and NASD Rules; unsuitability; breach of fiduciary obligations; misrepresentations and omissions; and failure to supervise. Claimants' claims involved a variety of securities, including stocks, warrants, mutual funds, and options. Claimants requested compensatory damages in the amount of $628,000.00; lost opportunity damages in the amount of $180,000.00; interest; attorneys' fees; and punitive damages.

In their Answer, Respondents denied the allegations made in the Statement of Claim and asserted the following defenses: Claimants' claims are barred by the doctrines of estoppel, waiver, ratification, and laches; Claimants have failed to mitigate their alleged damages; Claimants' claims are time-barred by virtue of the expiration of the applicable Federal and State statutes of limitations; Claimants authorized all transactions at issue in this proceeding; any and all damages for which Claimants seek recovery herein were caused by Claimants' own culpable conduct, comparative and/or contributory negligence and/or assumption of the risks involved; and Claimants' claims are ineligible for arbitration pursuant to Rule 10304 of the NASD Code of Arbitration Procedure to the extent that more than six years have elapsed since the time they purchased the securities at issue herein.

The arbitration panel awarded as follows:

1. Montauk be and hereby is solely liable for and shall pay to Claimants the sum of $369,945.00 as compensatory damages, inclusive of interest.

2. Kaplan be and hereby is solely liable for and shall pay to Claimants the sum of $75,000.00 as compensatory damages, inclusive of interest.

3. Barreca be and hereby is solely liable for and shall pay to Claimants the sum of $75,000.00 as compensatory damages, inclusive of interest.

4. Claimants' request for punitive damages is hereby denied.

5. Upon confirmation of this Award by a court of competent jurisdiction, NASD Regulation, Inc. shall expunge all references to this arbitration from the permanent CRD records of Respondent Roger.

Claimants were represented by Lawrence S. Brochin, Esq., a sole practitioner, Great Neck, NY. Respondents, First Montauk Securities Corp. ("Montauk") and Richard Roger ("Roger") were represented by Matthew Tracy, Esq., Winget, Spadafora & Schwartzberg, LLP, New York, NY.

***Gregory v. Wachovia Securities, Inc. f/k/a, Interstate/Johnson Lane Corporation,et al.*, NASD Case Nos. 98-00142; 00-00894;** *2001 NASD Arb. LEXIS 300;* March 13, 2001

Claimants asserted the causes of action for breach of contract; excessive trading and churning; breach of fiduciary duty; negligence and violations of the rules of the NYSE and the NASD; unauthorized trading and conversion; suitability; violations of the South Carolina Uniform Securities Act; violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission; violations of the South Carolina Unfair Trade Practices Act; and violations of federal civil racketeering laws through the commission of mail fraud and wire fraud. The causes of action relate to substantial losses incurred by Claimants in connection with heavy trading activity of securities in their account. Claimants requested compensatory damages in the amount of $328,518.00; consequential damages in the amount of $423,238.00; punitive damages; interest; costs; and attorneys' fees.

Wachovia Securities denied the allegations made in the Statement of Claim and asserted the following defenses: Claimants waived their right to object to the transactions in their account; assumed the risks of loss in connection with the transactions in their account; Claimants were contributorily negligent and proximately caused the losses in their account; Claimants were comparatively negligent and are responsible for the losses in their account; Claimants failed to mitigate their damages; and that Claimants were barred from recovery by the applicable statutes of limitations or statutes of repose

The arbitration panel awarded as follows:

1. Wachovia and McShea are liable, jointly and severally, and shall pay to Robert Gregory and Carol Gregory, jointly, compensatory damages in the amount of $150,937.50, plus interest which shall begin to accrue as of February 14, 2001, at the statutory rate under South Carolina law of eight and three-quarters percent (8.75%) per annum, and shall continue to accrue until the Award is paid in full.

2. Wachovia and McShea are liable, jointly and severally, and shall pay to Robert Gregory and Carol Gregory, jointly, the sum of $27,788.92 representing reimbursement of costs, and Wachovia shall pay all forum fees.

3. Claimants' requests for attorneys' fees and punitive damages are denied.

Claimants were represented by Mitchell Willoughby, Esq., Willoughby & Hoefer, P.A., Columbia, South Carolina. Respondents were represented by Pamela P. Warnement, Senior Vice President and Deputy General Counsel, Wachovia, Charlotte, North Carolina.

***Grothaus v. Trautman, Kramer & Company, Inc., et al.*, NASD Case Number: 99-00490**; *2001 NASD Arb. LEXIS 290;* March 14, 2001

Claimant asserted causes of action for Violation of Section 2 of Article III of the National Association of Securities Dealers Rules of Fair Practice, violation of Rule 405 of the New York Stock Exchange for trading unsuitable securities and engaging in unsuitable transactions, fraud, unauthorized trading, churning, breach of fiduciary duty, and failure to supervise/control person liability. The causes of action relate to the following known allegedly unsuitable securities purchased on behalf of claimants in this case: Zoom Telephonics, E-Data, Tri-Cord Systems, Compositech, Ltd, IAT Multimedia, Myraid Genetics, Merix Corp., Syquest Technology Inc., Medaphis Corp., and ACT Teleconferencing. Claimants requested compensatory damages of $280,000.00, plus punitive damages, interest, costs, and attorneys fees.

Respondents denied the allegations made in the Statement of Claim and asserted the following defenses: NASD lack of jurisdiction to award punitive damages; failure to state a claim for punitive damages; failure to state a claim for breach of fiduciary duty; failure to state a claim for damages for losses sustained in trading unsuitable securities; waiver; and estoppel.

The arbitration panel awarded as follows:

1. The claims against Respondents Mark Gillis, Robert Kramer, Gregory Trautman and Mark Barbera are dismissed with prejudice and denied in their entirety.

2. The panel recommends the expungement of all reference to the above captioned arbitration from Respondent Mark Gillis, Robert J. Kramer, Gregory O. Trautman, Mark Barbera's registration records maintained by the NASD Central Registration Depository ("CRD"), with the understanding that pursuant to NASD Notice to Members 99-09, Respondents must obtain confirmation from a court of competent jurisdiction before the CRD will execute the expungement directive.

3. Respondent Trautman, Kramer & Company, Inc. shall be and hereby is solely liable to Claimant Robert Grothaus in the amount of $24,176.37 as compensatory damages.

4. Respondent Trautman, Kramer & Company, Inc. shall be and hereby is solely liable to Claimant Robert Grothaus in the amount of $10,000.00 as a sanction for failure to adequately comply with Claimant's discovery requests and the panel Chairperson's order to produce documents and information.

5. Claimant's request for interest and punitive damages is hereby denied.

Claimants were represented by Hayward Pressman, Esq. and Diane Mall Sammarco, Esq., Pressman & Associates, New York City, New York. Respondents were represented by Michael Schwartzberg, Esq., Winget, Spadafora & Schwartzberg, LLP, New York City, New York.

***Mueller v. Gaines Berland Inc., Alan Gaines and Arthur M. Coffee*; NASD Case Number: 99-00076**; *2001 NASD Arb. LEXIS 367;* February 12, 2001

Claimant asserted causes of action including the following: Breach of Fiduciary Duty, Violations of NASD Rules, Violation of Rule 10b-5, Violation of the Texas Securities Act, Article 581, Section 33, Violation of the Texas Deceptive Trade Practices Act, Negligent Misrepresentation, Fraud, Violation of Section 27.01 of the Texas Business and Commerce Code, Failure to Supervise

Control Person Liability. The causes of action relate to the purchase and sale of U. S. Energy, National Energy Group, Bellweather Exploration, APS Holding, Marine Drilling, and Infinity, Inc., stock. Claimants requested compensatory damages of $1,778,000.00, plus punitive damages, interest, costs, and attorneys fees.

Respondents denied the allegations made in the Statement of Claim and asserted the following defenses: Claimant's failure to timely object to any of the transactions of which he complains constitutes a ratification of these transactions and a waiver or estoppel of Claimant's right to any recovery sought in the Statement of Claim; Claimant's claims are barred by all applicable statutes of limitations; the Respondents acted at all times in compliance with the applicable rules and regulations, acted in good faith, and did not induce the alleged act or acts, if any, constituting any alleged violations of law; and the damages of Claimant, if any, are the proximate result of the market conditions and/or other factors beyond the control of the Respondents, and Claimant is therefore barred from seeking recovery thereof from Respondents.

The arbitration panel awarded as follows:

1. That Respondents Gaines Berland, Inc., Arthur Coffee and Alan Gaines are hereby jointly and severally liable for and shall pay Claimant Mark Mueller compensatory damages of $250,000.00;

2. That Respondents Gaines Berland, Inc., Arthur Coffee and Alan Gaines are hereby jointly and severally liable for and shall pay Claimant Mark Mueller attorney's fees of $100,000.00. In making this award of attorney's fees the panel reviewed and considered all pleadings, documents, briefs, exhibits and oral arguments of counsel including but not limited to Section 38.001 TX. Civ. Prac. Rem. Code, TX Sec. Act. Ar. 581 VATCS, Section 33 TX DTPA, and Section 27.01 TX Bus. Comm. Code and find that authority exists for this award; and

3. That Respondents Gaines Berland, Inc., Arthur Coffee and Alan Gaines are hereby jointly and severally liable for and shall pay Claimant Mark Mueller costs of $22,921.65. In making this award of costs the panel reviewed and considered all pleadings, documents, briefs, exhibits and oral arguments of counsel including but not limited to Section 38.001 TX. Civ. Prac. Rem. Code, TX Sec. Act. Ar. 581 VATCS, Section 33 TX DTPA, and Section 27.01 TX Bus. Comm. Code and find that authority exists for this award.

Claimants were represented by Gerald S. Siegmyer, Esq. and David E. Sharp, Attorney at Law, Houston, Texas. Respondents were represented by Mark Astarita, Esq., Beam & Astarita, Bloomfield, N.J.

James H. Oliver, et. al v. National Securities Corporation and The Boston Group, et al.; **NASD Case Number: 99-00940**; *2001 NASD Arb. LEXIS 364;* February 28, 2001

Claimants alleged breach of fiduciary duty, fraud, failure to supervise, violation of Federal and State Securities Laws, and violation of NASD Rules of Fair Practice and NYSE Rules. The dispute involved the purchase and/or sale of various securities. Claimants sought compensatory damages not less than $163,282.43, rescission, lost opportunity costs, punitive damages, interest, attorney's fees, interest, and costs of arbitration.

Respondents National Securities Corporation, Dwight C. Southwick, and Clifford F. Mastricola requested dismissal of the Statement of Claim in its entirety. Respondents, The Boston Group, Michael Allocca, Jr., Ian E. Gilbey requested dismissal of the Statement of Claim in its entirety, attorney's fees, and costs of arbitration.

The arbitration panel awarded as follows:

1) Respondents The Boston Group and Robert A. Diminico are jointly and severally liable to and shall pay Claimants $100,000.00 in compensatory damages.

2) Respondents The Boston Group and Robert A. Diminico are jointly and severally liable to and shall pay Claimants $300,000.00 in punitive damages pursuant to California Civil Code Section 3294.

3) Respondents Eric S. Hutner, Philip E. Steele, Kevin E. Scannell, John R. Brady are dismissed without prejudice.

4) Each party shall bear its own costs, including attorney's fees.

Claimants were represented by Ryan K. Bakhtiari, Esq., Aidikoff & Uhl, Beverly Hills, California. Respondent National Securities Corporation was represented by: Kristin Gaerttner, National Securities, Corporation, Seattle, Washington. Respondent The Boston Group was represented by Robert A. Diminico, National Securities, Corporation, Los Angeles, California.

Parks v. Olde Discount Corporation, Todd Bukaty, Barry C. Wheeles, Ernest J. Olde; **NASD Case No. 99-03559**; *2001 NASD Arb. LEXIS 338;* March 2, 2001

Claimants alleged that Respondents churned their account on a discretionary basis and utilized margin without fully disclosing the risks to Claimants. It was specifically alleged that Respondents traded securities in Claimants' account without obtaining authorization to do so; concealed material information; did not use reasonable diligence in supervising or monitoring the abusive practices of brokers churning

Claimants' account; failed to determine whether purchases and sales in Claimants account were suitable and completely disregarded their duties to Claimants.

Claimants requested an award of statutory damages under §17-1268 K.S.A. as follows: $53,312.13 in capital losses, $1,515.50 in margin interest, $35,167.32 in statutory interest, costs and attorneys fees. In addition to the statutory damages, the Claimants ask for such additional damages, including punitive damages, which will place them in the same position they would have been invested in common stocks in a properly managed account.

Respondents Olde Discount Corporation, Todd Bukaty and Barry C. Wheeles respectfully requested that all claims be dismissed, and that the Claimants be assessed the costs, fees and expenses of this baseless arbitration claim. Respondents Bukaty and Wheeles also requested an order expunging any reference to this claim from their records.

During the course of the hearing of this matter, Respondent Ernest J. Olde renewed his Motion to Dismiss. After considering the arguments presented on behalf of the parties and the evidence presented to that time, the Arbitration panel granted the Motion to Dismiss.

The arbitration panel awarded as follows:

1. Respondents Olde Discount Corporation and Todd Bukaty shall be and hereby are jointly and severally liable for and shall pay to Claimants Ronald M. Parks and Lynn E. Parks the sum of $ 25,725.50 as compensatory damages.

2. Respondents Olde Discount Corporation and Todd Bukaty shall be and hereby are jointly and severally liable for and shall pay to Claimants Ronald M. Parks and Lynn E. Parks the sum of $ 6,991.46 as interest.

3. That to the extent not specifically awarded or otherwise provided for above, all other claims and requests for relief by any party hereto are denied with prejudice.

Claimants were represented by Barry D. Estell, Esq., Mission, Kansas. Olde Discount Corporation, Todd Bukaty and Barry C. Wheeles were represented by Carranza M. Pryor, Esq., Maynard Cooper & Gale, P.C., Birmingham, Alabama. Ernest J. Olde was represented by Brian Smiley, Esq., Page Gard Smiley & Bishop, LLP, Atlanta, Georgia.

***Shipley v. Merrill Lynch Pierce Fenner & Smith, Inc. and David A. Cohen*; NASD Case No. 00-01326**; *2001 NASD Arb. LEXIS 326*; March 8, 2001

Claimant asserted the following causes of action: unsuitability; failure to supervise; breach of contract; breach of fiduciary duty; common law misrepresentation; negligence; and comparative negligence. The causes of action relate to Respondent Cohen's management of Claimant's portfolio, including the liquidation of U.S. treasury bonds, certificates of deposit and corporate notes, and the purchase of low or non-rated, highly volatile and speculative securities, including stocks, corporate bonds, real estate investment trusts, foreign securities or ADRs, limited partnerships, and mutual funds.
Claimant requested compensatory damages in the amount between $50,000.00 and $99,999.00; disgorgement of all commissions, mark-ups/mark-downs, payment for order flow, and any other forms of compensation received by Respondents from the transactions at issue; selective rescission of all unprofitable, unsuitable trades; punitive damages; interest; costs; and attorneys' fees.

Respondents denied the allegations made in the Statement of Claim and asserted the following defenses: Claimant failed to state a claim upon which relief may be granted; Claimant is barred from recovery by the applicable statutes of limitations; Claimant directed, authorized, consented to, acquiesced in, and ratified all transactions in the account with Respondent MLPFS; Claimant made all investment decisions with regard to the account, and Claimant's losses, if any, were caused by market conditions outside the control of Respondents; Claimant expressly authorized and approved each transaction prior to execution; Respondents acted in good faith with regard to Claimant's account; All transactions were confirmed in writing to Claimant; and Claimant did not timely complain or object to Respondent MLPFS with respect to the transactions.

The arbitration panel awarded as follows:

1. Respondents are liable, jointly and severally, and shall pay to Claimant compensatory damages in the amount of $60,000.00, plus interest which shall begin to accrue as of October 15, 1998, at the rate of ten percent (10%) per annum, and shall continue to accrue until the Award is paid in full.

2. Respondents are liable, jointly and severally, and shall pay to Complaint the sum of $ 7,108.41 representing reimbursement of Claimant's expert witness fees.

3. Claimant's request for punitive damages is denied.

4. Claimant's request for attorneys' fees is denied.

Claimants were represented by Neal J. Blaher, Esq., Law Office of Neal J. Blaher, Orlando, Florida. Respondents were represented by Charles L. Henderson, Vice President and Senior Counsel, Respondent MLPFS, New York, New York.

***Swain v. Salomon Smith Barney, Inc., Theodore A. Buck, Jr.*; NASD Case No. 99-04487**; *2001 NASD Arb. LEXIS 164*; February 14, 2001

Claimants alleged that Buck visited them at their home and induced them to open various accounts with Salomon Smith Barney, promising that he would serve as their financial consultant and work closely with them to plan for their financial needs. Claimants asserted that Buck also told them that their account would be closely monitored by him and by Salomon Smith Barney and that they would be advised on changing market conditions. According to Claimants, Buck told them that he had a buy and sell philosophy of 10-15% on the downside and that Claimants would be immediately notified and advised if any of their positions fell into this range or fell below Claimants' costs.

Claimants stated that, at Buck's request, they transferred 2,000 shares of Wordcruncher Internet Technology Stock to Salomon Smith Barney, but were never provided with copies of the account papers, although they requested them. Claimants stated that on January 26, 1999, they instructed Buck to sell their Wordcruncher stock, which was trading at $3-$ 36 per share. According to Claimants, Buck told them this stock would not be sold as it was "in limbo" and "frozen" during the transfer period between brokers. On February 16, 1999, Claimants again discussed with Buck the sale of Wordcruncher, which was then trading at about $26. Buck assured Claimants he would watch the stock and advise them of any changing market conditions. Between February 16 and February 19, 1999, Wordcruncher fell from 15 to 13. Buck did not advise Claimants of the drop. Claimants, relying on Buck's promise to advise them, did not follow Wordcruncher during that time period. On Monday, February 22, 1999, Claimants tried unsuccessfully to reach Buck. Wanting to avoid further losses, Claimants placed a sell order for 2,000 shares of Wordcruncher which was executed by Salomon Smith Barney on February 22 at $10.50. Claimant requested compensatory damages of $55,000.00, punitive damages of $5,000.00, and attorneys fees.

Respondents contended that Claimants' account; Claimants are barred from recovery under the doctrines of ratification, estoppel, waiver and laches by reason of their failure to complain promptly after written confirmation slip, monthly account statements and other documents evidencing or setting forth the transactions in Claimants' account; Claimants' claim is barred by Claimants' failure to mitigate any alleged damages; any losses allegedly sustained in Claimants' account were attributable to market conditions and were not attributable to any fault or wrongdoing on the part of Respondents.

The arbitration panel awarded as follows:

1. That Respondents Salomon Smith Barney and Theodore Buck, jointly and severally, are liable to and shall pay Claimants compensatory damages in the amount of $ 15,000; interest is awarded on this amount at the rate of 6% simple interest per annum from January 26, 1999 until the date the Award is paid.

2. That the parties shall bear their own respective cost and fees, including attorneys' fees.

Claimants were represented by Jonathan A. Azrael, Esq., of the law firm of Azrael, Gann & Franz, LLP, Baltimore, Maryland. Respondent Salomon Smith Barney was represented by Christopher B. O'Malley, Esq., Office of the General Counsel of Salomon Smith Barney, Inc., New York, New York.

***Thompson v. Meyers Pollack Robbins, Inc., Michael Ploshnick, Shelli Ploshnick, and Bear Sterns Securities Corp.*; NASD Case Number: 99-02364**; *2001 NASD Arb. LEXIS 309;* March 6, 2001

On June 12, 1998, Claimant was awarded a total of $ 737,156.00, plus interest, against MPR in NASD Arbitration 96-02458. The Award in favor of Claimant in the 1998 action was never satisfied by MPR. Claimant alleged that the individual Respondents in this case at all times have been the principals and control persons of MPR and merely used the corporate entity as a shell for personal financial gain. MPR has since gone out of business but still has substantial assets at BSSC. Claimant alleged that the funds are being held by BSSC to cover claims involving MPR. Thus, Claimant has filed a new action against BSSC, MPR and the individual respondents mentioned above. Claimant requested compensatory damages of $5,000,000.00.

Respondent denied the allegations made in the Statement of Claim and asserted the following defenses: Claimant's action is barred by the doctrines of res judicata and collateral estoppel; MPR did not appear at the 1998 hearing, thus, Claimant was granted a default judgment. Moreover, much of the award was comprised of punitive damages, attorneys' fees and pre-judgment interest. Therefore, the imposition of this award against BSSC would violate due process.

The arbitration panel awarded as follows:

In favor of the Claimant and against the Respondents. The Claimant is granted an equitable lien in the amount of $737,156 against the assets of Meyers Polock Robbins, Inc. held by Bear Sterns Securities Corp. as security for the claims against it related to Meyers Pollock & Robbins' Inc., Clearing accounts. This Award is against all respondents, however, Claimant takes nothing against Respondents Michael Plochnick and Shelli Ploshnick individually. All

forum fees shall be paid by Bear Sterns Securities Corp. Bear Sterns Securities Corp. shall reimburse Claimant for the filing fee.

Claimant was represented by William S. Sheperd, Esq. of William Sheperd & Associates, Houston, TX. Respondents were represented by John C. Allen, Esq. of John C. Allen, P.C., Houston, TX.

Recent Administrative Decisions

In the matter of DEAN WITTER REYNOLDS INC., et al.; **S.E.C. Administrative Proceeding File No. 3:9686**; *2001 SEC LEXIS 99;*January 22, 2001

The Division of Enforcement alleged that the broker Oberholzer engaged in fraudulent conduct in the accounts of four of his clients and that Dean Witter and its branch office manager Peterson failed reasonably to supervise Oberholzer with a view towards preventing this conduct. The Division also alleged that Dean Witter willfully violated the securities laws by maintaining inaccurate books and records, and that Oberholzer aided and abetted this violation. The case centered on whether or not Dean Witter had proper supervisory procedures in effect.

Through expert testimony it was established that the branch office manager has the primary supervisory responsibilities at a branch. In addition to monitoring each account executive's performance, branch managers must ensure each account executive complies with all applicable rules and regulations, including those specific to Dean Witter. This includes supervising and approving all new accounts. As part of this function, branch managers review and approve all new account forms. Account executives are also responsible for updating this information if and when it changes and branch managers must confirm that all required documentation is collected when an account is opened, and are ultimately responsible for updating and maintaining accurate client information. Branch managers must also perform a daily review of order tickets. This review includes ensuring that the ticket was completed properly and identifying large transactions or investments requiring branch manager approval. It also allows the branch manager to determine whether an account executive has multiple clients buying or selling a security on an allegedly "unsolicited" basis. When absent from the branch office, branch managers may delegate order ticket review and other duties to a licensed assistant branch manager. Branch managers are required to supervise active accounts and investigate any unusual activity occurring in those accounts. They must review active accounts each month, and are provided a monthly activity report generated by Dean Witter's computer surveillance system to aid in this duty. Branch managers are responsible for reviewing the accounts appearing on the activity report, interviewing the account executive and, if they deem necessary contacting the clients. Each month, branch managers must complete a supervisory log confirming the completion of all daily, weekly, and monthly supervisory activities. This log is then sent to the compliance department. Among other things, the branch managers must certify that the account executives' "Daytimers," in which important communications with clients are recorded, have been reviewed at least annually and that active clients have been contacted.

The supervision of the Dean Witter compliance department was also reviewed. The compliance department reviews active accounts on a monthly basis, providing additional information to the branch managers. The compliance department's computer surveillance system provides various account information for the compliance analysts' review, including commissions, net asset value, and turnover ratio. It also provides certain client profile information such as income, net worth, and investment objectives. Compliance analysts must consider whether a client's trading activity appears to be consistent with the client's sophistication, stated investment objectives, and financial means. They also attempt to detect improper sales practices, such as churning.

It was established that if an account executive wishes to solicit more than ten clients to purchase a security not recommended by Dean Witter, he must complete a security solicitation request form, which must be reviewed and approved by the branch manager and the regional sales director. A security solicitation request form is required for solicitation of [ten] or more customers for purchases of equity securities which are not rated B+ or better by [Standard & Poor's], or followed by [Dean Witter] Research, or the subject of an underwriting in which [Dean Witter] was a participant within [the] last [six] months.

The ALJ considered the underlying violations allegedly committed by the broker. It was alleged by the Division of Enforcement that the brokers churned the four accounts. The ALJ noted that, in a non-discretionary account, an account executive may exercise "de facto" control if the client places her trust and faith in the account executive and routinely follows his advice *Rowe v. Morgan Stanley Dean Witter,* 191 F.R.D. 398, 407 (D.N.J. 1999); and that control may be inferred in a non-discretionary account when the client is unable to manage the account and must rely on the account executive, routinely following the account executive's recommendations. *Canady,* 69 SEC Docket at 1477; Rowe, 191 F.R.D. at 408.

It was also alleged by the Division that the broker made unsuitable purchases in the accounts. The ALJ noted that an account executive engages in unsuitable trading "when

he or she makes recommendations that are unsuitable in light of the customer's stated investment objectives, in connection with actual misrepresentations and omissions." *Barbato,* 69 SEC Docket at 193-94 ; *Brown v. E.F. Hutton Group Inc.,* 991 F.2d 1020, 1031 (2d Cir. 1993); *Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1032 (4th Cir. 1997).

The ALJ concluded that the broker had churned the account and made unsuitable investments in the accounts but that Dean Witter had proper supervisory procedures in place and therefore did not violate applicable rules and regulations. The ALJ also found that the Division had failed to prove its case of failure to supervise against branch office manager.

[Ed. Note: This decision of 70 pages contains an excellent discussion of the role of the branch office manager and the compliance department in the supervision of the activities of brokers and detailed expert opinion testimony as to industry standards of supervisory procedures and the appropriate supervisory responses to activity levels in an account.]