The P I A B A Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

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The

PIABA

Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

December, 1999

Volume 6, Number 4

Editor's Notes

This issue of the *Quarterly* contains an article by Joseph C. Long, entitled, "Return to Basics III: Duty to Investigate; Contributory and Comparative Negligence; and *In Pari Delicto*. Also included is an article by J. Pat Sadler and William A. Jacobson entitled, "Using the New York Debtor and Creditor Law to Obtain Relief Against Successor Broker Dealers."

The deadline for receiving submissions for the March, 2000 issue of the *Quarterly* is March 10, 2000. 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.

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LETTER FROM THE PRESIDENT

James E. Beckley, JAMES E. BECKLEY & ASSOC., Wheaton, Illinois

In the dark of the year, primitive people invented rituals to drive the sun back North. Some involved sacrifice. Some music. The Chinese used bamboo flutes, bamboo because it stayed green even covered with snow.

The ancient Romans celebrated the festival of Saturnalia when the sun reached the most southerly point on the horizon. The feast lasted a week, with dancing, parties, and exchanges of gifts. Most interesting was the custom by which the lowest slave in the household became master for a day, while everyone in the household had to obey him. This inversion of roles was amusing then, instructive now.

Even the mightiest attorneys among us, the most successful, the most aggressive are--in fact--servants. We are in fealty to our clients. This is a high standard, one to which we must rededicate ourselves every time we turn the key in the office door.

In the coming year, I hope to see PIABA an aggressive voice in the defense of investors' rights. I hope to explore with many of you the possibility of providing a pro-bono arbitration forum for those who have been impoverished by the wrongful activity of brokers and their employers. I hope to improve the educational and practice programs begun by my predecessors.

Finally, I hope that you and everyone in your families celebrated a joyous holiday season and that the coming year will offer peace and prosperity to us all.

Jim

THE UNTIMELY PASSING OF JIM BECKLEY

As you know, Jim Beckley passed away on Christmas Day as a result of complications from asthma. Those of us who knew Jim and worked with him and partook of his wit and wisdom will miss him. A memorial service will be held on Saturday, February 26, 2000, at Quigley Preparatory Seminary, 103 East Chestnut, Chicago, IL. Donations can be made to: In His Step Ministries, Post Office Box 827, Canton, Mississippi 39046.

L. Jerome Stanley, Edito

PIABA BOARD ACTION

The PIABA Board of Directors met via tele-conference on January 14, 2000. The Board elected Joe Long as President-Elect for the term 2000-01. After discussions about the utility of selecting an interim president to serve the remaining portion of Jim Beckley's term, the Board Elected Joe Long as President, to serve until October 2001. The Board voted to leave Jim Beckley's board seat open in his honor until the Annual Meeting next October.

In Memory of James E. Beckley

Joseph C. Long, UNIVERSITY OF OKLAHOMA, Norman, OK

It is with a great deal of sadness that I add this addendum to Jim's column as President. As most of you now know, Jim died of complications due to asthma in the early hours of Christmas last year. He will be greatly missed. I did not know Jim as well as many of the long term PIABA members, but I had the pleasure of serving with him on the PIABA board for the last four years. There are many things to remember about Jim. Certainly, there was his intellect. There was also his fervor for the cause of individual investors in arbitration. Jim did not come by this fervor naturally. As some of you know, he started as counsel for broker-dealers. However, as is often said of converts, they are the most passionate to the ideas they espouse. Certainly, this was true of Jim.

On a lighter note, I will always remember Jim for his command of the English language and English literature. He would often make obscure references which I and many others had no clue as to what he meant. Finally, Jim will also be remembered for the ubiquitous bow ties he wore with great pride long after most of us had forgotten, if we ever knew, how to tie them.

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.

Contributions should be mailed to: The PIABA QUARTERLY, 7910 Wrenwood Blvd., Ste. B, Baton Rouge, Louisiana 70809; FAX (225) 926-4348. E-Mail: stanlaw@premier.net. All copy is subject to the approval of the publisher. Any material accepted is subject to such revision as is deemed appropriate in the publisher's discretion.

Jim is gone and will be sorely missed. However, life and PIABA must go on. The Board has asked me to succeed him and to finish his term as President of PIABA. As with any change of a president, there will be personality differences, differences in goals, and differences in approach. I will try my best to live up to the standards that he established in his two short months in office. Jim, please, look over my shoulder and help me to be true to the beginning you started.

In the next issue of the *Quarterly*, I will outline my goals and priorities as President of PIABA. But that task must await until next time, as this is properly Jim's issue.

Joe

From the Professor

RETURN TO BASICS III: DUTY TO INVESTIGATE; CONTRIBUTORY AND COMPARATIVE NEGLIGENCE; AND *IN PARI DELICTO*

Professor Joseph C. Long
UNIVERSITY OF OKLAHOMA, Norman, OK

As promised in the Fall *Quarterly*, this article will discuss the availability of the affirmative defenses of contributory and comparative negligence[1] and *in pari delicto* in securities cases. Broker-dealers routinely assert these defenses along with their cousins waiver,[2] estoppel,[3] and ratification[4] as boiler-plate in their answers to a client's arbitration claim. As will be seen below, the defense of contributory or comparative negligence is not available in securities cases, and the doctrine of *in pari delicto*, while often available is strictly applied. As a result, *in pari delicto* is hardly ever sustained under the facts of a particular case.

I. Overview of Doctrines of Comparative or Contributory Negligence and *In Pari Delicto*

A. The Duty to Investigate and Contributory or Comparative Negligence

The duty to investigate and contributory or comparative negligence are not separate topics. Instead they are two sides of the same coin. If there is a duty on the part of a broker's customer to investigate, then failure to perform that duty would constitute either contributory or comparative negligence. Conversely, if the customer has no duty to investigate or perform any due diligence, then lack of such diligence is not contributory or comparative negligence on his part.[5] Further, even if there is a duty to investigate, so that breach of that duty would constitute either comparative or contributory negligence on the part of the investor, such negligence may not be a defense where the conduct of the broker is either intentional or wilful and wanton.[6]

B. Doctrine of *In Pari Delicto*

The concept of duty and contributory or comparative negligence, however, does not provide a complete picture as to whether an investor's cause of action may be denied. Both the United States Supreme Court[7] and the state courts[8] have held that the doctrine of *in pari delicto* may have application in all types of securities litigation, non-registration as well as fraud actions. As the Supreme Court said in ***Pinter v. Dahl***,[9] the term "*in pari delicto*"[10] literally means in equal fault.

The doctrine of is common law origin and:

> In its classic formulation, the...defense was narrowly limited to situations where the plaintiff truly bore at least substantially equal responsibility for his injury, because 'in cases where both parties are *in delicto*, concurring in an illegal act, it does not always follow that they stand *in pari delicto*; for there may be, and often are, very different degrees in their guilt'.[11]

In addition, there was a public policy limitation on the application of the in pari delicto defense ***even in situations where the plaintiff bore substantial fault for his own injury.*** As Storey said: "[T]here may be on the part of the court itself a necessity of supporting the public interests or policy in many cases, however reprehensible the acts of the parties may be."[12]

While the doctrine had been applied in state securities case for a number of years,[13] the doctrine was first approved for use in federal securities actions in ***Bateman Eichler, Hill Richards, Inc v. Berner.***[14] ***Bateman*** was an action brought under SEC Rule 10b-(5), where a tippee sought to recover from his tipper, based on a claim that the purported inside information tipped was false. The Court first reviewed the history of the in pari delicto doctrine at common law and, then, concluded that it should apply in securities cases:

> (1) [O]nly where as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.[15]

The doctrine, while recognized in the securities context, has rarely succeeded in actual practice. In most cases, the courts have found that the facts involved do not support application of the defense.[16] As will be seen below, it applies to causes of action not involving fault as well as those involving various degrees of fault.[17] Further, it may be used in connection with both implied and express statutory causes of action.[18]

II. Registration Violations

A. Contributory or Comparative Negligence

In the case of securities registration violations under either Section 12(a)(1) of the Securities Act of 1933,[19] or Section 410(a)(1) of the Uniform Securities Act,[20] the statutes themselves make clear that the investor has no due diligence requirement to determine whether the securities were registered or should have been registered.[21] The duty to register or exempt the securities falls entirely upon the person selling the securities.[22] As a result, the investor may know either that the securities were unregistered or that the securities were unregistered and should have been[23] and still recover for the non-registration violation.

There are two major policy reasons for this conclusion. First, the public policy of the securities acts is that securities should be registered.[24] Exemption of securities is the exception rather than the rule. Therefore, the state has an interest in allowing an investor who knows that the securities should have been registered to recover. As the court concluded in ***Fierer v. Ashe***:

> [A] contributory negligence defense is not sufficient to overcome the public policy considerations underlying the securities laws.... The purpose of "blue sky" laws is to allow the purchaser to rescind where the securities offered are not issued in compliance with the [securities act]. ... This purpose would be defeated if recovery was conditional upon exercise of due care on the part of the purchaser of the securities.[25]

Further, the benefits which accrue to the public in protecting them from sales of unregistered securities outweighs any inequity which might result from allowing an investor with knowledge of the registration violation to recover.[25] This is true even though there is no fraud, misrepresentation, or scienter on the part of the seller.[27]

The second policy reason is much more practical. Without this conclusion, any seller of securities could prevent civil liability for non-registration violations by telling the investor at the time of purchase that the securities should have been registered an were not. To prevent such an obvious ploy, both Section 410(g) of the Uniform Securities Act,[28] and Section 14 of the Securities Act of 1933[29] provide that a waiver of compliance with the Acts is void as against public policy.[30]

In light of the above outlined public policy and cases, it should be clear that the investor has no duty to determine whether securities were registered or whether they should have been registered. Lacking this due diligence duty, there can be no contributory or comparative negligence in failing to discover either of these facts.

B. *In Pari Delicto*

On the federal side, application of in pari delicto to non-registration violations became firmly established by the Supreme Court in ***Pinter v. Dahl***.[31] Again, while ***Pinter*** makes clear that the defense can be appropriate in cases involving section 12(a)(1) violations, it also makes clear that its use will be highly restricted. First, the Court, following ***Bateman*** held:

> [A] defendant cannot escape liability unless, as a direct result of the plaintiff's own actions, the plaintiff bears at least substantially equal responsibility for the underlying illegality. The plaintiff must be an active, voluntary participant in the unlawful activity that is the subject of the suit. ... Unless the degree of fault are essentially indistinguishable or the plaintiff's responsibility is clearly greater, the *in pari delicto* doctrine should not be allowed, and the plaintiff should be compensated.[32]

Second, the Court recognized that the congressional policy behind the Securities Act of 1933 placed an important brake on the judicial development of the doctrine of *in pari delicto* in securities cases. It said:

> The second prong, which embodies the doctrine's traditional requirement that public policy implications be carefully considered before the defense is allowed, ... ensures that the broad judge-made law does not undermine the congressional policy favoring private suits as an important mode of enforcing federal securities statutes.[33]

Echoing the position outlined above in the context of contributory or comparative negligence, It went on to say:

> Refusal of relief to those less blameworthy would frustrate the purpose of the securities laws; it would not serve to discourage the actions of those most responsible for organizing forbidden schemes; and it would sacrifice protection of the general investing public in pursuit of individual punishment.[34]

Turning to the issue of when, and when not, the doctrine should be available, the Court made clear that the purchaser's knowledge of the violation, by itself, ***does not constitute equal culpability.***[35] This is true even when the purchaser is sophisticated and does not need the protection of the Act.[36] The Court concluded:

> Although this [conclusion] may appear to offend a sense of fair play, allowing the investor to sue regardless of his knowledge of the violation when he purchased the securities, furthers the interest of the Securities Act; the seller then has a strong incentive to comply with the registration disclosure provisions.[37]

The Court indicated, however, the doctrine might be available in the non-registration setting in two specific and very limited situations: (1) where the plaintiff had induced the issuer not to register; and (2) where the plaintiff acted essentially as a promoter. But the Court, in connection with the second example, makes clear that the plaintiff must truly be a promoter and not merely an investor:

> In our view, where the Section 12(1) plaintiff is primarily an investor, precluding suit would interfere significantly with effective enforcement of the Securities Act. . . . Because the Act is specifically designed to protect investors, even where a plaintiff actively participates in the distribution of unregistered securities, his suit should not be barred where his promotional efforts are incident to his role as an investor.[38]

State law is more confused as to the availability of the *in pari delicto* defense in the case to non-registration violations. Many courts in a series of cases from the early days of state securities regulation and before the adoption of either the Uniform Securities (1956) or the more recent Revised Uniform Securities Act (1985) have applied the doctrine to non-registration violations.[39] More recently, the trend, in state securities law both under the Uniform Acts and other modern statutes, appears to be toward rejecting the application of *in pari delicto* and other equitable or common law defenses in favor of allowing only those defenses specifically recognized by the statute itself.[40]

The state cases which do recognize *in pari delicto* in the case of non-registration violations generally limit its application to persons who are active in a corporation at the time the unregistered securities are sold and who continue to be active in corporate management and affairs after their purchase.[41] Thus, even where the investor helped the promoter lie to the securities commissioner to obtain a sales permit, the court held the investor ***not in*** *pari delicto*.[42]

As in the case of the federal act, knowledge of the non-registration clearly does not put the investor in pari delicto.[43] As the court said in ***Martine v. Moore***:

> It is well established that the knowledge of absence of permit is insufficient to bar recovery. ... The philosophy of liability under the ...[s]ecurities [l]aws rests on the theory that where active participation and investment are separated there shall be recovery. It would indeed be incongruous to allow the violator to retain the gains of his violations by the simple expediency of permitting the investor window-dressing activities, which window-dressing activities in all probability would assist the violator in parting the investor from his funds and in placating the investor for a longer duration.[44]

In summary, while the doctrine of *in pari delicto* is clearly an available defense in cases under Section

12(a)(1) of the Securities Act of 1933, it may not be applicable under Section 410(a)(1) of the Uniform Act. In either case, where the doctrine is recognized, it has been carefully restricted to apply only to promoters[45] and true insiders.[46]

III. MISREPRESENTATION OR OMISSION VIOLATIONS

The treatment of the defenses of contributory or comparative negligence and *in pari delicto* under Section 12(a)(2) of the Securities Act of 1933 and Section 410(a)(2) of the Uniform Act is pretty much the same as for registration violations.

A. Contributory or Comparative Negligence

The key to the defense of contributory or comparative negligence under Sections 12(a)(2) and 410(a)(2) is whether there is a duty on the part of the investor to investigate. At the federal level, the courts have made abundantly clear that ***the investor has no such duty under Section 12(a)(2).***[47] The duty to disclose is entirely on the seller of securities. The investor is like a sponge who must be given all information which the seller wishes him to have or the law requires to be given.

This lack of duty exists in spite of the parenthetical phrase in Section 12(a)(2) proving that "the purchaser not know[ ] of such untruth or omission". This phrase deals with ***actual knowledge.***[48] In ***In re Olympia Brewing Co. Sec. Lit.***, the court summarized this point, saying:

> [T]he statutory language of §12[(a)](2) clearly indicates that plaintiff must not have known of the untruth or omission, while putting the burden on defendant to show that it does not know or with reasonable care could not have known of the untruth or omission. This tends to establish that the drafters did not intend to require reasonable inquiry by the purchaser. This conclusion is strengthened by §13...which prescribes the limitations period applicable to §12[(a)](2). There, plaintiff's claim must be brought within one year after the discovery of the untruth or omission, of after such discovery should have been made through the exercise of "reasonable diligence" by the plaintiff. While due diligence is incorporated in the section prescribing the limitations period, it is absent in the section creating liability.[49]

As noted above, the standard here is actual knowledge and not constructive knowledge which could be obtained by investigation. This distinction becomes very important in the case where oral representations by seller's agent say one thing and the written prospectus indicates another. If the customer does not read the prospectus, then he is not charged with constructive knowledge of the written statements which conflict with the oral representations he received. In ***MidAmerica Federal Savings & Loan Assoc. v. Shearson/American Express, Inc.***,[50] Shearson argued that the investor should be charged with the information contained in the written prospectus which was contrary to that which the investor had been told by Shearson's agent. The Tenth Circuit specifically rejected this claim saying:

> The fact that there may be both oral communications and a written prospectus involved in a transaction, and that section 12[(a)](2) places them in the alternative cuts against that the prospectus take precedence, particularly here where the sales were induced by means of the oral misrepresentations.[51]

The court went further to note that under Section 12(a)(2) availability elsewhere of truthful information cannot excuse untruths or misleading omissions' by the seller.[52] Following the logic of the Tenth Circuit to its ultimate conclusion, if MidAmerica had read the prospectus and knew that there was a conflict between what it said and what it had been told orally by the Shearson's agent, ***it would have no duty to inquire as to which representation was correct***.

If there is no duty to investigate, failure to investigate can not constitute either contributory or comparative negligence. Therefore, contributory or comparative negligence have no place under Section 12(a)(2).[53] The court in ***Comeau v. Rupp*** summarized:

> The plaintiffs do not have to prove that they could not have discovered the falsity upon reasonable investigation. ... There is no duty that the plaintiffs investigate beyond their own general knowledge at the time of the purchase. ... In other words, the plaintiffs are not required to prove due diligence, and the lack of due diligence or contributory negligence is not a defense to a §12[(a)](2) claim.[54]

With one notable exception,[55] the state courts have reached the same conclusion under Section 410(a)(2) of the Uniform Act.[56] As the court said in ***Kelsey v. Nagy***:[57]

> [I]f the legislature had intended to impose a duty to investigate upon the buyer, it would have expressly included such in the wording of the statute. The proscriptions of [Section 410(a)(2)], however, embrace a fundamental purpose of substituting a policy of full disclosure for that of caveat emptor. That policy would not be served by imposing a duty of investigation upon the buyer.[58]

B. *In Pari Delicto*

The case law concerning the application of the doctrine of *in pari delicto* to either Section 12(a)(2) or 410(a)(2) is not well-developed. There are a few cases which suggest that the doctrine is available in misrepresentation and omission cases.[59] As far as Section 12(a)(2) is concerned, this conclusion is clearly warranted by the Supreme Court's decision in ***Pinter*** that the doctrine of *in pari delicto* should be an available defense in all securities actions. As far as Section 410(a)(2) of the Uniform Act is concerned, if *in pari delicto* is available under Section 410(a)(1) for non-registration violations, then logic suggests that it should be available for misrepresentation and omission violations. However, under either state or federal law, the strict application of the rule as outlined by ***Pinter*** is appropriate. To date, the author has found no cases, state or federal, which have actually applied the *in pari delicto* defense to bar recovery by an investor.[60]

IV. SEC Rule 10b-(5) Violations

A. Contributory or Comparative Negligence

SEC Rule 10b-(5) requires a different analysis than does Section 12(a)(2) or 410(a)(2). It is generally recognized that the investor does have a duty of due diligence under SEC Rule 10b-(5). Therefore, it would initially appear that contributory or comparative negligence would be a valid defense under Rule 10b-(5). However, since ***Ernst & Ernst v. Hochfelder***,[61] defendants can only be held liable if their conduct was intentional or wanton and reckless.

It is a general principle of tort law that contributory or comparative negligence have no place where the defendant's conduct amounts to more than simple negligence. Thus, simple contributory or comparative negligence is not a defense to intentional or wanton or reckless conduct by the tortfeasor.[62]

Following the lead of general tort law the federal courts generally have held that the lack of due diligence, which would be simple negligence, is not a defense under SEC Rule 10b-(5).[63]
As one court said:

> To the extent [that the investor] claims violations of Section 10(b)...[and Rule 10b-(5)]. it is clear that [his] negligence or lack of due diligence in purchasing the securities leading to his injury is irrelevant to his ability to recover damages. ... [L]ack of due diligence is not a defense to a violation of [SEC Rule 10b-(5)].[64]

The Tenth Circuit correctly summarized to the rule here, when it said in ***Holdsworth v. Strong***:[65] "If contributory fault of plaintiff is to cancel out wanton or intentional fraud, it ought to be gross conduct somewhat comparable to that of defendant."

B. *In Pari Delicto*

As noted above, the ***Bateman*** case makes clear that *in pari delicto* may be used as a defense in a 10b-(5) action. However the conduct of the plaintiff will have to be severe before the doctrine will apply. In ***Bateman***, the Court refused to apply the doctrine to a tippee suing his tipper.[66] It rejection of the application of *in pari delicto* to a tippee was based on both the lack of equal fault and policy grounds. As to the lack of equal fault, the Court concluded: "That the tippee properly can be characterized as being of substantially equal culpability as his tippers."[67] It went on to say:

> [A]n investor who [voluntary] engages in [impossible trading on inside information] is [not] necessarily as blameworthy as a corporate insider or broker-dealer who discloses the information for personal gain. Notwithstanding the broad reach of §10(b) and Rule 10b-5, there are important distinctions between the relative culpabilities of tippers, securities professionals, and tippees in these circumstances.[68]

Turning to the policy considerations, the Court felt that barring this type of suit "would inexorably result in a number of alleged fraudulent practices going undetected by the authorities and unremedied."[69]

The Court noted that the SEC has always lacked the manpower and resources to ferret out all violations. It, as Congress recognized, must rely heavily upon private actions to help it police the industry. With the growing size and complexity of the securities market, this dependence has become even stronger. Finally, the Court concluded to allow the *in pari delicto* doctrine to bar recovery in the case of the defrauded tippee would significantly undermine the concept of enforcement by private suit. "It would deny any incentive to the defrauded tippee to bring suit against his defrauding tipper..."[70]

If the Court will not sanction the use of the in pari delicto doctrine in the case of a defrauded tippee, it is unlikely that the use of the doctrine would be appropriate in any case involving a public investor bringing suit against his broker in arbitration.

1. As the Seventh Circuit said in *Teamsters Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522, 527 (7th Cir. 1985):

   For a long time contributory negligence was an absolute bar to recovery for negligence. [M]ost...states [have] replac[ed] the absolute bar of contributory negligence with the doctrine of comparative negligence.

2. Discussion of these other defenses will have to wait for a future issue of the *Quarterly*. For cases dealing with waiver, *see e.g.*, *Meason v. Gilbert*, 236 Ga. 862, 226 S.E.2d 49 (1976); *Foreman v. Holsman*, 10 Ill.2d 551, 141 N.E.2d 31 (1957).

3. *See generally*, Annot., "Purchaser's Right to Set Up Invalidity of Contract Because of Violation of State Securities Regulation As Affected by Doctrines of Estoppel or *Pari Delicto*", 84 A.L.R.2d 479 (1962).

4. *See e.g.*, *Fortenberry v. Weber*, 18 Cal. App.3d 213, 95 Cal. Rptr. 834 (1971) (no ratification because no notice of facts).

5. *Comeau v. Rupp*, 1988 WL 93,977 (D. Kan. 1988).

6. *Teamsters Local 282 Pension Trust Fund v. Angelos,* 762 F.2d 522 (7th Cir. 1985), *citing* William Prosser & Robert Keeton, *The Law of Torts 462* (5th ed. 1984) and *Rest.2d, Torts* §§481, 482 (1965).

7. *Pinter v. Dahl*, 486 U.S. 622 (1988), and *Eichler, Hill Richards, Inc v. Berner*, 472 U.S. 299 (1985).

8. *See generally*, Annot., "Purchaser's Right to Set Up Invalidity of Contract Because of Violation of State Securities Regulation As Affected by Doctrines of Estoppel or *Pari Delicto*", 84 A.L.R.2d 479 (1962).

9. 486 U.S. 622, 632 (1988), *citing Eichler, Hill Richards, Inc v. Berner*, 472 U.S. 299, 306, fns. 12 & 13 (1985).

10. The full Latin phrase is "*In pari delicto potior est conditio defendentis*", which has been translated to read: "In the case of equal or mutual fault...the position of the [defending] party...is the better one." *Bateman, Eichler, Hill Richards, Inc. v. Berner* , 472 U.S. 299, 396 (1985).

11. *Id.* at 307, *quoting* 1 Joseph Storey, *Equity Jurisprudence* 304-305 (13th ed. 1886).

12. 1 Joseph Storey, *Equity Jurisprudence* 305 (13th ed. 1886), *quoted with approval in Bateman Eichler, Hill Richards, Inc.*, 472 U.S. at 307.

13. *See generally*, Annot., "Purchaser's Right to Set Up Invalidity of Contract Because of Violation of State Securities Regulation As Affected by Doctrines of Estoppel or *Pari Delicto*," 84 A.L.R.2d 479 (1962).

14. 472 U.S. 299, 310-311 (1985).

15. *Id.* at 307.

16. *Pinter v. Dahl*, 486 U.S. 622, 635 n.12 (1988).

17. *Pinter v. Dahl*, 486 U.S. 622, 633-634 (1988).

18. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 309-310 (1985).

19. 15 U.S.C. §77l(a)(1).

20. Uniform Securities Act (1956), §410(a)(1), 7B *Uniform Laws Annot.* 643 (Mast. Ed. 1985).

    See e.g., *Hardy v. Musicraft Records*, 93 Cal. App.2d 698, 209 P.2d 839 (1949); *Fierer v. Ashe*, 142 Ga. App. 290, 235 S.E.2d 598 (1977).

21. Section 5 of the Securities Act of 1933, 15 U.S.C. §77e makes it unlawful to sell or deliver a security without furnishing a statutory prospectus, unless the security or the transaction in which it is sold, is exempt under either Section 3 or 4.Such prospectus

only be obtained by registering the securities. Similarly, Section 301 of the Uniform Securities Act, provides that a security can not be offered or sold without the security being either registered or exempt.

The burden of proving an exemption under either statute is on the person claiming the exemption, the seller or his broker. *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953); Uniform Sec. Act (1956), §402(d).

23. Such knowledge alone does not give rise to an *in pari delicto* defense. *Investors Equity Group, Inc. v. Rosenkrantz, Lyon & Ross, Inc.*, 822 F. Supp. 429, *opinion on reconsideration*, 822 F. Supp. 436 (W.D. Mich. 1993).

24. The securities acts, both state and federal, were enacted to substitute the doctrine of *caveat venditor* for the common law concept of caveat emptor. Thus, disclosure through registration becomes the burden of the seller of securities. This obligation places the common law "due diligence" obligation normally placed on the buyer. *See e.g.*, *Graham v. Kane*, 264 Ark. 949, 756 S.W.2d 711 (1979).

25. 142 Ga. App. 290, 292, 235 S.E.2d 598, 600 (1977).

26. *Graham v. Kane*, 264 Ark. 949, 954, 576 S.W.2d 711, 713-714 (1979).

27. The Supreme court expressed the same idea in *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986), where the Court said:

> Respondents also overlook the fact that Congress' aim in enacting the 1934 Act was not confined solely to compensating defrauded investors. Congress intended to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions. This deterrent purpose is ill served by a too rigid insistence on limiting plaintiffs to recovery of their "net economic loss."

28. The Court made a similar statement about the purpose of the 1933 Act. 478 U.S. at 659.

This section reads:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this act or any rule or order hereunder is void.

29. 15 U.S.C. §77n. This section reads virtually the same as Section 410(g) quoted above.

30. *See e.g.*, *Hayden v. McDonald*, 742 F.2d 423 (8th Cir. 1984), *overruled on other grounds*; *Meason v. Gilbert*, 236 Ga. 862, 226 S.E.2d 49 (1976); *Foreman v. Holsman*, 10 Ill.2d 551, 141 N.E.2d 31 (1957). *See also*, *Dunn v. Bemor Pet., Inc.*, 680 S.W.2d 304 (Mo. App. 1984), which used this logic to reject the *in pari delicto* defense.

31. 486 U.S. 622 (1988).

32. *Id.* at 635.

33. *Id.* at 633.

34. *Id.* at 636.

35. *Id.* at 636. *See also*, *Wassel v. Eglowsky*, 399 F. Supp. 1330 (D.Md. 1975).

36. *Id.* This means that the sophistication of the purchaser is irrelevant, and evidence on the point should not be allowed.

37. *Id.* at 637, n. 13. The Court also rejected the idea that allowing the purchaser to buy knowing of the violation allows the purchaser to speculate at the seller's expense for the period of the statute of limitation. It points out that the statute specifically allows such conduct. It said: "Section 12[(a)](1)'s deterrent effect is achieved, to a great extent, by [Section 13] allowing suits for a full year following sale." *Id.*

38. *Id.* at 639.

39. *See generally*, Annot., "Purchaser's Right to Set Up Invalidity of Contract Because of Violation of State Securities Regulation As Affected by Doctrines of Estoppel or *Pari Delicto*," 84 A.L.R.2d 479 (1962).

40. *See e.g.*, Hall v. Johnston, 758 F.2d 421 (9th Cir. 1985) (Oregon Act); Gowdy v. Richter, 20 Ill.

App.3d 514, 314 N.E.2d 549 (1974) (only statutory defenses, no common law ones); *Dunn v. Bemor* Pet., Inc., 680 S.W.2d 304 (Mo. App. 1984). The *Dunn* case recognizes the split in the case law, but rejects the application of in pari delicto under the Uniform Act.

41. *See e.g., Hayden v. McDonald,* 742 F.2d 423 (8th Cir. 1984), *rev'd on other grounds* (Minnesota Act); *Henderson v. Hayden, Stone, Inc.*, 461 F.2d 1069 (5th Cir. 1972) (Florida Act); *Thomas v. Hemmelgarn*, 579 N.E.2d 1333 (Ind. App. 1991); *Theye v. Bates*, 166 Ind. App. 652, 337 N.E.2d 837 (1976).

42. *Smith v. Turner*, 238 Cal. App.2d 141, 47 Cal. Rptr. 582 (1965). *See e.g., Austin v. Hallmark Oil Co.*, 21 Cal.2d 718, 134 P.2d 777 (1943) and *Rankin v. Bankey*, 196 Cal. App.2d 554, 16 Cal. Rptr. 721 (1961), for other cases finding no factual basis for applying *in pari delicto*.

43. *See e.g., Maner v. Tepper*, 250 Cal. App.2d 526, 58 Cal. Rptr. 740 (1967).

44. [1961-1971 Transfer Binder] Blue Sky Law Rep. (CCH) ¶70,612 (Cal. Mun. Ct., Los Angeles, July 31, 1963).

45. *Pinter v. Dahl*, 486 U.S. 622, 639 (1988) (Doctrine only available where plaintiff's role in the offering or sale of the unregistered securities is more of a promoter than an investor.)

46. The Court in *Pinter* expressed this idea saying:

> [C]ourts frequently have focused on the extent to which the plaintiff and the defendant cooperated in developing and carrying out the scheme to distribute unregistered securities.

Id. at 637.

47. *See e.g., Beloit Corp. v. Emett & Chandler Cos., Inc.*, 1991 WL 153459, 940 F.2d 1533 (9th Cir. Apr. 1, 1991) (Table case) (Section 12(a)(2) imposes no affirmative duty of investigation); *Casella v. Webb*, 883 F.2d 805 (9th Cir. 1989); *Sanders v. John Nuveen & Co., Inc.*, 619 F.2d 1222 (7th Cir. 1980); *Alton Box Board Co. v. Goldman, Sachs & Co.*, 560 F.2d 916, 919 (8th Cir. 1977) (No duty under Section 12(a)(2) to investigate beyond own general knowledge at time of purchase); *Gilbert v. Nixon*, 429 F.2d 348 (10th Cir. 1970); *Aronson v. TPO, Inc.*, 410 F. Supp. 1375, 1379 (S.D.N.Y.1976).

48. *See e.g., Casella v. Webb*, 883 F.2d 805, 809 (9th Cir. 1989) (Constructive knowledge not bar recovery under Section 12(a)(2)); *MidAmerica Federal Sav. & L. Assoc. v. Shearson/American Express, Inc.*, 886 F.2d 1249 (10th Cir. 1989) (Constructive knowledge not applicable under either Section 12(a)(2) or Section 410(a)(2)).

49. 612 F. Supp. 1367, 1370 (N.D. Ill. 1985). *See also Casella v. Webb*, 883 F.2d 805, 809 (9th Cir. 1989).

50. 886 F.2d 1249 (10th Cir. 1989).

51. *Id.* at 1255.

52. *Id.* at 1256-1257, *quoting* Kaminsky, "An Analysis of Securities Litigation Under Section 12(2) and How It Compares with Rule 10b-5," 13 Hous. L. Rev. 231, 2670268 (1976). *See also Dale v. Rosenfeld*, 229 F.2d 855, 858 (2d Cir. 1956).

53. *Molecular Technology Corp. v. Valentine*, 925 F.2d 910 (6th Cir. 1991) (comparative negligence has no place under state or federal securities law).

54. 1988 WL 93,977 (D.Kan. Mar. 23, 1988).

55. *Landry v. Thibaut*, 523 So.2d 1370 (La. App. 1988) holds that contributory negligence ***is*** a defense under the Louisiana Securities Act. This position was followed in *Tranchina v. Howard, Weil, Labouisse, Friedrichs, Inc.*, 1996 WL 392172 (E.D. La. July 11, 1996).

56. *See e.g., Bradley v. Hullander*, 272 S.C. 6, 249 S.E.2d 486 (1978); *McCrachen v. Edward D. Jones & Co.*, 445 N.W.2d 375 (Iowa App. 1989) (Iowa Securities Act does not allow reduction of damages based upon comparative fault).

57. 410 N.E.2d 1333, 1336 (Ind. App. 1980).

58. This same analysis also applies in breach of fiduciary duty cases, a common allegation in arbitration. The relationship between the broker-dealer and the customer is one of agency, and an agent, by definition, is a fiduciary. The existence of a fiduciary duty relaxes the principal's duty to investigate. As the court said in *Hobbs v. Bateman, Eichler, Hill Richards*,

164 Cal. App.3d 174, 201-202, 210 Cal Rptr. 387 (Cal.App.2 Dist. Jan. 29, 1985):

> Where a fiduciary relationship exists, facts which ordinarily require investigation may not incite suspicion...and do not give rise to a duty of inquiry.... Where there is a fiduciary relationship, the usual duty of diligence to discover facts does not exist.

Quoted with approval in Eisenbaum v. Western Energy Resources, Inc., 218 Cal. App.3d, 267 Cal. Rptr. 5 (1990).

59. *See e.g.*, Silverberg v. Paine, Webber, Jackson & Curtis, 710 F.2d 678 (11th Cir. 1983) (Section 12(a)(2) and the Florida Act); Ames v. Uranus, Inc., 1994 WL 482626 (D. Kan. Aug. 24, 1994).

60. A review of the cases cited in Annot., "Purchaser's Right to Set Up Invalidity of Contract Because of Violation of State Securities Regulation As Affected by Doctrines of Estoppel or *Pari Delicto*", 84 A.L.R.2d 479 (1962), reveals these cases all involve registration violations. An independent computer search of both Lexis and Westlaw failed to find any Section 12(a)(2) or 410(a)(2) cases applying *in pari delicto*.

61. 425 U.S. 185 (1976).

62. Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522 (7th Cir. 1985), *citing* William Prosser & Robert Keeton, *The Law of Torts* 462 (5th ed. 1984) and *Rest.2d, Torts* §§481, 482 (1965).

63. *See e.g.*, Holdsworth v. Strong, 545 F.2d 687, 693 (10th Cir. 1976)(en banc); Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522 (7th Cir. 1985); Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1048 (7th Cir. 1977).

64. In re Olympia Brewing Co. Sec. Lit., 612 F. Supp. 1367 (N.D.Ill. 1985).

65. 545 F.2d 678, 693 (10th Cir. 1976) (en banc), *quoted with approval in* Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d at 1048.

66. 545 F.2d 678, 693 (10th Cir. 1976)(en banc), *quoted with approval in* Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d at 1048.

67. In doing so, the Court rejected the idea of "caveat tippee". *Id.* at 315.

67 *Id.* at 315.

68 *Id.* at 312-13.

69 *Id.* at 315.

70 *Id.* at 316.

USING THE NEW YORK DEBTOR AND CREDITOR LAW TO OBTAIN RELIEF AGAINST SUCCESSOR BROKER DEALERS

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All too often, small brokerage firms which have facilitated fraudulent acts go out of business before customers can obtain relief through the arbitration process.

Customers of Firm A may be further frustrated when they receive a letter from a new and unknown brokerage firm (Firm B), informing the customer that his account will be transferred to Firm B on a date in the very near future. Letters of this type often go on to say that Firm B will clear through the same clearing firm as Firm A and will take over the office and employees of Firm A.

While these letters are written in a manner designed to make the customer think the change is good news, experienced counsel know this ruse is simply a ploy to avoid mounting liability for past transgressions. The problem is what to do about it. The combination of Firms A and B is never done as a merger, so how do we find a theory of liability against Firm B (which is operating and has assets) for the misdeeds of Firm A (which by the time of the arbitration hearing is long gone)? The New York Debtor and Creditor Law[1] may offer the answer.

Transfers for Less Than Fair Value

The New York Debtor and Creditor Law offers potential relief when the successor firm receives assets from the defunct firm for which the successor firm has paid

less than fair value. These assets may take many forms as will be discussed later in this article.

The two sections of the Law which establish the right to relief are sections 273-a and 276. Section 273-a applies when the person making a conveyance without fair consideration is either a defendant in an action for damages[2] or is subject to a judgment in such an action. Under 273-a, the conveyance is fraudulent as to the plaintiff *without regard to the actual intent of the transferor.* The claimant who has filed his action before transfer of assets to the successor firm is obviously at an advantage in that he does not have to prove fraudulent intent.

Section 276 applies to every conveyance made with actual intent to hinder, delay or defraud either present or future creditors, regardless of whether the transferor was a defendant or judgment debtor at the time of the transfer.

Even when one must proceed under §276, there may be ways to prove the transferor's fraudulent intent. Often times, fraudulent brokerage firms will not close the doors and transfer assets to a successor until customer complaints and arbitration claims have mounted. The firm may also have stopped paying certain operating expenses before it stops doing business. The argument can be made that a debtor who transfers assets for less than fair value under these circumstances knows that the transfer will hinder, delay or defraud its creditors.

It is important to note that in a proceeding against a recipient under either §273-a or §276, the sole issue to be determined is whether and to what extent the recipient received property for less than fair value. The statute allows the recipient to defend only the fair value issue and not the validity of the underlying claim.

Identifying the Types of Assets Likely to be Fraudulently Transferred

The two main categories of assets which are likely to be transferred from the closing firm to the replacement firm are tangible assets used in the business and customer accounts.

The tangible assets range from furniture and fixtures to phone systems, computers and other common office equipment and are relatively easy to trace. However, since the replacement firm's liability is limited to the difference in the fair value of the assets it receives, less payments made, these assets may not provide much relief. Customer accounts are an entirely different proposition.

Invariably, an unscrupulous brokerage firm preparing to go out of business will attempt to transfer as many of its active accounts as possible to the replacement firm. Often this is done by the use of a negative response letter sent to all customers stating that the transfer will occur in *x-* number of days unless the client directs otherwise.

Pat Sadler, one of the authors, recently argued successfully before an arbitration panel that the transfer of customer accounts in this manner constitutes a transfer of assets within the meaning of the New York Debtor and Creditor law. We argued the proposition that customer accounts are the property of the firm and not the account executive. We cited case law and argued to the panel that this was not a case of individual customers deciding to follow their account executive from one firm to another, but instead was a case of the bulk transfer of accounts from one firm to another.

Valuing Customer Accounts

Mike Walsh of Walsh Consulting in Jacksonville has developed an excellent approach to valuing customer accounts transferred from one firm to another. First, he establishes an industry standard "cost of acquisition" approach which pegs the cost of acquiring a single customer account at $200. There is a good deal of written material from several firms in the industry which supports this figure. Many times, this approach alone may be as far as you need to go depending on the number of accounts transferred and the size of your case.

Mike's second approach involves valuing the actual accounts which were transferred. This involves getting financial data such as the firm's FOCUS reports for periods immediately before and after the transfer and performing an analysis of the data.

While building your case on the value of customer accounts will require the employment of an expert, the results may very well justify the expense. In the case recently tried by Pat Sadler, Mike Walsh was able to provide to the panel a range of value of between $250,000 and $500,000 for the transferred accounts, which resulted in a collectable six-figure award against the brokerage firm.

Conclusion

Using the New York Debtor and Creditor Law can be a very effective tool in situations where the offending firm has disappeared into the night only to be replaced by an allegedly independent firm. It won't work in every case, but it's one more arrow in the quiver.

1. New York CLS Debtor and Creditor Law, §100, et seq.

2. There is ample New York authority that a respondent in an arbitration proceeding is a defendant in an action for money damages within the meaning of §273-a. See *One Hundred Pearl v. Vantage Securities,* 887 F.Supp. 636 (S.D.N.Y. 1995).

RECENT COURT DECISIONS REGARDING ARBITRATION

Bankruptcy Court Determines Suitability Claim is Nondischargeable and Imputes Broker's Fraud to the Principal of the Broker Dealer Making The Principal's Debt to the Claimant Also Nondischargeagble

In *Owens v. Miller*, 240 B.R. 566 (U.S.B.C., W.D. Mo., October 25, 1999), the Court considered: 1) could representations by the broker that he would invest the claimant's money in capital preservation investments, while in fact he invested in speculative investments, make the arbitration award obtained by the investors nondischargeable in the broker's bankruptcy; and 2) could the broker's fraud be imputed to the principals of the broker-dealer so as to make the award nondischargeable to the principal of the broker-dealer as well. The *Owens* court found both the debt of the broker and the debt of the principals nondischargeable.

The claimants had filed an arbitration claim against the broker and the firm and the principal of the broker-dealer. The arbitration panel issued an award against the broker and the principal, finding the liability to be joint and several.

The Court noted that, under Section 523(a)(2)(A) of the Bankruptcy Code, a bankruptcy discharge does not discharge a debtor from any debt where money or services were obtained by false pretenses, a false representation or actual fraud. In order to have the debt be nondischargeable, the creditor must show that: 1) the debtor made the representation; 2) that the debtor knew at the time the representation was false; 3) the representation was made intentionally with the purpose of deceiving the creditor; 4) that the creditor justifiably relied on such representation; and 5) that the creditor sustained a loss as a proximate result of the representation.

The Court found the representations made by the broker to be false and that the broker had the requisite intent, noting that "The intent element of Section 523 does not require a finding of malevolence or personal ill-will; all it requires is a showing of an intent to induce the creditor to rely and act on the misrepresentations in question."

The Court next considered the dishargeability of the debt for the principal of the broker-dealer. The Court noted that, under controlling U.S. Eighth Circuit jurisprudence, in order for an agent's fraud to be imputed to the principal, the creditor is required to show that the principal knew or should have known of the agent's fraud, or that the principal was recklessly indifferent to his agent's fraud.

The principal had argued that because Section 20(a) of the Securities and Exchange Act imposes liability based on mere negligence of the controlling person (*See, Drobbin v. Nicolet Instrument Corp.* 631 F. Supp. 860 (S.D.N.Y. 1986)), that nondischargeability under Section 523 cannot be based under 20(a) because Section 523 requires fraud. The Court dismissed the argument, holding that the fraud of the agent in itself was sufficient for nondischargeability under Section 523.

The principal also asserted that there were no reported cases finding nondischargeability under Section 523 on the basis of controlling person liability. The Court noted the lack of such precedent, but also noted that there was no contrary authority indicating that such a holding is impermissible.

New York District Court Dismisses Discrimination Action Against the NASD and the NYSE

In *Martens v. Smith Barney,* 1999 WL 1095343 (S.D.N.Y., 12/2/99, No. 96CIV3779), the Court responded to motions to dismiss by the NASD and the NYSE in a case involving statutory discrimination claims which challenged the securities industry's practice of requiring arbitration of these claims.

The Court dismissed the due process claims made against the NASD and the NYSE, finding that those two organizations exercise insufficient state action to trigger constitutional due process protections. The Court noted that any prior rulings as to the public/private nature of these entities is not controlling since the U.S. Second Circuit has held that a ruling that an exchange is private for a particulate purpose does not mean it is private for all purposes. (*See, United States v. Solomon,* 509 F. 2d 863 (2d Cir. 1975). Moreover, the Court stated that the U.S. Second Circuit had

recently found the NASD to be a private actor in a case virtually identical to the instant case and therefore ruled that the NASD and NYSE were not state actors. (*See, Desiderio v. NASD*, 191, F.3d 198 (2d Cir. 1999)*.*

The *Martens* Court also followed the *Desiderio* decision and held that the Title VII statute does not preclude mandatory arbitration of Title VII claims.

[Ed. Note: the NASD, with SEC approval, has amended its rules to remove the mandatory arbitration provision.]

RECENT NASD ARBITRATION AWARDS

Christine F. Goodis vs. Michael R. Miller, Timothy B. Gabriel and Summit Investment Group -- NASD Arb. No. 98-04716

Claimant alleged that she was an unsophisticated investor as that her account representative at Summit and her prior brokerage firms was defendant Miller. Claimant alleged that Miller sold stocks out of her IRA account without Claimant's authorization and purchased stock in Abacan Resources Corporation, a startup company exploring for oil in Nigeria. Claimant also alleged that Miller made another unauthorized purchase of stock in Osicom Technologies, and that both of these securities were speculative, volatile and unsuitable stocks for Claimant. Claimant also filed a claim against Gabriel, who was the president of Summit Investment Group. She claimed that Summit and Gabriel failed to maintain suitable and appropriate procedures to supervise the activities of Miller.

Claimant requested an award of $13,900.00, plus interest at 6% per year, attorneys fees, punitive damages and treble damages under the Pennsylvania Unfair Trade Practices and Consumer Protection Law.

Respondents claimed that Claimant had designated her investment objectives as long term growth and short term trading with a speculative risk level and that all transactions in the account were discussed with Claimant after reviewing the attendant risks.

The single arbitrator awarded Claimant $13,900.00, plus interest at 6%, and attorneys fees in the amount of $3,390.00. Claimant was represented by Karen A. Eriksen, Esq. of Pittsburg, Pennsylvania.

Hiram W. Jennings and Shirley Jennings vs. Financial Network Investment Corporation and John Brackett — NASD Arb. No. 98-02237

Claimants alleged that their investments objectives at all times, and in particular, including the six years prior to the filing of the original claim, had been conservative income and growth. Claimants further alleged that the disputes giving rise to their claim were based upon fraudulent misrepresentations made by the Respondent concerning the safety, liquidity and conservative structure of limited partnerships purchased by Claimants. Claimants alleged that the misrepresentations included fraudulent concealment of the partnerships' financial problems and ongoing concealment of the declining values of the partnerships and claimed losses based on the portion of Respondents' misconduct which occurred in the preceding six years which related to the concealment of the declining values in the investments. Claimants requested an award of $200,000.00 less distributions received, and reasonable expenses and punitive damages.

Respondents alleged that the claims made by Claimant were ineligible for arbitration pursuant to Rule 10304 and that the claims were further bared by the applicable statue of limitations.

The arbitration panel granted Respondents' Motion to Dismiss and determined that all claims by Claimants including the claims for punitive and compensatory damages should be dismissed after considering the evidence presented at an in-person pre-hearing conference. Claimant was represented by Scot D. Bernstein, Esq. of Sacramento, California.

Michael E. O'Kane vs. John Verga, Michael Iavarone, Michael Newman, Michael Accurso, Marshall Bernstein, Linda Bernstein and Maidstone Financial, Inc. — NASD Arb. No. 98-01206

Claimants asserted causes of action based on common law fraud, misrepresentation, breach of contract, breach of fiduciary duty, violations of the anti-fraud provisions of the Federal Securities Laws, failure to supervise and control person liability. Claimants requested compensatory damages in the amount of $1,250,000.00 and punitive damages of $500,000.00.

Respondents contended that Claimants had full knowledge of risk associated with their investment and

that Respondents acted in good faith. Respondents further alleged and that the Claimants' claims are bared due to comparative fault, lack of diligence and failure to mitigate damages.

The arbitration panel made an award against Michael Bernstein and Maidstone Financial, jointly and severely, in the amount of $175,000.00, plus interest at the legal rate of 9%. Claimants' claim for punitive damages and attorneys fees were denied. Claimants were represented by Stuart L. Melnick, Esq., New York, New York.

Thomas W. Arnett and Patricia E. Arnett vs. Texas Capital Securities, Inc. – NASD Arb. No. 97-03020

Claimants asserted causes of action of breach of contract, negligence, common law fraud, unsuitability, violations of federal and state securities laws and violations of the rules and regulations of the NASD and NYSE relating to the purchase of WRT Energy Corporation. Claimants requested compensatory damages of $334,000.00 and punitive damages of $500,000.00.

Respondent contended that Claimants had full knowledge of risk associated with their investment and that at all times they had complied with NASD rules of fair practice and all NYSE rules governing the conduct of securities brokers.

The arbitrators awarded the Claimants $123,000.00 in compensatory damages and $87,000.00 in attorneys fees. Claimants were represented by Charles W. Powell, Esq. of Houston, Texas.

Elliot Dufour and PaineWebber, Inc. vs. Merrill Lynch, Pierce, Fener and Smith — NASD Arb. No. 99-03823

Claimant contended that the restrictive convenient contained in Dufour's employment agreement with Merrill Lynch were unenforceable under Texas law because they were a covenant not to compete which failed to meet the requirements of Texas law and were in restraint of trade. Claimant further contended that the information used to contact Dufour's customer base did not constitute a trade secret or confidential information of Merrill Lynch under Texas law. Claimant requested injunctive relief against Merrill Lynch in unspecified compensatory damages.

Merrill Lynch contended that Claimant violated his employment agreement, Merrill Lynch's trade secret rights, and his duty of loyalty to Merrill Lynch by using and disclosing confidential and proprietary information regarding Merrill Lynch's customers.

The arbitration panel awarded a permanent injunctive relief against the Claimant incorporating all the terms of the Merrill Lynch financial consultant employment agreement which was signed by the Claimant. The permanent injunction was to run for a period of six months and excluded members of Claimant's family and any Merrill Lynch's customers whose accounts the Claimant had serviced prior to becoming a Merrill Lynch employee. The arbitrators also found in favor of Merrill Lynch, against PayneWebber, Inc., the Claimant's new employer, in the amount of $530,000.00 plus interest at 10%. Claimant was represented by Bradley Whalen, Esq. of Houston, Texas.

Philip Ellis vs. Advest, Inc. and Steven Rothman — NASD Arb. No. 97-06027

Claimant alleged that Respondents induced Claimant to make investments which were unsuitable and that Respondents churned the Claimant's account by recommending the purchase and sale of investments without regard to the interest of Claimant, in violation of SEC rule 10b-5 and Florida Statues Section 517.301.

Respondent Advest alleged that Claimant was a sophisticated investor who directed the size and character of his investments and that Claimant received confirmations on each trade and continued to execute transactions after receiving the confirmations, and that Claimant's dely in complaining and his failure to abide by the terms of the client agreement precluded him from attempting to reverse trades which he had authorized and approved.

The arbitration panel denied all of Claimant's claims, including Claimant's request for punitive damages and held that each party should bear their respective costs, including attorneys fees. Claimant was represented by Albert B. Lewis, Esq. of St. Petersburg, Florida.

James A. Fisher, et al. vs. Bear Stearns and Company, Steven Akerman, Barry Gaines, Mark Seruya and Stuart Weisbrot -- NASD Arb. No. 96-04997

The Claimants were 30 investors who sought to recover losses sustained through investment programs offered by Robert D. Schmidt and administered through Bear

Stearns. Mr. Schmidt had declared bankruptcy and was incarcerated as a result of his handling of Claimants' monies. Claimants asserted that investments were made, at least in part, as a result of the involvement of Bear Stearns and its agents Steven Akerman, Barry Gaines and Mark Seruya. Claimants alleged that Respondents made false representation and/or omitted to disclose material information to Claimants about Mr. Schmidt, the Schmidt entities LMJ and IMS, and investment programs known as RAFSA and PCP.

Respondents denied the liability on each of the claims and claim that their role in investments was of an administrative nature and that they did not have a relationship with the individual Claimants and therefore could not be held liable.

Claimants requested $11,800,000.00 in compensatory damages and $50,000,000.00 in punitive damages. The arbitration panel made an award for the individual clamants Claimants based on their individual losses. The total amount of the award was $1,470,000.00. Of that total, Bear Stearns was found jointly and severably liable to the Claimants for $1,052,000.00. Claimants were represented by Jeff Denise Ferentz, Esq. of Newport Beach, California.

Colin Ma vs. Global Strategy Group, Inc., Jamie Morrill, Robert Carlin, John Williams and First Southwest Company

Claimant asserted causes of action against his broker, Jamie Morrill, under federal securities laws and against Global Securities Group, Inc. under the theory of respondeat superior and a as a controlling person under federal securities laws. As to Robert Carlin, Claimant asserted a cause of action based on his being a controlling person under the federal securities laws. Claimant's claim related to the purchase of 53,000 shares of Advantage Life Products, Inc. Claimant requested compensatory damages of $100,000.00 and punitive damages of $300,000.00.

Respondents asserted that Claimant was a sophisticated investor who authorized and directed all the transactions in the account and ratified each of the transactions by failing to complain. Respondents further alleged that Claimant's claims are bared by applicable statues of limitations, that Claimant to mitigate his damages, and that Claimant assumed the risk of investing in the securities markets.

The arbitration panel awarded Claimant $93,625.00, plus interest against Jamie Morrill, Robert Carlin and Global Securities, Inc., and punitive damages against Jamie Morrill in the amount of $300,000.00, with each side to bear their own costs and expenses, including attorneys fees. Claimant was represented by Allen L. Reeves, Esq. of Fremont, California.

Lois R. McCann vs. Howard C. Rapp, Dominion Capital Corporation, Douglas W. Powell, and Charles Dewey Elliott – NASD Arb. No. 98-02062

Claimant alleged that Rapp, under the supervision of Elliott, Powell and Dominion, was not licensed to sell securities in Florida and that under the remedies set forth in Section 517.211 of the Florida Securities Statue, Claimant was entitled to recission, damages and interest. Claimant further contended that the securities sold by Rapp to Claimant were high risk investments and unsuitable for Claimant, who was a 65 year old widower with no securities experience. Claimant requested compensatory damages in the amount of $127,000.00 and punitive damages and attorneys fees.

Respondents alleged that the Respondent Rapp made no misrepresentations, omissions or unsuitable recommendations to the Claimant and that the Claimant was familiar with the risk, lack of liquidity and other features associated with the investments that she made.

The arbitration panel issued an award against Dominion *or any successor entity,* Powell and Rapp, jointly and severely, in the amount of $67,334.00, plus interest in the amount of $16,160.00,, and held that each party should bear their respective costs, including attorneys fees and expert witness fees. Claims against Respondent Elliott were dismissed. Claimant was represented by David L. McGee, Esq. of Pensacola, Florida.

Eugene Smith vs. Dean Witter Reynolds, Inc. – NASD Arb. No. 98-04757

Claimant alleged that Respondent's broker, Herb Mandell, engaged in a trading strategy of short term equity trading which resulted in heavy losses and over $100,000.00 in commissions. Claimant alleged that he transferred his IRA account shortly after taking retirement and had no prior investment experience and had expressed an interest in mutual funds. Claimant further contended that during this six year time that the account was open, the broker advised Claimant to undertake a short term trading strategy and never discouraged the Claimant from short term trading on his own initiative.

Respondent denied all the allegations of unsuitability and failure to supervise and alleged that Claimant's objectives were growth and that all trades were discussed and authorized by Claimant who was a knowledgeable, intelligent investor who actively monitored his account.

The arbitration panel awarded the Claimant the sum of $110,772.00, denied Claimants request for punitive damages, and held that each party shall bear their respective costs including attorneys fees. Claimant was represented by Sidney R. Barnett, Jr., Esq. of Atlanta, Georgia.

Roger M. Rowley vs. Heritage West Securities, Inc. and Martin L. Rising – NASD Arb. No. 98-04502

Claimant alleged his account was opened with Respondents as a discretionary account with Rising selecting the investments in the account. Claimants also alleged that Rising concentrated approximately $110,000.00, or half of the $200,000.00 account, into a single OTC Bulletin Board security known as Rosneftegazstroy Jsc, which was a highly speculative, Russian-based company. Claimant alleged that the investment was illiquid and plummeted in value a short time after it was purchased and Claimant suffered nearly a complete loss of his investment. Claimant also alleged that Respondents were negligent by using their discretionary authority to execute unsuitable investments in the account and churned the account. Claimants requested compensatory damages of $102,000.00 and punitive damages of $100,000.00.

Respondents contended that Claimant opened a discretionary account for the express purpose of which was for speculation, and that the Claimant represented himself to be a high net worth, high income individual who was interested in aggressive trading, that there were four transactions involving the stock issue, and that during the time frame of the purchases, the value had increased.

The arbitration panel denied the claim against both Respondents and held that each party should bear their own expenses. Claimant was represented by Robert D. Mitchell, Esq. of Phoenix, Arizona.

Josef A. Blatstein vs. GNK Securities Corporation and John Glen Flanagan -- NASD Arb. No. 98-02628

Claimant alleged that he was a seventy-eight year old retiree living on a fixed income and had limited education and command of the English language. Claimant further alleged that, at the recommendation of Flanagan, he purchased several stocks including Diana Corporation, Source Media, Organogonesis and Healthdyne; all stocks which were recommended by GKN and were highly speculative and volatile and not in keeping with the Claimant's investment objectives. Claimant requested compensatory damages in the amount of $179,855.00 plus punitive damages and attorneys fees.

Respondents alleged that the ten transactions executed in Claimant's account were suitable based on the information provided by the Claimant to branch manager; that the Claimant had indicated that he had vast experience in active short term margin trading of stocks and options; that many of the transactions that Claimant alleged were authorized were actually executed on an unsolicited basis; and that the Claimant had purchased the Diana stock at other brokerage firms on an unsolicited basis including unsolicited purchase on the same day as the alleged unauthorized transaction.

The arbitration panel awarded the Claimant compensatory damages in the amount of $49,664.00, jointly and severely against the Respondents, and denied Claimants request for punitive damages, interest and attorneys fees. The Claimant was represented by Kenneth S. Sandler, Esq., of Hollywood, Florida.

Norman E. Anderson vs. West America Securities Corporation and Lawrence Joseph Salice – NASD Arb. No. 98-03269

Claimant alleged that he received a cold call from former broker Salice who told Claimant that he was a broker with Royce Securities, Inc. claimant further alleges that Salice then told Claimant he was leaving Royce and going to work for the Respondent. Salice then solicited Claimant's purchase of 188,500 shares of Hollywood Productions, Inc. warrants. Claimant further contended that at the time of the solicitations were made Salice was not licensed to sell securities in the State of Florida. Claimant requested compensatory damages of $117,800.00 and interest and expenses of the arbitration.

Respondent West America denied the allegations and contended that it had no knowledge of any contact Claimant may have had with Salice and that Claimant represented himself as having a net forth of more than $5,000,000.00 and a yearly income of $250,000.00 and had investment objectives of growth and speculation and previous investment experience.

The arbitration panel awarded $112,560.00, jointly and severely, plus interest in the amount of $23,564.00. Claimants request for costs and expenses and other relief were denied. The Claimant was represented by Robert H. Rex, Esq., Boca Raton, Florida.

Guidelines for Use of the PIABA List-Serves – *As Adopted by PIABA Board of Directors-- December, 1999*

Note: The PIABA Board of Directors adopted the following *Guidelines for Use of the PIABA List-Serves* in December, 1999. The *Guidelines* were mailed to each PIABA member in January, 2000, with the *Affidavit of Membership Qualifications and PIABA List-Serve Guidelines Agreement*. The Board encourages each member to read and study the Guidelines. If you have not completed the *Affidavit*, please do so and return to the PIABA Office as soon as possible.

0. What is a "list-serve"? A list-serve is a list of email addresses. Think of it as a single address that acts as shorthand for a long list. If you send an email message to the list-serve address, your email will be received by everyone on the list -- in the case of PIABA's main list-serve, hundreds of PIABA members. Please note that many but not all PIABA members are on the list-serve. PIABA members are free to remove themselves from any PIABA list-serve at any time.

While not all PIABA members are on the list-serve, **only** PIABA members should be on it. Moreover, only PIABA members should be given access to information contained or exchanged on the list-serve. Use of the list-serve by non-members of PIABA is unauthorized. Like other list-serve problems, unauthorized use of the list-serve should be reported to PIABA at the following email address: **piabalaw@aol.com**.

A list-serve is a powerful tool. As with other power tools, however, careless use of the list-serve can result in injury to you (or your clients) and inconvenience to your friends and neighbors. We are providing these guidelines in the hope that they will assist you in avoiding some of the potential pitfalls associated with use of list-serves and enable us to operate the PIABA list-serves more effectively.

1. Restrictions on Use. You are not permitted to use any PIABA list-serve to advance or defend the interests of any broker-dealer, associated person or other securities industry participant in any controversy or dispute with a customer or investor. Thus, for example, if you are defending a stockbroker or broker-dealer against a customer claim, you may not send inquiries regarding that matter to any PIABA list-serve. You may not forward or publish PIABA list serve correspondence to a person or firm who is involved in a defense case that involves the subject matter or contents of the correspondence. By using any list serve you agree that violations of these restrictions on use subject you to liquidated damages of $10,000.

Other uses are permitted. For example, if you are representing a registered representative in an employment controversy with a broker-dealer, you may inquire about your list of possible arbitrators. If you represent a general contractor in an arbitration with a real estate developer at the American Arbitration Association, you may post an email inquiry about the arbitrators proposed by AAA. The only excluded category is the representation of securities industry participants against customers or investors. ***Violation of these restrictions can lead to the revocation of your access to the PIABA list-serves and/or your expulsion from PIABA.***

Whenever you send an email to any PIABA list-serve, you must specify the capacity in which you are writing. There is only one exception to this disclosure requirement: a case in which you represent a public customer in a dispute with a broker-dealer, registered representative, associated person or other securities industry participant. Thus, if you represent a franchisee in a AAA arbitration against a franchisor, you are required to say so in your email. If you represent a broker-dealer in a clearing controversy against another broker-dealer, you are required to disclose that as well. If you make no disclosure, your silence will be taken as an affirmative representation that you represent a public customer in a broker-customer dispute. ***Making a false representation regarding your role -- whether you do so overtly or through silence -- is grounds for revocation of your access to the PIABA list-serves and/or your expulsion from PIABA.***

2. Loose Lips Sink Ships. Spies are among us. Remember, PIABA's membership includes some attorneys who do limited amounts of securities industry defense work.

Don't write something in email to the hundreds of people on the list-serve (who, in turn, might forward your writings to many more) unless you are willing to have it waved around at the hearing by opposing counsel. Similarly, don't write something that is going to get you sued for defamation. Given the large number of participants, you must assume that the restrictions on the use of PIABA's list-serve will be violated from time to time. **Think very carefully about the possible ramifications of what you write.**

> **Example:** Suppose you write that you are handling a case on behalf of a sophisticated claimant against ABC broker-dealer, and that your email works its way into the hands of ABC's defense counsel. Even if you don't provide the name of your client, the email could come back to haunt you. For example, if the case you described in your email is your only case against ABC, you can expect ABC to point that out, leading to an inference that the claimant sitting next to you is the sophisticated investor you described in your email. So you shouldn't say your client is sophisticated unless you are certain that you will want to take that position at the hearing, in settlement discussions, and so on.

3. Save us time by using the subject line. The list-serve generates a lot of email. This will grow as PIABA grows. We all want to get through our email as efficiently as possible. The following guidelines may help.

a. Inquiries about arbitrators. If you are inquiring about New York arbitrators, say so on the subject line. That way, members who know nothing about New York arbitrators won't have to spend time opening and reading your email.

b. Inquiries about broker-dealers and representatives. Try to fit the names on the subject line if possible. If there are too many, you may want to close the subject line with "etc." so that readers will know that there are more names in the text of your email.

c. Inquiries about specific experts, issuers, securities, and so on. Same as broker-dealers and representatives. See 3b, above.

d. Replies to sub-lists. If you are replying to an email sent to one of PIABA's various specialized sub-lists, it will help immensely if you identify the email to which you are replying. (Please do so on the subject line.) Otherwise, it may not be clear which email you are responding to. See 6b for a more complete explanation of this phenomenon.

4. Make it easy for us to read. Lists of arbitrators are far easier to read if they are arranged in list form rather than paragraph form. Likewise lists of broker-dealers, representatives, experts, issuers, securities, and the like. Making your email easy to read will save us all time and probably will get you more replies.

5. Make it easy for our computers to read. Ideally, attachments ought to capable of being opened in Word or WordPerfect. Where that is not possible, you should say what software will be necessary to open them.

6. Where do replies go?

a. General rule -- the primary list-serve and regional sub-lists. If you are reading an email message that has been sent to the entire PIABA list-serve (piaba-list@piaba.org) or to one of the regional sub-lists (*e.g.*, piaba-california@piaba.org), and you only click on "reply," your reply will go only to the sender of the email to which you are replying. (While this sometimes is called a "private reply," ***remember that email is never as secure as a telephone call.***) If you think your reply will be of interest to the entire membership, and you want to send us all a copy, you will need to include the address of the main list-serve (piaba-list@piaba.org) in either of two places on your screen: the "address" or "send to" box; or the "cc" or "copy to" box.

b. Exception -- the specialized sub-lists. On the other hand, if you are reading an email message that has been sent to one of PIABA's several specialized sub-lists, and you click on "reply," ***your reply automatically will go to everyone on that specialized sub-list. PIABA's various committee list-serves*** (*e.g*, PIABA's NASD Rulemaking and Federal Legislation Committee list-serve, "fed-leg@piaba.org") ***all work this way.***

If you want to reply privately in this latter situation (*i.e.*, to the sender only, and perhaps to other selected people), you will need to delete the address of the specialized sub-list from the "address" or "send to" box in your reply and insert only those email addresses to which you intend to send your email.

Conversely, if you want your reply to go to the entire sub-list, it will help the others on that list follow the action if you tell everyone which email you're responding to. Ideally, you should use the subject line for that purpose. For example, if you're responding to Jake Javitz's October 14 e-mail to the annual meeting committee list-serve, say

"Response to Jake Javitz's 10/14/99 email," or words to that effect, on the subject line. Alternatively, and at the very least, you should include a salutation (*e.g.*, "Hi, Jake") at the beginning of your email, so that the other readers won't have to guess what's going on. Taking either of these steps will help prevent the unidentified email problem. *See also* 3d.

DISCLAIMER AND IMPORTANT WORDS OF CAUTION

The Public Investors Arbitration Bar Association ("PIABA") provides this and other list-serves for the convenience of its members. PIABA has no obligation to continue to provide this service to any member or to the membership generally. PIABA reserves the right to discontinue this service completely and/or to exclude any person from any list-serve at any time without notice for violating the restrictions on use set forth above or for any other reason. PIABA does not censor, edit, or exercise any other control over the content of emails sent to the list-serve; nor is there any way of preventing an email sent to the list-serve from being forwarded to persons outside of the list-serve. PIABA can give no assurance that e-mails sent to the list-serve will be received or read by others on the list-serve. List-serve users are cautioned that the list-serve is not a confidential communication, and that communications sent to the list-serve may find their way into the hands of opposing parties and their counsel.

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James E. Beckley
Memorial Service

will be held on Saturday,
February 26th at 3:00 p.m.

Quigley Preparatory Seminary
103 East Chestnut
Chicago, IL 606011

"His Majesties' Clerkes"
will perform in honor
of Jim's request

Quigley Seminary is located
one block west of the
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Donations can be made to

In His Steps Ministries
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