To View an Article Click Article Title

# The P I A B A Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

June 1996 Volume 3 Number 2

**In This Issue...**

Letter From the President 1

Arbitrator Recruitment Update 3

From The Professor 4

SIA Makes Its Response to the Rudder Report 5

The U.S. 5th Circuit Rules on ERISA and Eligibility in Kramer 6

Seventh Circuit Holds Firm Liable As Control Person in Harrison 6

Sixth Circuit Affirms Defamation and Punitive Damage Award in U-5 Case 7

Michigan U.S. District Court Finds No Private Remedy for Broker for NASD Rule Violation 7

PIABA Files Amicus Brief on the AMEX Window 7

Michigan U.S. District Court Examines Reasonable Reliance and the “Prospectus Defense” 8

$1.3 Million Blue Sky Rescission Claim Granted 8

Derivatives May Not Be Good Investments For Banks Acting As Fiduciaries, OCC Says 8

New Arizona Securities Legislation 9

Federal Judge Denied Summary Judgment and Slams Polaris 9

Polaris Class Action Certified 10

NASD National Arbitration and Mediation Committee Update 11

Report From New York 11

The Bulletin Board 12

The PIABA Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

June 1996

Volume 3 Number 2

## Editor's Notes

The PIABA 5th Annual Meeting will be held from October 17 - October 20, 1996 in Aventura, Florida, at the Turnberry Isle Resort and Club. PIABA will accept Meeting Registration Forms through October 4, 1996. We encourage you to reserve your hotel room as soon as possible. (A Registration form is included in this mailing.)

Included in this issue is "From the Professor" — the first installment in what is to be a recurring column from PIABA Director Joe Long on legal developments 'ecting securities arbitration and ..igation.

The deadline for receiving submissions for the September issue of the *Quarterly* is August 30. All submissions, regardless of length, should be accompanied by a computer disk of the submitted material.

*The PIABA Quarterly is a publication of The Public Investors Arbitration Bar Association (PIABA) and is intended for the use of its members. Statements and opinions expressed are not necessarily those of PIABA or its Board of Directors. Information is from sources deemed reliable, but should be used subject to verification.*

## Letter From the President

L. Jerome Stanley, L. JEROME STANLEY, P.C., Baton Rouge, LA

The PIABA Board of Directors met in New Orleans on April 22 and 23, 1996. Much of the meeting involved preliminary discussions of topics for presentation at the Annual Meeting. As you know, the Annual Meeting will be held beginning with the evening reception on Thursday, October 17, with the program to run on Friday, Saturday and Sunday, October 18, 19, and 20.

The daily topics to be covered at the Annual Meeting and members of the committee who are responsible for organizing the presentation for each day are:

Friday — law update, SRO Developments, Meditation and ENE;
Committee — Mark Maddox, Rosemary Shockman, Bob Dyer;
Saturday — Pennystock cases, Cross Examination of Compliance officers, Current Brokerage Firm Real Estate Products;
Committee — Seth Lipner, Joe Long, Diane Nygarard, Jerry Stanley;

## In This Issue...

| | Page |
|---|---|
| $1.3 Million Blue Sky Rescission Claim Granted | 8 |
| Arbitrator Recruitment Update | 3 |
| The BULLETIN BOARD | 12 |
| Derivatives May Not Be Good Investments for Banks Acting as Fiduciaries, OCC Says | 8 |
| Elections | 4 |
| Federal Judge Denies Summary Judgment and Slams Polaris | 9 |
| From The Professor | 4 |
| Michigan U.S. District Court Examines Reasonable Reliance and the "Prospectus Defense" | 8 |
| Michigan U.S. District Court Finds No Private Remedy for Broker for NASD Rule Violation | 7 |
| NASD National Arbitration and Mediation Committee Update | 11 |
| New Arizona Securities Legislation | 9 |
| PIABA Files Amicus Brief on the AMEX Window | 7 |
| Polaris Class Action Certified | 10 |
| Report From New York | 11 |
| Requests For Attorneys | 2 |
| SIA Makes Its Response to the Rudder Report | 5 |
| Seventh Circuit Holds Firm Liable As Control Person in Harrison | 6 |
| Sixth Circuit Affirms Defamation and Punitive Damage Award in U-5 Case | 7 |
| The U.S. 5th Circuit Rules on ERISA Eligibility in Kramer | 6 |

Sunday — Product Evaluation, Ethics & Professionalism, Business Meeting.
Committee — Jim Beckley, Boyd Page, Bill Lapp, Cary Lapidus.

We also have the availability of display space for vendors at the Annual Meeting. If you know of any vendors or expert witnesses who would be interested in a booth area, please have them contact Rosemary Shockman.

The Board received a report from our Executive Director Brooke Geiger on the arbitrator recruitment program. It was decided that PIABA would include the NYSE in our arbitrator recruitment program.

The Board also discussed at the meeting the method by which we have been handling phone requests we have been receiving regarding requests for attorneys. We received a report on the subject from Brooke Geiger. I have included a copy of Brooke's report following the President's Letter.

The Board is scheduled to meet again on July 22 to finalize the schedule and speakers at the Annual Meeting. If you have a suggestion or contribution, p[illegible]e contact one of the members of the appropriate co[illegible]mittee listed above.

As is reported later in this issue, the SIA has made its second official response to the Rudder Report. Our response to the SIA letter will be formulated at the July 22nd Board Meeting.

Lastly, I encourage those of you who have not signed up to attend the Annual Meeting (we have about 120 people committed so far) to sign up as soon as possible so that we can finalize the advance preparations.

Best wishes,

Jerry

## Requests for Attorneys

PIABA began receiving telephone calls from investors in need of an experienced securities arbitration attorney in their area several years ago. An article, which appeared in *Smart Money Magazine*, recommended its readers contact PIABA for a list of its members if they felt they were having a problem with their broker or brokerage firm account. At the time, PIABA had no full time employee or office.

More publications are printing articles recommending their readers contact PIABA for a list of its members. A recent *Kiplinger's Retirement Report* (June 1996, Vol. 3, No. 6) recommended contacting PIABA for a list of securities arbitration attorneys in its *Your Questions Answered* (p.8) column. PIABA's telephone number can also be found on the Internet. Frequently, CPAs and attorneys who have no experience in securities arbitration refer investors to PIABA. Also, the Securities and Exchange Commission refers investors to PIABA in a form letter sent to those who contact them with a securities problem.

This office handles an average of 10 telephone calls per week, as well as written correspondence, from investors requesting a list of PIABA members. I would like to inform each of you of the office procedure used when I receive one of these calls.

- A *Request for Attorneys* form listing the name and address of the caller and the time and date of the call is completed.

- A personalized form letter and a list of PIABA members from the State requested is mailed (and/or faxed) to the caller. This list is sorted alphabetically by State, then by City and then by Last Name. All requests are responded to within one day.

  At times, an investor requests a list of PIABA members from a State other than the one they

The PIABA QUARTERLY is published quarterly in the interest of the members of The Public Investors Arbitration Bar Association. Editor-In-Chief - Jerry Stanley; Associate Editor - Seth Lipner. The PIABA QUARTERLY welcomes information on cases or articles that would be of interest to PIABA members. Contributions should be mailed to:
The PIABA QUARTERLY, 7909 Wrenwood Boulevard, Suite C, Baton Rouge, Louisiana 70809; FAX (504) 926-4348. All copy is subject to the approval by the publisher. Any material accepted is subject to such revision as is deemed appropriate in the publisher's discretion.

live in.

At times, an investor requests a list of members from a State in which PIABA has no members (i.e., Idaho). In this case, a list of members from surrounding states (i.e., Washington and Oregon) is sent.

- A copy of each letter and list is made and kept on file.

If you have any questions regarding the way that these telephone calls are handled, please do not hesitate to contact me. Thank you.

Brooke Geiger

## Arbitrator Recruitment Update

On June 3, 1996 over 600 NASD Arbitrator Applications were shipped via UPS to those who were recommended to PIABA by various members.

A PIABA NASD Arbitrator Recruitment response form was enclosed with the NASD Arbitrator Applications as well as a self-addressed stamped envelope. PIABA requested that each recruit mail the form to us once they have completed and mailed their Arbitrator Applications to the NASD.

The Board of Directors would like to thank the following individuals for their participation and patience in PIABA's effort in assisting the NASD and the NYSE in expanding the arbitrator pool. Over 500 individuals have been recommended as prospective arbitrators by these members.

Adam H. Smith, Esq.
Allan J. Fedor, Esq.
Fran Fedor, Esq.
Alan Templeman, Esq.
Anthony Hom, Esq.
Anthony J. Kohler, Esq.
Anthony Zinge, Esq.
Barry Kirschner, Esq.
Brian A. Carlis, Esq.
Carol G. Gelfeld, Esq.
Cary S. Lapidus, Esq.
Charles Mihalek, Esq.
Chris Vernon, Esq.
David Shellenberger, Esq.
Denis Dice, Esq.
Dennis A. Bell, Esq.
Diane A. Nygaard, Esq.
Don K. Leufven, Esq.
Donald G. McGrath, Esq.
Donald McNelley, Esq.
Gary M. Berne, Esq.
Gerald E. Marcus, Esq.
Glenn Campbell, Esq.
Harold J. Bender, Esq.
Herbert Deutsch, Esq.
Irvin B. Levin, Esq.
J. Boyd Page, Esq.
J. Michael Bishop, Esq.
J. Pat Sadler, Esq.
Jane L. Stafford, Esq.
Jeffrey Feldman, Esq.
Jeffrey Gaffney, Esq.
Joel A. Goodman, Esq.
John D. Hudson, Esq.
John Perry Brooks, Esq.
Joseph Carmichael, Esq.
Joseph D. Sheppard, III, Esq.
Larry E. Meyer, Esq.
Leonard Meyer, Esq.
Leonard Steiner, Esq.
Lynn Hanig, Esq.
Mark A. Tepper, Esq.
Mark Raymond, Esq.
Michael Casey, Esq.
Neal J. Blaher, Esq.
Nicholas D. Thomas, Esq.
Patricia A. Shub, Esq.
Rafael Satomayor, Esq.
Ricki C. Ring, Esq.
Robert Hughes, Esq.
Scot Bernstein, Esq.
Seth Lipner, Esq.
Stephen Murphy, Esq.
Steven M. Sherman, Esq.
Steven Murphy, Esq.
Stuart Goldberg, Esq.
Susan Donegan, Esq.
Susan N. Perkins, Esq.
Thomas R. Grady, Esq.
William Paul Nolan, Esq.

At this time, the National Association of Securities Dealers is in the process of revising the Arbitrator Profile Form. It is our understanding that the revised form will be ready for distribution in late March. The NASD has advised that the revised forms are shorter and simpler. PIABA feels that these revisions make the forms more appealing to the applicant. Therefore, we have postponed the NASD Arbitrator Profile Form mailing until the revised forms are ready for distribution.

If you have not mailed your arbitrator recommendations to Brooke, please do so as soon as possible.

Thank you.

## Elections

At the Board of Directors meeting in New Orleans, April 20-21, the following officers were elected for 1996-97:

Rosemary Shockman - President
Boyd Page - Treasurer
Seth Lipner - Secretary

Additionally, the Board nominated Boyd Page, Jerry Stanley and Mark Maddox for election to the Board for the 1996-2000 period.

## From The Professor

Submitted by: Joseph C. Long, Professor of Law
OU Law School, Norman, OK

This is the first of what is hoped will become a regular feature in the *Quarterly*. Its purpose is to make the membership aware of new issues and cases which have come to my attention. In this regard it will be a potpourri. As this first issue does, it will often contain a mixture of short discussion of recent cases of significance, as well as offer information on new approaches or ideas which the members might want to consider in bringing their arbitrations.

One of the great things about PIABA is the interchange of information between members. I would greatly appreciate ideas from the members to use in this column. If you have tried an idea and it has worked for you or received a decision which you are proud of, but don't want to take the time or trouble to write it up for inclusion elsewhere in the *Quarterly*, please send it to me. If I use the idea or case, I will try to give appropriate credit to the member. Further, let me say a word about unreported decisions by arbitrators, trial or appellate courts. Members often receive or know of these unreported decisions. Since few decisions are appealed to appellate courts where reported decisions are the norm, there is little law in the area. As a result, these unreported decisions, often may make the difference between winning and losing because they are often on the cutting edge. Please make a concerted effort to send them to me. I will try to use as many of them as I can in this column. But, more importantly, I will collect them, so that in the future we may be able to make them available to the general membership. Enough for the introduction, time to turn to substantive matters.

One of the things that has complicated many arbitrations is the tendency of many brokerage defendants to engage in collateral court litigation over issues which properly belong before the arbitrators. This practice muddies the arbitration waters, causes much delay, and requires expenditure of plaintiff resources which could better be spent in preparing for the arbitration itself. Member Mark Tepper of Fort Lauderdale and I may have found a way to stop this abusive practice.

Mark had three cases against Biltmore in which he represented the plaintiffs. The first two were settled, but contained confidentiality agreements. These agreements, if they prevent the plaintiff from discussing or testifying about the conduct involved in their case, rather than the terms of the settlement itself, I believe are contrary to public policy and should not be enforceable. However, that is an issue for another time.

The agreements in the Tepper cases provided that the plaintiffs could testify in proceedings before a self-regulatory agency, if compelled to testify. Mark read this exception to include both self-regulatory enforcement proceedings and arbitrations, if a subpoena was issued. As a result, he included the two previous clients on the witness list for the third case and sought to have the panel issue subpoenas requiring their attendance. Without asking the arbitrators for a decision on the propriety of such testimony through a motion in limie, Biltmore responded by filing two suits in court, one in Illinois, where one witness lived, the other in Florida where the second witness resided. The suits sought to enjoin the witness from testifying. They also sought damages for breach of the confidentiality agreement. Further, they sought damages from Mark on the basis of interference with contractual relations.

Mark and I felt that the suit was merely an improper attempt to prevent the arbitrators from determining what evidence they would hear in violation of Section 34 of the NASD Rules of Arbitration. We took the position that the filing of the suit was a violation of Section 5 of the NASD Rules. This Section provides:

> No party shall, during the arbitration of any matter, prosecute or commence any suit, action, or proceeding against any other party touching upon any of the matters referred to arbitration pursuant to this Code.

We asked the arbitrators to enjoin Biltmore from continuing the collateral litigation and to sanction them. Our brief argued both that the arbitrators under Section 35 were proper body to make such determination and that they had the power to sanction for the violation. In response, Biltmore claimed, based upon a non-public document generated some place within the National Association of Securities Dealers in response to the Ruder Report, that the National Association of Securities Dealers interpreted Section 6 not to prohibit collateral litigation of this nature. The National Association of Securities Dealers Director of Arbitration provided an affidavit that indicated that such was not the

position of the National Association of Securities Dealers.

The arbitrators, in a written decision, found that the collateral litigation did violate Section 6. They ordered Biltmore to immediately dismiss the actions against the client and Tepper. Biltmore immediately asked for a rehearing and arbitrators reaffirmed the violation.

Biltmore attempted to technically comply with the arbitrators' order to dismiss, while securing a hearing before both trial judges asking, among other things, that the arbitrators be enjoined from continuing with the arbitration. Both courts refused such injunctions. The Illinois court in a short written order identified the suit for what it was, an attempt to prevent the arbitrators from deciding whether they would hear the testimony, and indicated he had no authority to interfere. This ruling is presently being appealed by Biltmore.

While the arbitrators originally denied the motion to grant sanction, they did so without prejudice. Mark and I have more recently filed a new motion for sanctions based upon the original violations, plus the new violations of continuing the litigation in the face of the arbitrators' instruction to dismiss. These new motions are still pending.

We are convinced that our interpretation to Section 6 is correct. Research indicates that many rts have held that a court does not have the authority to enjoin any action once arbitration has commenced. There appear to be two limited situations where court stays or injunctions are appropriate. One deals with the issue of whether there is an agreement to arbitrate. This decision must be made before any arbitration proceedings are proper. Normally, unless the agreement specifically allows the arbitrators to make this decision, it is a matter for the court. Second, it appears that the court can grant a stay or an injunction to maintain the status quo until arbitrators can be appointed and take over the case. At this time, the court's stay or injunction should be dissolved, and the issue re-examined by the arbitrators.

One other issue that came up in the Biltmore case which merits separate discussion is the ability of a person not a named- party to the arbitration contract to force arbitration under it. Biltmore took the position that Tepper was not a party to the arbitration and therefore could not ask the arbitrators for relief. The arbitrators concluded that Tepper was an agent of the plaintiff and therefore entitled to seek the protection of the arbitration agreement. This issue is often coming up in the setting of whether an introducing broker can force the client to arbitrate based upon the customer agreement with the clearing broker. Increasingly the wer appears to be "no". See Monisoff v. American Eagle Investment, Inc., 1996 U.S. Dist LEXIS 8095 (S.D. June 10, 1996). There appear to be two exceptions to this rule. First, as in the case of Tepper in the Biltmore case, if the introducing broker can show that it is an agent of the clearing broker, then as an agent it could enforce the arbitration clause. However, the introducing broker does not want to admit to being an agent because then liability will attach under Section 410(b) of the Uniform Securities Act to the introducing broker for the actions for the clearing broker. Second, the introducing broker can enforce the arbitration agreement if it can show that it was an intended beneficiary of the arbitration contract. See Paine Webber Jackson & Curtis, Inc. V. Chase Manhattan Bank, 728 F.2d 577 (2d Cir. 1984). The court in Monisoff stated: "[W]here an agreement between a customer and a clearing broker does not express a clear intent to benefit the introducing broker, the introducing firm will not be held to be a third-party beneficiary." Id. At *4 [Emphasis added.], citing McPheeters v. McGinn, Smith & Co., Inc., 963 F.2d 771, 773 (2d Cir. 1992).

## SIA Makes Its Response to the Rudder Report

In a June 7, 1996 letter to the NASDR, the SIA updated its previous response to the Rudder Report.

In its latest correspondence, the SIA makes a counter proposal to the reforms suggested by the Rudder Report in four areas: 1) punitive damages; 2) the eligibility rule; 3) collateral action, and 4) pre-dispute arbitration agreements. As has been its history, the SIA proposals are so one-sided as to call into question whether the proposals are made for the purpose of continuing a dialogue on these points or to create such an impasse as to stop the implementation of these reforms in total.

As to punitive damages, the SIA proposes a cap of $250,000 or one time compensatory damages, whichever is least. Not only does the SIA propose a one time compensatory damage cap, its proposal defines compensatory damages as the price paid minus distributions, minus sales proceeds or present value, but without interest or attorneys fees.

The SIA's ploy is simple — nothing times one is nothing. If compensatory damages are defined in such a way as to diminish these damages to an unrealistically small amount, then punitive damages, as the equal of these "compensatory" damages, will be limited to an amount which is actually much less than compensatory damages as they are defined under virtually every state blue

sky statute.

Regarding the eligibility rule, the SIA proposal 'ts the compromise position taken by the Rudder ..port — approving of the portion of the proposal favorable to the industry, and rejecting the unfavorable part. The SIA opposes the suspension of the 6 year, rule but in the same breath endorses the creation of a motion to dismiss procedure, complete with the early appointment of a separate arbitration panel to hear the preliminary motion. The Board of PIABA has previously voiced its concern that this bifurcation of the arbitration process will add an unnecessary and burdensome layer to what has become an all too extended arbitration process.

Predictably, the SIA also opposed the amendment of Section 6 to eliminate collateral action, defending what, in its opinion, has helped rid the system of unwarranted claims against its members.

Lastly, the SIA also takes issue with the Rudder Commission's recommendation that pre-dispute arbitration agreements should be changed, citing the cost involved in the destruction of existing agreements. No mention is made, of course, of the fact that the industry has adjusted its agreements several times to redo the choice of law and statute of limitation sections. It appears that the costs of making changes that are beneficial to the industry in arbitration can always be justified.

It is apparent that the SIA's latest proposal is hing more than a partisan dissection of the Rudder ..port. The SIA's penchant for offering one-sided "compromises" makes progress in improving the arbitration process most difficult.

## The U.S. 5th Circuit Rules on ERISA and Eligibility in Kramer

The Kramer v. Smith Barney, CA7,. No. 95-10441, 5/23/96, case involved an arbitration claim brought Mr. Kramer, both individually and as the trustee of two pension plans. In a confusing but interesting decision, the Fifth Circuit found that the ERISA claims were eligible for arbitration while the individual claims were not. PIABA member Tracy Stoneman represented Kramer in this case.

Kramer originally filed for arbitration but Smith Barney responded with a collateral attack in New York state court. The New York court granted Smith Barney's motion and stayed arbitration of the claims based on eligibility. Kramer then filed the action in Texas state court and Smith Barney removed the case to Federal ‾urt. Relying on Celebre v. Merrill Lynch, 855 upp. 172 (N.D.Tex.1994), the District Court held that claims made ineligible for arbitration were not litigable in federal court. In making its review, the Fifth Circuit made separate determinations as to the eligibility of the Federal ERISA claims and the personal state law claims.

In its opinion, the Fifth Circuit noted that ERISA has its own statute of limitations (29 U.S.C. Section 1113 — in the case of fraud or concealment, six years from discovery), and then set about trying to rectify this limitations period with the eligibility section of AMEX Rule 605 (i.e., NASD Section 15).

Citing Section 410 of the ERISA statute, which states that any agreement which relieves a fiduciary from liability is void "as against public policy", the Fifth Circuit held that "to render Kramer's ERISA claims ineligible for arbitration would impair his substantive rights" and reinstated the arbitration. The Fifth Circuit sidestepped the New York state courts' prior ruling since, according to the Fifth Circuit, the New York court was precluded from taking jurisdiction over a "cause of action within the exclusive jurisdiction of the federal courts".

As well as the ERISA claims fared, Kramer's individual claims fared poorly. The Court first gave deference to the New York court's decision barring arbitration and then rejected Kramer's contention that his non-arbitrable claims could then be brought back to court , stating that it would be "bizarre" to allow the litigation of these stale arbitration claims .

Even though it won on the individual claims issues, Smith Barney has filed for rehearing on the ERISA issues. We will keep you informed.

## Seventh Circuit holds Firm Liable As Control Person in Harrison

The Harrison case should be of interest to those with cases involving the situation where brokers take clients' funds and misappropriate them to their own use. Harrison v. Dean Witter, CA7, No. 95- 1970.

In this instance, the broker induced the client to make payments to the broker personally for a special municipal bond investment program. The broker gave the client a promissory note for his investment. Instead of investing in munis, the broker invested in options, which, as is usually the case, lost money.

The jury at the district court level found for the client and against Dean Witter as a controlling person under Section 20 (a) of the Exchange Act.

This was in spite of the fact that all of the initial returns to the investor were in the form of a personal check frc ıe broker and that the tax forms sent to the client by the broker showed that the broker and not Dean Witter was the source of the income. Apparently, the jury attached significance to the fact that there was usually high activity and losses in the broker's personal accounts which were not investigated by Dean Witter.

The Court stated that, "Dean Witter cannot totally ignore repeated warning signs that there were clandestine and irregular activities being conducted by its representatives within and around its organization."

## Sixth Circuit Affirms Defamation and Punitive Damage Award in U-5 Case

In Glennon v. Dean Witter, CA 6, No. 95-5257, 1996 WL 224000, the Sixth Circuit affirmed a district court award of defamation and punitive damages to a broker in a U-5 dispute.

Dean Witter made the usual defenses — that the U-5 ng should be afforded absolute immunity under New York law; that the arbitration panel manifestly disregarded the law on this point; and that the limited review of the punitive damage award violated its due process rights.

The Appeals Court stated that its review of the district's courts decision on the arbitration award would be a *de novo* review — the Appeals Court would make its own inquiry into and determination of clear error in findings of fact and questions of law, citing Merrill Lynch v. Jaros, 70 F3 418, (6th Cir. 1995). The Appeals Court affirmed that the manifest disregard of the law standard was very narrow — "if the applicable legal principal is clear and well-settled and it [the arbitration panel] refuses to follow that legal principal."

Because there was no choice of law provision in the employment contract, the Appeal Court held that the forum state's [Tennessee] choice if law rules should apply. Since Tennessee law would not allow the firm absolute immunity on the U-5, the Appeals Court affirmed the district courts' ruling.

Most importantly, the Appeals Court upheld the punitive damage award. The district court had allowed the punitive award based on the fact that Dean Witter was a voluntary participant to the arbitration proceeding and that the NASD panel was not a state actor. The Appeals Court added its finding that the manifest disregard of the law standard in arbitration permits a standard of review which complies with due process standards. (Note: The compensatory award was 728,000; the punitives were $750,000.)

## Michigan U.S. District Court Finds No Private Remedy for Broker for NASD Rule Violation

The U.S. District Court in Michigan dismissed an action against the NASD by ex-Prudential brokers who sought to force the NASD to inquire into Prudential's amendment of their U-4's and U-5's to reflect claims made in the Prudential SEC claims process . Myers v. NASD, DC E. Mich, No. 95-CV-75077.

The Myers ruling concluded that the NASD was under no obligation to investigate the U-4 and U-5's before filing them. The plaintiffs had argued that, under the law, the NASD, "shall not be liable for good faith actions or omissions", and that the good faith requirement creates a private cause of action if the NASD breached that standard.

## PIABA File Amicus Brief on the AMEX Window

PIABA has filed an Amicus Brief in a Florida state court case involving the availability of the Amex window. Fahnestock, et.al v. Dean Witter, 4th Dist. No. 96-345. Bob Dyer is the counsel for the plaintiffs. Neal Blaher wrote the Amicus brief on behalf of PIABA. We express our appreciation to Neal for his time and effort on the Amicus brief which was both authoritative and persuasive.

## Michigan U.S. District Court Examines Reasonable Reliance and the "Prospectus Defense."

A Michigan District Court denied a CFP 12 (b) (6) motion to dismiss for failure to state a claim. Parkhurst v. North American, ED Mich., No. CV-95-40216, 1996 WL 128033. This case involved the purchase of stock through a private placement memorandum.

The Parkhurst plaintiff alleged that she was given the disclosure documents but that the broker represented that they were merely routine paperwork for the purchase of securities and did not give her copies of the document after she signed them.

The Parkhurst judge cited "ample" case law which indicated that investors are denied relief under Rule 10b-5 where oral misrepresentations conflict with contemporaneous written documentation.

More importantly, the judge went on to distinguish a 10b-5 claim from a 1933 Act 12(2) claim. He noted that 12(2) authorizes a remedy based upon misleading omissions from either oral communications or written prospectus and that constructive knowledge cannot bar a purchaser's recovery under 12(2). Based on that distinction, the judge denied the motion to dismiss.

## $1.3 Million Blue Sky Rescission Claim Granted

Submitted by: William A. Jacobson, KAPLAN & JACOBSON INC., Providence, RI

A recent United States District Court decision illustrates how state blue sky violations can be used very effectively to obtain relief for the client, where allegations of fraud or other misconduct may be difficult to prove and would be very costly and time consuming to litigate.

In Tanner v. Stratton Oakmont, Inc., et al., United States District Court, Western District of Louisiana (No. 95-0906), plaintiff was a Louisiana resident who was solicited to purchase $1 million of common stock pursuant to a private placement of securities of Atrium Holding Co., Inc. The proceeds of the private placement were used to purchase a 100% interest in Adler Coleman Clearing Corp.

Plaintiff was solicited by a stock broker working on behalf of Monroe Parker Securities, Inc. (Purchase, New York) and Stratton Oakmont, Inc. (the deal manager). Neither the stock broker who solicited the sale nor the securities were registered in Louisiana at the time of the solicitation and sale. The stock broker instructed plaintiff to use a Texas business address on the purchase documents, since the stock broker and the securities were registered in Texas. Plaintiff sued to rescind his purchase under the Louisiana blue sky laws on the ground that the solicitation and sale of unregistered securities by an unregistered stock broker violated Louisiana law.

The defendants' primary defense was the allegation (denied by plaintiff) that defendants had informed plaintiff of the lack of registration, and plaintiff therefore became *in pari delicto* with defendants by using plaintiff's Texas address. The United States District Court for the Western District of Louisiana granted summary judgment in plaintiff's favor, finding that as a matter of law plaintiff's alleged knowledge of the registration violation was not material since the Louisiana blue sky rescission statute imposed strict liability on the stock broker and others who materially assisted in the solicitation and sale.

The Court awarded plaintiff $1,000,000, plus an additional $142,000 in pre-judgment interest, and $151,000 in attorney's fees and costs. The Court denied plaintiff's application for award of a one-third contingent fee as "reasonable attorney's fees," finding that under the rescission statute the hourly attorney's time was "reasonable" compensation, regardless of the fee arrangement between plaintiff and his counsel.

## Derivatives May Not Be Good Investments for Banks Acting as Fiduciaries, OCC Says

The Office of the Comptroller of the Currency warned national banks that "while derivative investments may be appropriate for the bank's own account, they may not be acceptable for an institution acting as a fiduciary" in the release of long-expected OCC guidance on fiduciary risk management of derivatives and mortgage-backed securities.

The agency is particularly concerned about collateralized mortgage obligations and structured notes. CMO's, mortgage-backed securities, and other derivative investments derive their value from an underlying asset, such as a pool of mortgage loans, in the case of CMOs and MBS. These derivatives instruments also include financial contracts like futures, forwards, options, caps, floors, and various combinations of the above.

The OCC guidance notifies national banks acting as fiduciaries that they have to address the nine types of risk—credit, interest rate, liquidity, price, foreign ex-

change, transaction, compliance, strategic, and reputation risk—when evaluating derivative investments for others just as they do for their own investments. "The OCC considers it an unsafe and unsound practice for a bank to purchase derivative instruments or mortgage-backed securities, or any other asset in a fiduciary capacity, without a full appreciation of the risks involved," the agency bulletin said.

## New Arizona Securities Legislation

Rosemary J. Shockman, SHOCKMAN & MCKEEGAN, Scottsdale, AZ

Significant amendments to the Arizona Securities Act have become effective. Some PIABA members participated in efforts to modify the legislation as it west through the legislative process, in an effort to blunt the negative effect of the bill on investors. Some of the suggested modifications are reflected in the final bill. One witness who testified before the House Committee observed that the final bill was very "mediocre and not well written". Because the Arizona Securities Act now contains contradictory and confusing provisions, we do not attempt to interpret the Act here, but merely point out significant areas of change.

- Plaintiff has the burden of proving "loss causation": in certain cases. Some or all cases against broker/dealers may be exempted from this.
- Fault will be allocated among allegedly culpable entities. There are exceptions when an entity has limited worth. This will potentially be an area of controversy in arbitration.
- Adds most of the new federal securities class action provisions.

Before filing any new Arizona case, claimants' lawyers should read the amendments to the Arizona Securities Act. (A.R.S. Section 44-1991, *et seq.*)

## Federal Judge Denied Summary Judgment and Slams Polaris

Submitted by: Joel H. Bernstein, GOODKIND LABATON RUDOFF & SUCHAROW LLP, New York, NY

In a sweeping opinion, Senior Judge Milton Pollack of the United States District Court, Southern District of New York, denied a motion for summary judgment brought by Polaris Holding Company, Polaris Aircraft Leasing Corp., Polaris Investment Management Corp., Polaris Securities Corporation and Peter G. Pfendler, paving the way for a class action suit arising out of the sale of Polaris Aircraft Income Funds I-VI ("PAIF") to go to trial. Aside from the obvious interest counsel who continue to arbitrate or litigate claims regarding the PAIFs will have, this opinion strikes a major blow at issuers and brokerage firms who seek to escape liability based upon the "bespeaks caution" doctrine and "inquiry notice" aspects of the statute of limitations. Additionally, Judge Pollack is now the second judge in the United States to hold that the RICO provisions of the Private Securities Litigation Reform Act of 1995 (Section 107 (Pub. L. No. 104-67, 109 Stat. 737,758 (Dec. 22, 1995)) are not retroactive.

Bespeaks Caution

In the opinion (In re: Prudential Securities Incorporated Limited Partnerships Litigation, MDL Dkt. No. 1005, M-21-67 (MP) Order # 82, June 10, 1996) Judge Pollack responded to arguments raised by the defendants that based upon risk disclosures in prospectuses of what "could" happen with respect to the PAIFs they were entitled to summary judgment because the prospectuses bespoke caution. However, the Court noted:

The Consolidated Complaint alleges that Polaris knew, but did not disclose, at the time the prospectus and sales pitches were designed, that it had purchased aircraft with evanescent residual values that would decline dramatically to the point of virtual non-existence as a practical matter. Plaintiffs cite evidence gleaned during the limited discovery to date that experts retained by Polaris predicted and warned the marketeers of the limited partnerships that residual values of its aircraft *would* decline radically. This information contradicted both the residual value information provided in sales materials and the inadequate warnings in prospectuses that residual value *could* decline. General risk disclosures in the face of specific known risks which border on certainties do not bespeak caution.

The doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away.

Judge Pollack recognized that since residual values of aircraft were expected by Polaris to decline, the prospectus representation of a partnership objective of "preservation of capital" was impossible to achieve. Thus, the prospectuses themselves were false and misleading.

The Court distinguished two prior class action rulings in favor of Polaris, issued on motions to dismiss (Harner v. Prudential Sec., Inc., 785 F. Supp. 626 (E.D.Mich. 1992) (aff'd, 35 F.3d 565 (6th Cir. 1994) and Weisl v. Polaris Holding Co., No. 29239/92 (Sup.Ct.N.Y.Co. April 19, 1994), aff'd Slip. Op. (N.Y. App. Div. April 25, 1996)) stating "[t]hese decisions thus unintentionally overlooked the context in which Polaris' seemingly comprehensive risk disclosures were made. It is this context, rather than the plain language of the prospectuses, which is relevant to the bespeaks caution doctrine.

Inquiry Notice/Statute of Limitations

The Court also made mincemeat of Polaris' c[illegible]n that the four year RICO statute of limitations had expired because "the many 'storm warnings' present in those documents [should] have alerted plaintiffs to potential fraud" from the moment they invested. The Court noted that the Second Circuit standard regarding inquiry notice is whether "'the circumstances are such as to suggest to a person of ordinary intelligence the probability that he has been defrauded...". Citing Armstrong v. McAlpin, 699 F. 2d 79, 88 (2d Cir. 1983).

In the case of Polaris the Court found that the earliest investors were in possession of such information was October, 1990 when capital losses were first suffered as a result of the sale of some PAIF aircraft, but more likely, January, 1992 when the format of Prudential's monthly statements changed so that the value of PAIF partnerships was no longer reported at par.

Private Securities Reform Act of 1995

Finally, responding to Polaris' arguments that § 107 of the Act, amending RICO to prohibit use of securities fraud (in most cases) as a predicate act was retroactive, the Court concurred with the opinion in District 65 Retirement Trust for Members of the Bureau [illegible] Wholesale Sales Representatives v. Prudential Securities, Inc., 1996 WL 1717563 (N.D. Ga.) and held that there was nothing in the plain language of the statute or the legislative history to indicate that the provision should be applied retroactively.

Conclusion

While litigation and arbitration proceedings regarding the PAIFs and other Prudential limited partnerships are winding down to a chapter in history, the Court in Prudential has issued an important decision that should be helpful to counsel representing investors for years to come. More and more frequently, defense counsel have been relying on inadequate disclosures in prospectuses in their attempts to escape their fraudulent conduct. Prudential teaches that where it can be shown that defendants were in possession of specific facts regarding the actual risks of offered securities those facts must be disclosed and that disclosures of what might happen are insufficient.

## Polaris Class Action Certified

Submitted by: Joel H. Bernstein, GOODKIND LABATON RUDOFF & SUCHAROW LLP, New York, NY

On June 5, 1996 Judge Pollack issued an order certifying a class of all investors in Polaris Aircraft Income Funds ("PAIF") I - VI. The class (actually a sub-class within the entire Prudential-Global limited partnership class action) includes investors in PAIFs through Prudential and other brokerage firms as well. The class excludes any person who has settled litigation or arbitration proceedings with any of the Polaris defendants as well as those who have settled or submitted to Expedited Arbitration pursuant to the Prudential/SEC settlement. Significantly, however, investors who have arbitrated or litigated with Prudential regarding the PAIFs, outside of the Claims Fund (for example, NATIONAL ASSOCIATION OF SECURITIES DEALERS or AAA arbitration) will not be excluded from the class. At this writing there has been no determination of the extent of any damage offset for those investors who have had recoveries in the past.

While no trial date has yet been set for the Polaris class action we expect that a trial will take place before the end of 1996. Some of your clients may be interested in testifying on behalf of investors against Polaris. We are seeking class members who are interested in appearing at trial who received the standard pitch from their brokers, that is that (a) Polaris would use investor funds to purchase aircraft which would be leased to creditworthy airlines; (b) lease revenues would be distributed to investors quarterly for 8 - 12 years and © since aircraft were expected to hold their value over time, at the end of the partnership's life the investor would receive his or her principle investment back.

Additionally, we seek testimony from brokers employed by any brokerage firm who repeated this sic sales pitch to investors in reliance on sales materials and seminars prepared by Polaris.

If PIABA members have any clients who meet the class requirements, please contact any of the following for information:

Joel H. Bernstein, Esq.
Diane Zilka, Esq.
Goodkind Labaton Ruduff& Sucharow
100 Park Avenue
New York, New York 10017
(212) 907-0700

Rosemary Shockman, Esq.
John McKeegan, Esq.
Shockman & McKeegan, Esqs.
6263 North Scottsdale Road
Suite 290A
Scottsdale, AZ 85250
(602) 596-1986

William Butterfield, Esq.
Finkelstein Thompson
& Loughran
2828 Pennsylvania Ave., N.W.
Washington, D.C. 20007
2) 337-8000

Denise Schwartzman, Esq.
Kathy Meermans, Esq.
Chimicles Jacobson
361 West Lancaster Avenue
Haverford, PA 19041
(610) 642-8500

Kevin Roddy, Esq.
Milberg Weiss Bershad Hynes
& Lerach
355 S. Grand Ave. Ste. 4170
Los Angeles, CA 90071
(213) 617-9007

## NASD National Arbitration and Mediation Committee Update

Submitted by: Mark E. Maddox, MADDOX, KOELLER & HARGETT, Indianapolis, IN

In an unprecedented move toward diversity, . NASD's National Arbitration and Mediation Committee is now composed of three PIABA members: William S. Lapp, Roger L. Dietz and Mark E. Maddox. In addition to serving on the full committee, these PIABA members are also serving on the following sub-committees: Roger L. Dietz - Arbitrator Qualification, Training & Selection, and Mediation and Other Forms of ADR (chairman); William S. Lapp - Executive, Rules & Procedures, Non-Attorney Representation (chairman) and Pre-dispute Eligibility, Punitives; Mark E. Maddox - Rules & Procedures, Pre-dispute Eligibility, Punitives.

It is worth noting that Lapp and Maddox constitute two out of five votes on the very important Rules & Procedures Sub-Committee, which reviews all proposed amendments to the NASD Code of Arbitration Procedure before such matters are formally considered by the full committee.

With the addition of the new PIABA members and other non-industry representatives to the committee, it is my view that the National Arbitration and Mediation Committee is a balanced group that will fairly consider the views of both the public investor and the securities industry as it continues to review and make recommendations in response to the Ruder task force report.

## Report From New York

Submitted by: Seth Lipner, DEUTSCH & LIPNER, Garden City, NY

Bybyk Is Big Victory For Investors:

The Second Circuit ruled in PaineWebber v. Bybyk that NASD § 15 issues are for the arbitrators, not the courts. The court rejected arguments that (a) the eligibility rule was a jurisdictional issue affecting arbitrability and thus an issue for the courts, and (b) that the New York choice-of-law clause invoked New York's arbitration law with respect to timeliness.

With respect to the first argument, the court determined that the eligibility rule was not incorporated into the contract, and thus it did not affect arbitrability. The 2nd Circuit thus rejected the Sorrells approach. The 2nd Circuit also rejected the "New York law" approach as antithetical to Mastrobuono, and they held that the New York choice-of-law clause defined only the substantive law to be applied. The court expressly rejected Luckie, because the Bybyks had "and its enforcement" in the choice-of-law (see Port Authority discussion below).

Finally, the Second Circuit held that the availability of attorneys fees was an issue for the arbitrators. PaineWebber did not appeal from the portion of the lower court's decision allowing the punitive damages claim to proceed to arbitration.

Congrats to John Lawlor for the victory. PIABA wrote an amicus brief.

P t Authority v. City of New York:

Justice Solomon decided this non-securities case last month. City of New York seeks arbitration against the Port Authority for breach of a lease of property at Kennedy Airport. Contract called for arbitration. Port Authority moves for a stay on statute of limitations grounds. There was choice-of-law clause, but all parties are New Yorkers.

Justice Solomon begins by finding that FAA applies even though all parties are New Yorkers. The lease was at Kennedy Airport, she reasons, so clearly "commerce" is involved. Then, citing Luckie's "and its enforcement" reasoning, she holds that New York arbitration law was not incorporated and thus doesn't apply.

We have an identical securities case before her now, Pru v. Catton. Pru filed another one in Westchester County, Pru v. Nelson. Both cases are sub judice. Pru claims (basically) "no commerce."

**Practice Note:**

Obviously, these cases are in New York state court because there was no diversity, so fed court wasn't an option. If you get a diversity one in New York, however, remember the time limit on removal (30 d s from service of process). With the continued state/ . ral spilt, the question whether you should "name the broker" remains important.

Otherwise, things are, for obvious reasons, quieting down. Still a few cases sub judice, on issues involving timeliness, punitives in state court, and the AMEX Window. Stay tuned.

**Conversation With Mary Shapiro**

In March, the NASD Liaison Committee of the PIABA Board met with Mary Shapiro, the new President of NASDR. NASDR was created following the Rudman Report. It is a subsidiary of the NASD charged with independently running the regulatory side of the NASD (as opposed to the market side). Mary Shapiro is a former Chair of the CFTC, and she comes to the NASD with solid regulatory credentials.

The meeting with Mary, her Chief of Staff, John O'Donnell and Debbie Masucci lasted about two hours. During that time, we expressed in great detail many of reactions and thoughts we had concerning the Ruder recommendations. Our initial feeling is that President Shapiro is serious about improving arbitration for the investor, and that our concerns will be addressed and considered. But, at the same time, we were left with the ressions that she is up against a big task (including problem of an insufficient budget and a panoply of problems), and that change is more likely to be incremental than monumental.

One area that came up that held promise was our expression of concern that NASD investigators and regulators work in secret, and that investors rarely get access to NASD investigatory files, where there is potentially important information about the broker or the firm. Ms. Shapiro promised to look into that issue, so that perhaps, in the future, regulators and victims attorneys can work together rather than separately. If you can think of any good examples where this type of sharing could have helped, drop her a note. If we keep on top of this, maybe we can get somewhere.

Following our meeting with Mary, we were pleased to learn that she appointed Linda Feinberg as NASD Executive Vice President for Adjudication. Linda Feinberg was an SEC staffer, a partner in Covington & Burling, and the principal author of the Ruder Report. Linda is a serious individual with a balanced approach toward arbitration. Linda has agreed to address the October PIABA meeting, and we look forward to working with her and hearing her views.

## The BULLETIN BOARD

NASD Administrative Section 15 Decisions.

It has come to our attention that the NASD has, in isolated cases, made an administrative decision in the arbitration department in New York dismissing claims based on Section 15 without sending the matter to the arbitrations for their decision. Anyone who receives a letter from the NASD arbitration department which attempts to administratively dismiss a claim based on Section 15, please forward the correspondence to the QUARTERLY.

* * * * * *

PLI's annual Securities Arbitration conference will be held in Los Angeles on July 15 and in New York on August 15. For information call David Robbins at (212) 755-3100. As part of the PLI manual, PIABA student - member Tom Mason has put together an exhaustive piece on the six-year rule. Tom is in the process of doing part two of his study and requests that PIABA members send him copies of all SRO administrative letters regarding the six-year rule. Tom's fax number is 520-299-7757.

* * * * * *

PIABA member Michael Farrell has re-
.ested assistance in locating any information on the following limited partnerships that were sold by Prudential Securities during the 1980s: Daniel Properties III; Pru Bache Energy Growth; Almahurst Bloodstock IV; and PruTech R & D Partnership. Specifically, Michael is looking for information to help prove that the degree of the risk made them unsuitable. If you have any information, please contact Michael Farrell at (601) 355-1994, fax (601)355-1998 or at Dixie91548@aol.com.

* * * * * *

Please contact PIABA member Jeffrey A. Feldman if **Stratton Oakmont** has delayed giving you or refused to give you the taped phone conversation with your clients. As you may know, Stratton Oakmont is required to tape all customer conversations pursuant to a Federal District Court Order. Please call Jeffrey Feldman at (415) 391-5555.

* * * * * *

Revised NASD Sanction Guidelines - The NASD has recently published revised *Sanction Guidelines*. The guidelines have been expanded to include reference to the specific rule violated and to include new subject areas such as backing away, continuing education, FIPS, late reporting of customer complaints, limit order protection, locked/crossed market, passive market making, settling away, and volume reporting.

The copyrighted *Sanction Guidelines* can be purchased for $35 by contacting NASD MediaSource at (301) 590-6578 for credit card order or by writing to: NASD MediaSource, P.O. Box 9403, Gaithersburg, MD 20898-9403. Checks should be made payable to the National Association of Securities Dealers, Inc. Calhoun Consulting Group, Inc. (617) 924-1522; Fax (617) 924-0919; e-mail:calhouncon@aol.com.

* * * * * *

Several PIABA members have recently received a chain letter requesting that business cards be sent to a Craig Sherwood c/o the Make-A-Wish Foundation in Atlanta, Georgia. These letters and the chain should be ignored. The Make-A-Wish Foundation has set up a special number to deal with the volume of calls it has received regarding a Craig Shergold and/or Sherwood. It seams that some years back a Craig Shergold requested that he be sent greeting cards and ultimately sought and got an entry in the *Guinness World Records* book. Craig is presently alive, his cancer in remission and as of over five years ago is no longer seeking cards. Unfortunately an incredible amount of mail continues to arrive in response to this expired cause. The Make-A-Wish Foundation does not and will not help fulfill such wishes. However, all is not entirely lost, the phone message states that the business cards are being recycled. Eric Hovdesven, SADLER & ASSOCIATES proinvst@atl.mindspring.com

* * * * * *

Pursuant to Rule 10-9.1 of the Rules Regulating The Florida Bar, the Standing Committee on the Unauthorized Practice of Law voted to hold a public hearing on June 21, 1996, at the Buena Vista Palace, Walt Disney World Village, Lake Buena Vista, Florida, at 10:30 a.m., on the issue of Whether non-attorney companies or individuals who offer advise on securities related matters and represent the public before, during and/or after any NASD, NYSE, AMEX or other stock exchange arbitration proceedings for compensation are engaged in the unauthorized practice of law. At that time, any interested party shall be entitled to present oral testimony. The time allotted for testimony may be limited. Written testimony may be filed at the time of or prior to the hearing by sending a copy of same to Lori S. Holcomb, Assistant UPL Counsel, The Florida Bar, 650 Apalachee Parkway, Tallahassee, Florida 32399-2300.

* * * * * *

Anybody having any knowledge of **American Finance Group Investment Trust** or **American Income Fund**, especially Gruntal's involvement in selling the product, please call Seth E. Lipner at 516-294-8899.

* * * * * *

PIABA BOARD OF DIRECTORS

James E. Beckley
Robert Dyer
Stuart C. Goldberg
Cary S. Lapidus
William S. Lapp
Seth E. Lipner, Secretary
Joseph C. Long
Mark E. Maddox
Diane A. Nygaard
J. Boyd Page, Treasurer
Rosemary Shockman
L. Jerome Stanley, President