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Letter From The President
Mark E. Maddox, MADDOX KOELLER HARGETT & CARUSO, Indianapolis, IN

Dear Friends:

I never expected to be composing this letter to you as the PIABA president. I had hoped that my last letter to you in the Fall of '99 would have been the last one for a long time. Unfortunately, events of the past year have required my return to head this organization that I love so much.

As we get ready to come together in October for our Fall Conference in San Antonio, I am experiencing many different emotions, some of which I'd like to share with you. First, I can't help but think that this Fall Conference was supposed to be Jim Beckley's year. Jim should be the one cracking the gavel at our Business meeting, and presiding over all the festivities. Although I remain saddened by his loss, I know that a spirit as irrepressible as Jim's will be with us always, particularly in San Antonio.

In honor of Jim, PIABA has created the James E. Beckley Award, and the first recipient of this Award will be honored in San Antonio. When we left Palm Desert last October, I believed that PIABA was in the best shape ever and had just finished one of its best years. Membership was at an all-time high, finances were as good as ever, we increased our respect with the media, NASD, SEC, Congress and GAO, and we had a very successful Fall Conference. Jim Beckley was taking the reigns of a hard-charging freight train.

The past year was something none of us could have predicted. Losing Jim early Christmas morning sort of set the tone for the whole year. Our great Board definitely made some mistakes, and for those I apologize. Although we eventually got things back on track, we did not put our collective talents to the best use, and we asked people to take on challenges for which they were not suited. I will commit to you that in my next 2 years (and probably last 2 years) on the Board, I will try to do better. The entire Board must do better.

And this brings us to the very important Board elections that will be conducted in San Antonio. Eight out of the fifteen Board seats are up, and already eleven outstanding members have been slated to compete. As I look at the field for people I will be serving with on our Board, I'm looking for the following characteristics: 1) People who have done enough and are still doing customer cases, and have an advanced understanding of the process; 2) People who have already shown a willingness to dedicate their time and do things for the organization; and, 3) People who play well with others, listen to other views, and that communicate their positions clearly and persuasively.

As we head into PIABA's first contested elections, I want to once again caution all candidates and members to try and keep the debates on the highest possible ground. If you choose to use the list-serve, please identify all such communications as "Campaign Literature." Please try to keep all messages positive and avoid personal or other attacks on any candidate. It should be very interesting to watch us go through this new experience.

As we look to the next year for PIABA, I am very pleased to be handing the reigns to my good friend Seth Lipner. Since the birth of PIABA, noone has done more for the organization, dedicated more time, or been such a tireless advocate for the public investor. As a former president of PIABA (and trusted advisor to others), he knows what this job requires and is willing to make the time to achieve his agenda. Seth is our best chance of leading PIABA to its full potential in 2001.

This past year has caused me to realize how precious and important life can be. In addition to losing Jim, I also lost my Father in July. These experiences have taught me to really enjoy the times I spend with friends and loved ones. San Antonio will be one of those special times. If you know of current or former PIABA members who you'd like to see in October, give them a call and make sure they are coming. See you in Texas!

Warmest Regards,
Mark E. Maddox

FROM THE PROFESSOR
Joseph C. Long, Professor of Law
University of Oklahoma

It is good to be back at the old stand again. This issue's topic is viatical settlement contracts. Viatical settlement contracts have been around for at least five years.[1] However, they are apparently just now beginning to be the subject of private civil litigation and arbitration.

The first step in our analysis is to understand what viatical settlements[2] and viatical settlement contracts are. A person who is terminally ill, usually with either AIDS or cancer, has an insurance policy on his or her life.[3] If the insured has no family or close relatives or friends he or she wishes to provide for, the money from the insurance policy will go into his or her estate. In such cases, the insured would rather enjoy the proceeds of the policy during his or her lifetime. This can be done by selling the right to receive the proceeds of the policy, upon the death of the insured, discounted to its present value.[4] This agreement is a viatical settlement.

The normal practice is for the insured, often through an agent, to approach a broker of such settlements like Life Partners, Inc.("LP"), Accredited Benefit Corporation ("ABC"), or Mutual Benefit Corporation ("MBC"), and negotiate the sale or auction of the underlying insurance contract. Depending upon the life expectancy of the insured, he may be able to realize somewhere between 50 and 70 percent of the face value of the policy. The broker then will re-sell the policy to investors.[5] The whole policy can be sold, or the broker can fractionalize the policy and sell interests to a number of investors.[6]

It is important to understand that the **viatical settlement itself is not a security.** Nor is it an insurance contract. Only the underlying contract is an insurance policy. As a result, the initial sale by the insured to the viatical broker, creating the viatical settlement, was originally unregulated. However, states, usually through the state insurance commissioner, are increasingly regulating this original sales process, to attempt to see that the insured gets a fair price for his or her policy.

As far as securities law goes, as noted above, it is **not** the viatical settlements themselves which are the securities. The viatical settlements are merely the investment vehicle employed as the orange grove land in ***SEC v. W.J. Howey Co***.[7] was. **The security here is the agreement the broker, such as ABC, enters into with the ultimate investor. This agreement, referred to as the viatical settlement contract,** to distinguish it from the underlying viatical settlement, **may be a security[8] in the form of an investment contract**.[9]

I. TYPES OF VIATICAL SETTLEMENT CONTRACTS BEING SOLD

There are four types of viatical settlement contracts[10] being offered. The differences lie in whether the settlements are fractionalized or sold whole and when the management services are performed,[11] either before or after the investor's investment.

If the viatical settlement is fractionalized and the viatical broker performs the evaluation and selection process **after** the investor delivers his money, as will be seen below, there is little question that the viatical settlement contract should be held to be a security. If on the other hand, the viatical settlement is fractionalized, but the broker's services are performed **before** the investor invests, the viatical settlement contract should be found to be a security. But, as will be seen below, there is authority from one federal Court of Appeals to the contrary.[12]

If the viatical settlement is not fractionalized and the evaluation and selection process is done **after** investment, as will be seen below, the viatical settlement contract, in a majority of jurisdictions, will be found to be investment contracts.

Finally, if the viatical settlement is sold as a whole and the viatical broker performs its evaluation and selection services **before** investment, i.e. the investor is allotted a viatical settlement from the broker's inventory, the settlement contract should be held to be an investment contract. However, for reasons outlined below, this will be the toughest type of settlement contract to establish as a security.

II. VIATICAL SETTLEMENT AGREEMENTS AS INVESTMENT CONTRACTS

The ***Howey*** test, later slightly changed and restated in ***United Housing Foundation, Inc. v. Forman***, reads:

> [An investment contract is] the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.[13]

This test has also been adopted for use under most state Securities Acts.[14]

The ***Howey*** test requires the showing of four elements. First, there must be an investment of money. Second, this investment must be in a common enterprise. Third, this investment must be induced by the investor's expectation of receiving some profit upon his investment. Finally, this profit has to be generated solely or substantially through the efforts of others and not by the investors' own efforts.[15]

1. Investment of Money.

Viatical settlement contracts met the first element of the ***Howey*** test.[16] It is now clear that the investment does not have to be in money. Instead it can be in the form of any bargained for consideration.[17] Thus, the investment can be in goods or services as well as money.[18] All viatical settlement brokers require the ultimate buyer to pay money as part of the viatical settlement contract. For example, ABC requires a minimum investment of $5,000 in its Retail Purchase program and $250,000 in its Wholesale Purchase program. ABC refers throughout it sales literature as these purchases being "an investment."

2. Common Enterprise.

The federal courts are closely divided upon the proper meaning of the concept of common enterprise.[19]

A. The Horizontal Test.

The Seventh Circuit beginning with the decision in ***Milnark v. M-S Commodities, Inc.***,[20] has championed what has come to be known as the horizontal concept of common enterprise. Under this theory, there must be multiple investors, a single investor will not suffice, and the funds received from these investors must be pooled in a common fund or enterprise under the management and control of the seller-promoter or some third person.

Applying this to viatical settlement contracts, it is clear that where the viatical broker fractionalizes the viatical settlements, selling interests to a number of investors, this common enterprise test is met. This test can also be met where the viatical broker retains a fractional interest in the viatical settlement for itself, even if the remainder of the viatical settlement is sold to a single investor.

However, this horizontal test for common enterprise will **not** be met in the case where the viatical broker does not fractionalize the viatical settlement and only acts as the agent of the investor to purchase the settlement.

B. The Board Vertical Test.

The Fifth and Ninth Circuits, among others, on the other hand, have specifically rejected this horizontal concept in favor of what has been referred to as the "broad vertical theory" of common enterprise.[21] The most common formulation of this test is that the "fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or third parties."[22] The Fifth Circuit further refined this test in ***Long v. Schultz Cattle Co.***, saying:

> While our standard requires interdependence between the investors and the promoter, it does not define that interdependence narrowly in terms of shared profits or losses. Rather, the necessary interdependence may be demonstrated by the investors' collective reliance on the promoter's expertise even where the promoter receives only a flat fee or commission rather than a share in the profits of the venture.[23]

This theory properly applied requires nothing more than two people, one, the investor, and the other, the seller-promoter, joining together to accomplish a common goal. This goal may be nothing more than the selling of goods for the mutual profit of both.[24] Or the goal may simply be the making of a profit solely for the investor.[25]

Applying this test to viatical settlement contracts, it should be apparent that this test will be met in the case of all viatical settlement contracts. It will be met in those cases where the viatical broker fractionalizes the viatical settlements because the investors are still dependent upon the broker to reach the common goal, even though there are also a number of other investors. Likewise, it will be met where the broker sells the entire viatical settlement contract to the investor. Again, the investor is still dependent upon the broker to accomplish their common goal, making money for the investor. It does not matter here whether the viatical broker makes his profit from the mark-up of the viatical settlement or as a commission for acting as the investor's agent in locating, selecting, and buying the viatical settlement for the investor.

C. The "Narrow" Vertical Enterprise Test.

The Ninth Circuit has unduly restricted the applications of the vertical common enterprise theory by further requiring the seller-promoter to share in the profits generated by the common enterprise.[26] This further restriction is inappropriate because the term used is "common enterprise", not the more specific terms "joint enterprise or joint venture." These latter terms clearly connote a sharing of profits. However, the more general term "common enterprise" signifies nothing more than two or more persons joining together to accomplish a common goal.

This restriction by the Ninth Circuit improperly eliminates from the coverage of investment contracts those situations where the seller-promoter acts as the investor's agent in performing the efforts necessary to accomplish the common goal and is compensated by the payment of a salary or commission for his efforts as in the case of discretionary trading accounts.[27]

As a result, those viatical settlement contracts where the broker sells the entire viatical settlement to a single purchaser will not qualify as an investment contract under this test for common enterprise. The viatical broker makes its profit from the mark-up of the viatical settlement or from a commission paid by the investor . He does not share in the profits to be generated by the payment of the death benefit under the underlying insurance policy.

3. Expectation of Profit.[28]

The third element of the ***Howey*** test is an expectation of profit. It should be noted that there only need be an **expectation** of a profit, not that the profit actually be received. In the case of a few viatical settlement contracts, contrary to most investment contract investments, this expectation will often be realized. In those few cases where the viatical settlement calls for the investor's name to be actually entered as the beneficiary under the underlying insurance contract, the investor will actually receive his profit upon the death of the investor. In these cases, if there is a problem, it lies in the fact that the investor does not get his profit within the promised time.[29]

Unfortunately, most viatical settlement contracts do not provide for the investor to be named as the beneficiary under the underlying insurance policy. The viatical broker or an escrow agent, usually affiliated with the broker, is normally designated as the beneficiary. In such case, the money will be paid, but the viatical broker or escrow agent, who may or may not pay it to the investor.

The concept of profit, at the federal level at least, has come to be restricted to a capital gain on the investment or money paid for the use of that investment in the form of interest or dividends.[30] This restriction has not been accepted by many states which continue to use a broader form of "profits" which encompasses any benefit which the investor has bargained for.[31]

There is no dispute that either test for "profit" is satisfied in the case of viatical settlement contracts. The investor is motivated to make his investment in a viatical settlement contract on the basis that he will receive a return on his investment. That profit is the difference between what he paid for the viatical settlement or his fractional interest therein and the death benefit, or fraction thereof, received.

The viatical brokers certainly induct this expectation as a part of their sales pitch. For example, ABC's sales literature constantly refers to the profit which will be received between the purchase price of the viatical settlement and the death benefit which is to be received on the insurance contract. This shows both an expectation and a profit. As the court said in ***Probst v. State****:* "It does not make common sense that a person would give away $100,000. An investment should presume an expected return or profit, although one is not guaranteed."[32]

4. Through the Efforts of Others.

The last element of the ***Howey*** test is that the profit be through the efforts of others.[33] Over the years there have been two important changes in the original ***Howey*** formulation of this fourth element, the efforts of others.

First, it has now become clear that the courts will look only to the management efforts of the investor and not any physical efforts which he is required to perform and which will not affect the outcome of his investment.[34] Second, the courts have departed from a strict reading of the "solely" requirement and modified the test to read "substantially" through the efforts of others.[35] The Ninth Circuit in the ***Turner*** case summarized these changes and restated the test to be "whether the efforts made by those other than the investor are the undeniably significant ones, those essential management efforts which affect the failure or success of the enterprise."[36]

One problem which the courts have yet to adequately discuss is what type of efforts will qualify. In my treatise, I have analyzed the cases and found that there are five different categories of efforts.[37] This approach has been accepted by a number of courts and state securities agencies.[38]

My third category is the relevant category here. In this category, the manager uses his special expertise to select items in which the investor will invest. The best example of this category is the registered representative in a discretionary account case.[39] He uses his expertise and knowledge of the market to select those securities or commodities which he will purchase for the investor in the same way an expert may use his expertise to select particular scotch whiskeys, stamps, coins, or diamonds.[40]

Here, the profit will normally come from the sale of the selected property to third parties rather than from the promoter. However, it is only because the promoter has used his expertise in selecting the item that the investor is able to realize this profit, as the investor does not possess the expertise to make the selection for himself.

The viatical settlement contracts fit clearly within this third category. We will use ABC as an example. The ABC sales literature outlines the process of buying viatical settlements and lists the various services that ABC will provide the investor through its viatical settlement contract. This literature indicates that there are a number of major things which must be done in connection with a viatical settlement contract investment.

First, once the insured's agent indicates that the insured or viator is willing to sell the policy, the viatical settlement broker must evaluate the medical records and confirm the estimated life expectancy. ABC, in its sales literature,[41] refers to this as "medical underwriting". ABC stresses the importance of this function. It indicates that many viatical companies underestimate this life expectancy. This underestimation results in the investor not receiving his return until a date later than the medical estimate of the insured's death. This delay, in turn, causes a lower **annual** return on the viatical settlement contract investment. This evaluation requires the employment of specialized medical skills which the investor certainly does not possess. Nor could he make the evaluation if he wanted to because he does not receive either the name or medical records of the person whose policy he purchases a fractional interest in.

Second, ABC indicates that it also must do "legal underwriting" on the prospective policy. This means that it must determine the policy is in good standing with the insurer, the premiums are current, that the policy is non-contestable, and written by an insurance company which meets ABC's rating requirements. Again, the investor does not have the skill or access to perform this function for himself.

Third, ABC indicates that it has to negotiate the actual purchase of the viatical settlement itself. This requires specialized knowledge of what policies are available and what price should be bid to secure the viatical settlement for the investor. Again. the investor lacks the information or skills to perform this function for himself.

Fourth, ABC indicates that it also has to perform certain post-purchase "policy functions maintenance functions such as premium payment, value-retention and value added services..." Maintaining the policy current by the payment of necessary premiums obviously is a key to recovering the death benefit it provides. Again, ABC sets aside a portion of the investor's original payment in an escrow account to provide the funds. The investor can not do this because he does not have access to the escrow account or the information as to when the policy payments are due.

Fifth, ABC indicates that, if the policy is contested by the insurance company, it will handle the legal defense.

Sixth, ABC indicates that it continues to "track" the viator's medical status under an agreement to release new and additional confidential medical information.

And finally, ABC files for the death benefit with the insurance company. Again, the investor does not have either the access or skill to perform these functions.

It is obvious from this list of major functions that must be performed by the viatical broker in order to make a viatical settlement contract work that the investors are entirely totally passive. They never have any contact with the patient whose policy they buy. They do not even select which viatical settlement they purchase interest in. This is done by ABC. They do not have access to the medical history of the person at any time. No investor has ever attempted to evaluate the medical information for himself. Instead, they rely upon ABC to secure the preliminary information about persons who are willing to sell all or part of their policy by entering into a viatical settlement.

ABC represents that it has expertise to evaluate this information and select suitable policies and patients for investment. It establishes the medical and other underwriting criteria for accepting the settlements and screens the applicants to see that these criteria are met. It does this by making an independent verification of the information supplied by the applicant or contact agent. The investors rely upon ABC to determine that the person and the policy meet these underwriting criteria.

Further, the investor is relying solely upon ABC determination of the life expectancy of the patient which determines the amount of his return on the settlement. The investor makes no independent verification of the patient information or whether her or she or the policy meets the underwriting criteria.

ABC then actually enters into the viatical settlement for the investor. As a part of this process, ABC secures a certificate of mental competency of the patient selling the policy. The money from the investors goes into a escrow account, and the escrow agent normally holds the title to the policy for the one or more investors.

Finally, ABC tracks the patients and notifies the investor upon the death of the patient. The trustee secures the death certificate necessary to file the claim on the policy, and then files the death claim with the insurance company to collect on the policy. Finally, the trustee sends the investor a check for the proceeds of the policy.

Again, these facts show that the investor is entirely passive, relying solely upon ABC. Without ABC, the investor could not participate in this investment medium. They do not have the knowledge of expertise to do so. They are entirely dependent upon the knowledge and expertise of ABC.[42]

Further, it is clear that ABC is running and administering the entire investment and settlement process. Without them, the whole scheme would fail. This is sufficient to meet the efforts test.[43] It is also very revealing that ABC, in its sales literature, outlines why an investor in viatical settlements does not want to perform the management efforts for themselves.

Applying this analysis to viatical settlements more generally, there should be little question that the last element of the ***Howey*** test is met where the viatical broker performs all these management services **after the investor makes his investment**. Many viatical settlement brokers wait until after the investor deposits his money in the escrow account before they go through the process of locating, evaluating, and buying viatical settlement agreements. Once the agreements are acquired, they are then fractionalized and allocated to individual investors according to the amount invested. These companies are clearly selling investment contracts.

However, other companies, including ABC, claim to maintain an inventory of viatical settlements, but will sometimes acquire new settlements to fit a particular customer's requirements.[44] In such case, they too are selling investment contracts.

The final category is those companies, like ***Life Partners***, which claim to always supply the viatical settlements from their pre-existing inventory. They claim that they are not selling investment contracts because all the significant management efforts have been completed by the time that the investor buys his settlement contract.

In a decision which surprised most securities regulators, ***Life Partners*** was able to convince the federal Court of Appeals for the District of Columbia Circuit in ***SEC v. Life Partners, Inc.***,[45] that this position was correct. Reversing the lower court, the D.C. Circuit held that LP's viatical settlement contracts were not investment contracts or securities.

The decision in ***Life Partners*** rests on two conclusions, one legal and one factual. The legal conclusion is that pre-purchase efforts done by companies like LP and ABC can not be considered at all, or only in conjunction with significant post-purchase efforts to determine whether the fourth element of the ***Howey*** test has been met. The factual conclusion is that the post-purchase efforts done by ***Life Partners*** were not significant management efforts.

It remains to be seen whether other state and federal courts and arbitrators will follow ***Life Partners***. They are clearly not bound to follow the ***Life Partners*** decision. It is persuasive authority at best, and its acceptance or rejection should be based upon the reasoning and logic it contains. The state securities agencies generally have not followed ***Life Partners.***[46]

In my opinion, the other courts and arbitrators should likewise reject it. Both the factual and legal conclusions on which the decision is based simply do not stand close scrutiny.[47]

The legal conclusion that pre-purchase efforts can not be considered is simply not persuasive. Why should pre-purchase efforts be excluded, while post-purchase efforts be considered? "Securitiness" depends upon whether the investor is passive, depending upon the efforts of others to achieve the return on his investment, not when the third party performs these management efforts. Further, the cases cited by the court in ***Life Partners*** to support its conclusion do not support the elimination of pre-purchase efforts. Nor can support for this position be found in any other earlier cases. The D.C. Circuit created this legal position from whole new cloth.

From a factual standpoint, the ***Life Partners*** decision is also simply wrong. The post-purchase efforts done by ***Life Partners*** were significant managerial efforts.[48] The investor will not realize his investment unless the viatical broker continues to pay the premium payments to keep the policy current. Second, he will not receive his return unless the viatical settlement broker successfully defends any contest action by the insurance company. Finally, the investor will not receive his return unless the broker, or someone on his behalf, files the death claim. In my opinion, the doing of these tasks are undeniably the performance of significant managerial efforts.

III. THE VIOLATION OF WHAT STATUTE TO ALLEGE AND WHOM TO SUE

The final two questions that must be considered are under what statute should the violation be alleged and who are the candidates to be sued.

The most common allegation will be the sale of an unregistered security. It would be appropriate to couple an anti-fraud allegation, if the investor has been misled or lied to. It is my opinion that the allegation should be laid under the state securities acts rather than the federal Securities Act of 1933. I believe that viatical settlement contracts are more apt to be held securities under the state statute than under the Federal Act because of the ***Life Partners*** decision.

As to who to sue, it should be obvious that the viatical broker which issues the viatical settlement contract is the primary target.[49] However, with the exception of the "big three", LP, ABC, and MBC, most of the companies are in bankruptcy and out of business. Further, it may be difficult to force the viatical broker into arbitration as most are not registered broker-dealers. If any of the big three are sued, expect that they will defend vigorously.

The next obvious person to sue, is the local representative who actually sold your investor his or her viatical settlement contract.[50] Again, under state law, this person is a "seller"[51] If this person is a registered representative, rather than an insurance agent or financial planner, then arbitration should be possible. However, these sales people often have limited resources.

The deepest pocket available is probably the broker-dealer who employed the registered representative. Certainly this broker-dealer may be forced to arbitrate. The case will have to be treated as a "selling away" case.[52] As under the federal acts, most state securities acts impose liability on "control persons".[53] A broker-dealer is a control person of its registered representatives **as a matter of law.**[54] The fact that the registered representative is probably not within the scope of his authority is irrelevant under control person liability.

It may also be alleged that the broker-dealer is a "seller"[55] who is primarily liable under the theory of respondeat superior. This theory will work well when there are anti-fraud allegations because the broker-dealer's liability for white collar torts such as fraud extends to agents as well as servants and to acts done outside the scope of the agent's employment.[56]

ENDNOTES

1. For a more detailed discussion of this area, see my earlier discussions of viatical settlements in 12 Joseph C. Long, Blue Sky Law §2A.02, "Investment Contracts-Viatical Settlements" (2000); Joseph C. Long, "Viatical Settlements As Securities: A Murky Area of Securities Law Begins to Clear, Parts I and II," 1998 Ohio Sec. Bul. (Nos. 2 and 3 1998); and Joseph C. Long, "The Anatomy of an Investment Contract," 1997 Enforcement Law Reporter (NASAA) 147.

2. An excellent source of general information in the area of viatical settlements is Gloria Grening Wolk, ***Viatical Settlements, An Investor's Guide*** (1998). Ms. Wolk, not a lawyer, is also very knowledgeable about viatical brokers and their continued existence and financial viability. She also has a large store of information about their contracts and practices as well as information about suits against the brokers and the attorneys bringing them. She serves as a clearing house for such information and maintains a web page. She can be reached at GGWOLK@viatical-expert.net.

3. Today, people do not have to be terminally ill to enter into viatical settlement agreements. All that is required is that a person have an insurance policy on his or her life and a desire to presently recognize the current value of that policy. The obvious problem with such settlement contracts is the difficulty of valuing the settlement agreement. The value of the settlement agreement is largely dependent upon the life expectancy of the insured. In the case of a person with AIDS or cancer, medical specialists can make a reasonably accurate estimate of the insured life expectancy. However, in the case of a healthy person, the only basis would appear to be the standard life expectancy tables. Since these tables are based upon statistics rather than medical evaluation, they are not much help in predicting the life expectancy of a particular individual.

4. The same type of thing is now being done in the case of lottery winners and recipients of structured settlements. These people want their money in a lump sum presently rather than receiving it in installments over a period of years.

5. The viatical broker makes its profits on the mark-up of the settlement agreement from the price paid the insured to the price paid by the investor. Thus, if the viatical broker buys the policy for 50 percent of the face value of the underlying policy, it will then re-sell it, coupled with the viatical settlement contract, at 60 percent or more to the ultimate investor.

6. In some cases, the viatical broker will retain an interest in the viatical settlement sold to the ultimate investors. Such retention is significant for securities classification because it will establish "narrow vertical" common enterprise used by some courts under the ***Howey*** test to determine the existence of an investment contract. ***SEC v. W. J. Howey Co.***, 328 U.S. 293 (1946).

7. 328 U.S. 293 (1946). In the past, other investment vehicles, such as oil lease lottery interests, ***see e.g., In re Overthrust Mineral Corp.***, [1982-1984 Transfer Binder] Blue Sky L. Rep. ¶71,849 (Wyo. Sec. State 1983), and commodity option contracts, ***see e.g., In re Goldstein Samuelson***, 1973 WL 30755 (Okla. Sec. Adm'r 1973), have been used in much the same way.

8. Some states like Maine and Iowa have amended their securities statutes to specifically deal with viatical settlement contracts. Other states like Alaska have adopted regulations outlining the securities agency's position that viatical settlement contracts are securities.

9. ***See SEC v. W.J. Howey Co.,*** 328 U.S. 293 (1946). There are now more than 100 orders by the state securities commissions holding viatical settlement agreements to be securities. Most of these orders, however, are uncontested. These cases may be recovered on Westlaw by entering MSEC-Admin. with the search word "viatical." See also Westlaw, CCH-BSLRLAW, search word "viatical". The Oklahoma Securities Commission presently has brought an enforcement action in state court against ABC. I am the Commission's expert witness in that case.

10. Viatical settlements are also involved in another type of investment opportunity which is clearly a security. In some cases, a corporation or trust is organized and shares or trust interests are sold to raise capital. The capital is then invested in viatical settlements which are owned by the corporation or trust. This arrangement is nothing more than a mutual fund which invests in viatical settlements rather than other forms of securities. The Arizona Commission has concluded, in a contested order, that these shares or trust interests are securities. ***In re Federal Funding Foundation Corp.***, 1998 WL 692686 (Ariz. Corp. Comm'n Sept. 25, 1998). ***See also, Hertzberg v. Dignity Partners, Inc.***, 191 F.3d 1076 (9th Cir. 1999).

11. There is no question that the evaluation and selection process is the most important function which the viatical broker performs under the viatical settlement contract. ABC touts that this process involves "[thorough underwriting (which generally requires a considerable degree of research) and policy acquisition, if done right, both take time.]"

12. ***SEC v. Life Partners, Inc.,*** 318 U.S. App. D.C. 302, 87 F.3d 536 (D.C.Cir. 1996).

13. 421 U.S. 837, 852 (1975).

14. ***See e.g., State ex rel. Day v. Petco Oil & Gas, Inc.,*** 1977 OK 4, 558 P.2d 1163 (1977), ***Probst v. State***, 1991 OK CR 30, 807 P.2d 279 (1991), and ***Howell v. Ballard***, 1990 OK CIV APP 92, 801 P.2d 127 (1990).

15. For a general discussion of the ***Howey*** test and its application by the state courts under the various state blue sky laws, ***see*** 12 Joseph C. Long, Blue Sky Law §2.05[2] (2000).

16. ***See*** 12 Joseph C. Long, Blue Sky Law §2A.02[3][a] (2000).

17. ***See e.g., Murphy v. Dare to be Great***, [1971-1978 Transfer Binder] Blue Sky L. Rep. (CCH) ¶71,053 (D.C. Super. 1972).

18. ***See Probst v. State***, 1991 OK CR 30, 807 P.2d 279 (1991).

19. ***See*** 12 Joseph C. Long, Blue Sky Law §2A.02[3][c] (2000).

20 . 457 F.2d 274 (7th Cir.), ***cert. denied***, 409 U.S. 887 (1972).

21. ***See e.g., SEC v. Koscot Interplanetary, Inc.***, 497 F.2d 473 (5th Cir. 1974); ***SEC v. Glen W. Turner Enterprises, Inc.***, 474 F.2d 476 (9th Cir. 1973).

22. ***SEC v. Glen W. Turner***, 474 F.2d 476, 482, n. 7, (9th Cir. 1973), citing ***SEC v. Los Angeles Trust Deed & Mortgage Exch***., 285 F.2d 162, 172 (9th Cir.), ***cert. denied***, 366 U.S. 919 (1961).

23. 881 F.2d 129, 140-141 (5th Cir. 1989).

24. ***Crowley v. Montgomery Ward & Co.***, 570 F.2d 877 (10th Cir. 1978).

25. The best illustration of this type of common enterprise is the entering into discretionary trading accounts in either securities or commodities. ***See e.g., Alford v. Shearson, Hayden, Stone, Inc.***, 485 F. Supp. 848 (D. Conn. 1980); ***Marshall v. Lamson Bros. & Co.***, 368 F. Supp. 486 (S.D. Iowa 1974).

26. ***See e.g., Mordaunt v. Incomco***, 686 F.2d 815 (9th Cir. 1982); ***cert. denied***, 469 U.S. 1115, 105 S.Ct. 801 (1985); ***Brodt v. Bache & Co.***, 595 F.2d 459 (9th Cir. 1978).

27. As noted above, the Fifth Circuit in ***Long v. Schultz Cattle Co.***, 881 F.2d 129, 140-141 (5th Cir. 1989), rejected this further restriction on the concept of vertical common enterprise.

28. ***See generally***, 12 Joseph C. Long, Blue Sky Law §2A.02[3][b] (2000).

29. This point must be considered when deciding whether to bring suit. The investor will get his principal back, plus a fixed return. The percentage of return, however, is not that promised by the broker selling the viatical settlement contract.

30. ***United Housing Foundation v. Forman***, 421 U.S. 837, 95 S.Ct. 2051, L.Ed.2d 621 (1975).

31. ***See generally***, 12 Joseph C. Long, Blue Sky Law §2A.02[3][b] (2000).

32. 1991 OK CR 30, 807 P.2d 279, 284 (1991).

33. ***See generally***, 12 Joseph C. Long, Blue Sky Law §2A.02[3][d] (2000).

34. ***SEC v. Glen W. Turner***, 474 F.2d 476 (9th Cir. 1973); ***D.M.C. v. Hays***, [1961-1971 Transfer Binder] Blue Sky L. Rep. (CCH) ¶70,897 (Colo. Dist. Ct. 1971).

35. ***SEC v. Glen W. Turner***, 474 F.2d 476 (9th Cir. 1973).

36. 474 F.2d at 482.

37. ***See*** 12 Joseph C. Long, Blue Sky Law §2.05[2][d][iii][C] (2000).

38. ***See e.g., Waterman v. Alta Verde Ind., Inc.***, 643 F. Supp. 797 (E.D.N.C. 1986); ***In re Wellington Precious Metals, Inc.***, [1984-1985 Transfer Binder] Blue Sky L. Rep. (CCH) ¶72,311 (Wyo. Sec. State 1985); ***In re Overthrust Mineral Corp.***, [1982-1984 Transfer Binder] Blue Sky L. Rep. (CCH) ¶72,243 (Wyo. Dist. Ct. 1985).

39. ***See e.g., Marshall v. Lamson Bros. & Co.***, 368 F. Supp. 486 (S.D. Iowa 1974).

40. ***See e.g., SEC v. Haffenden-Rimar, Int'l., Inc.***, 496 F.2d 1192 (4th Cir. 1974)(scotch whiskey); ***SEC v. Brigadoon Scotch Dist. Ltd.,*** 388 F. Supp. 1288 (S.D.N.Y. 1975)(coins); ***In re Gardner***, [1978-1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,757 (N.Y. Sup. Ct. 1979)(diamonds).

41. I have the sales literature and documents for ABC and the early documents used by LP. Ms. Wolk would be a good source for documents on other companies. ***See*** note 2, ***supra***.

42. ABC's viatical settlement contracts are a classic example of my category three "efforts." 12 Joseph C. Long, Blue Sky Law, §2.05[2][d][iii] (2000).

43. ***See e.g., State ex rel. Mays v. Ridenhour***, 811 P.2d 1220 (Kan. 1991).

44. By ABC's own admission, the acquisition process can take as much as 45 days or more **after the investor deposits his investment with the escrow agent.** It is also possible that the medical and legal "underwriting" on the settlement which the investor actually receives will be done after the purchase. This is especially true where the initial pairing done at the time of investment is not consummated, and another settlement must be substituted.

45. 318 U.S. App. D.C. 302, 87 F.3d 536 (D.C. Cir. 1996).

NASD SINGLE ARBITRATOR PILOT

Seth E. Lipner, DEUTSCH & LIPNER
Garden City, NY

On May 15, 2000, the NASD launched its "Single Arbitrator Pilot Project". The program voluntarily allows the parties, in cases with less than $200,000 in controversy to opt to have their cases decided by a single public arbitrator, rather than the customary three. PIABA urged the NASD to attempt such a pilot, and we are pleased the NASD done so.

We fear, however, that as constituted, the industry might still frustrate our attempt to make the single arbitrator concept work.

Current Approach

Currently, cases under $25,000 are heard by a single public arbitrator (and never by three). In cases between $25,000 and $50,000, the claimant may request either one (public) or three (mixed) arbitrators. If the claimant chooses to have three, the case will be heard by three. But if the claimant chooses "one", the respondent may still request three. Over $50,000, of course, all cases are heard by three arbitrators.

By way of comparison, for reasons of cost and efficiency, in commercial cases, the AAA has switched to a system of single arbitrators in cases under $500,000, unless both parties have agreed to three (either pre- or post- dispute). International arbitration is headed in the same direction. For example, the (British) Arbitration Act of 1995 provides for a default of a single arbitrator unless the parties agree otherwise.

The Workings of the NASD Pilot

Entry into the NASD's pilot requires the assent of both sides. Because the industry appeared unwilling to try the idea without first knowing who the single arbitrator will be, the decision to enter can only be made after the panel of three arbitrators is chosen by the parties. Thus, after the normal list selection, and after the three arbitrators are identified to the parties, the parties are invited to confer among themselves, and, if possible, agree that one of those arbitrators (industry or public) will hear the case alone. That agreement must be reached within fifteen (15) days of the notice of appointment of the panel.

Benefits of the System

The prime benefit of having a single arbitrator is efficiency, in this case earlier hearings and fewer dates needed. For example, with a single arbitrator, it is easier to pick dates for the hearing. Fewer conflicts will arise. There will be a 2/3 smaller chance that an arbitrator will disrupt a schedule by canceling or becoming unavailable. The hearing itself will also be more efficient. There will be less instance of an arbitrator who has to leave early, or one who spends too much time on the phone (or in the bathroom). Scheduling additional dates will be easier, also. Such efficiency, of course, is very important, especially in modest-sized contingent fee cases.

The other benefits, are, in no particular order, some modest forum fee reduction from the NASD, and the opportunity to have no industry arbitrator on the panel. The program is voluntary, so no investor is forced into it.

The Downside

The jurisdiction of the arbitrator is limited to $200,000. Although punitives and attorneys fees can be awarded, the maximum award (all together) cannot exceed $200,000. If, after entering the pilot, the Claimant decides to try for more than $200,000, it will require (a) the permission of the single arbitrator (for good cause shown) to reconvene a panel of three (3); and (b) re-selection of a panel of three.

Some, including those in PIABA, do not like the idea because they fear that a single arbitrator adds risk and uncertainty that is not present when the decision is made collegially, by three arbitrators. Even time may not tell whether those fears are counterbalanced by the benefits described above. In any event, since, under the pilot, the parties select from the already-appointed arbitrator, uncertainty is reduced when both sides trust the integrity and fairness of the chosen (single) arbitrator.

The biggest downside is that the industry can frustrate the move to a single arbitrator by never agreeing to enter the pilot. The prime reason the industry might so behave is their strong desire to hold onto the industry arbitrator in every case.

Proposed Plan

If you prefer three arbitrators in all your cases, don't enter the pilot.

If you see the benefits of one, try it. You have fifteen (15) days from notice of the appointment of the panel to obtain the agreement of your adversary. If you see an arbitrator on that list of three who you think could do an effective job as a single arbitrator, propose it to your adversary. Remember, the very presence of that arbitrator on your panel means that arbitrator was acceptable to both sides.

We predict, however, that despite the fact that the arbitrator you propose was acceptable to respondent, most respondents will not enter the pilot because it means losing the influence of the industry arbitrator. We need to test this proposition. If an insufficient number of claimant's attorneys try it, the NASD will abandon it. If, on the other hand, we try it over and over again, and the industry always says no, we can push to make it mandatory whenever the investor so elects. Document what happens, so we can build a record.

So we urge you to try the pilot in $60,000 cases, in $80,000 cases, etc. You have little to lose (other than the industry arbitrator). The gains in efficiency will more than make up for that loss.

OTHER INFORMATION

More information, including an FAQ, can be found on the NASD's web site. The Web Site directs questions to Jean Feeney, an NASD attorney, at 202-728-6959 or by e-mail to jean.feeney@NASD.com. You can also contact the author for information, thoughts, and ideas.

REPORT FROM NEW YORK
Seth E. Lipner, DEUTSCH & LIPNER
Garden City, NY

One of the members asked me to revisit, briefly, the situations where an out-of-state investor can be hailed into a New York court in a stay/vacate situation.

On a motion to stay arbitration, New York law is clear (now) that an out-of-stater who deals with an out-of-state office of a brokerage firm is not amenable to New York jurisdiction simply because (a) the claim was sent to the NASD or NYSE in New York; (b) the broker-dealer has its main office in New York; or (c) the agreement has a New York choice of law clause. New York does take jurisdiction if the investor lived in New York while the account as open (even if only for a few months), had an account with a New York branch, is involved in an arbitration in New York, or otherwise directed its activities toward New York.

The law in a confirmation/vacatur proceeding is more obscure. The out-of-stater who had an out-of-state arbitration ought to be able to avoid New York jurisdiction even if he had a New York account on the theory that that (jurisdictional) contact is unrelated to the issues in the confirmation proceeding, which challenges only the propriety of the arbitration. There is thus no nexus between the New York contact and the claim (confirmation) being made. There are, however, no cases either way because, in diversity cases, one can remove to federal court (over $75,000), and seek a transfer under 1404 because venue under the FAA does lies only where the defendant lives or where the hearing took place. Today, however, one must think twice about any removal in a vacatur proceeding because of the federal court's trend toward considering "manifest disregard" in such cases.

One final point, which we also made a few years back but which merits revisitation. A New York court recently vacated an award on the ground that the individual respondent did not have notice of the hearing because the arbitration papers were served (by the NASD) at his former place of employment, which was what was listed in the CRD. The decision was wrong, because the New York Court of Appeals (highest court) has ruled that since the NASD rules so provide, and the U-4 is an agreement, service at the employer of record is good service. We are not sure why the lower court judge blew it, but we suspect that he was not advised about that controlling case.

REPORT ON PIABA-NASD MEETING

Seth E. Lipner, DEUTSCH & LIPNER
Garden City, NY

On June 27, representatives from PIABA met with the senior executives of the NASD regarding arbitration in that forum. The principle focus of the meeting was on understanding and improving NLSS, including such subjects as how asking for arbitrators with "expertise" disrupts the rotation (it does, and we recommend you not ask for arbitrators with expertise); on obtaining a second list (in cases of list/preference exhaustion and vacancy); and on traveling arbitrators. Our dialogue with the NASD on these subjects will continue, and we promise more information at or before the Annual Meeting.

On one of the more important subjects, the NASD is amenable to a second list in cases of list/preference exhaustion and vacancy, but they will want to charge for it. The revision of the system, including the replacement arbitrator, will take a while, perhaps as much as a year.

We also took the opportunity to discuss with the NASD many of the issues which pop up on the e-mail and in other discussions. For example, we discussed our concerns about the IPHC script (i.e. the timing of discovery under the Guides, the request for mediation dates, and the suggestion that the parties pick dates for the return of dispositive motions). The NASD said it would address these points, and that it would remit the discussion to the NASD's National Arbitration and Mediation Committee sub-group on "Rules and Procedures" (Seth Lipner and Cary Lapidus sit on that sub-committee).

We also proposed that the NASD adopt a rule making it more difficult to make last-minute, tactical recusal motions, and another requiring a party asking for arbitrator expertise to send a copy of that request to all adversaries (to make sure the requested expertise relates to the case).

We persuaded the NASD to include on all arbitrator disclosure forms the CRD number for any arbitrator who has one, (including for "public arbitrators" who were once in the industry), and to print the home city and state of each arbitrator so we can monitor and deal with carpetbagger arbitrators. We are told it will take several months to get these changes accomplished, but (slow) progress is being made.

We also discussed the issues of CRD expungement (the NASD promises some proposal shortly), and we raised the recent complaints about joinder and severance. The NASD stated there had been no change in policy either at the administrative level or with the arbitrators on joinder, and they stated they were reviewing at least one recent severance decision that was particularly objectionable.

Finally, of course, we complained about the case administration nightmares we all experience too often. George Friedman's response was to encourage PIABA members to bring to the attention of the Staff Attorney all incidents of (a) irregularities in administrative procedure or (b) arbitrator misconduct. If the situation is not resolved at that level, the matter should be brought to the attention of the Regional Director, and then to his attention if necessary. He promises to address each and every such instance, and urges us to alert the NASD in such cases as soon as the problem arises. He stated they have greater difficulty addressing such problems when they are raised at times which are remote from the incident (e.g. several months later). He also encourages us to return the arbitrator evaluation forms, since the NASD uses these forms when it evaluates arbitrator performance. I know my practice is to not return the forms when I have nothing negative to say (before the award, I won't say anything positive); but I always send in the form when I have had a bad experience. We strongly urge you to do the same.

We expect to meet with NASD at regular intervals, and to follow up on these items, as well as any others which arise.

NASD TO HOLD ANOTHER “SETTLEMENT MONTH"

The NASD has informed that it will have another "Settlement Month" this coming October. During that month, the NASD will reduce the fee for mediation. You may plan accordingly.

RECENT COURT DECISIONS REGARDING ARBITRATION

North Carolina Court Refuses to Enforce Arbitration Agreement Against Deceased Customer

In ***Ragan v. Wheat Securities***, 2000 WL 78067 (N.C. App.), the court was presented with the issue of whether or not an arbitration agreement signed by a customer prior to his death could be enforced against his estate which brought an action against the brokerage firm after the death of the customer.

The deceased's estate had filed a civil action against Wheat First claiming that after the customer's death and after Wheat First had knowledge of the customer's death, and without obtaining authorization from the executor of the

deceased customer's estate, Respondent sold certain securities which were in the deceased customer's account and that following the sale of the securities they appreciate substantially in value.

The Respondent moved to compel arbitration under the arbitration clause in the deceased customer's arbitration agreement or, in the alternative, under the arbitration clause in the estate's money market account which had been opened up after the death of the customer, which money market account agreement also contained an arbitration agreement.

The trial court held that the arbitration clause under the deceased customer's securities agreement terminated upon his death, and that the arbitration clause in the money market account did not cover the subject matter of the arbitration. Wheat First appealed the trial court's decision. The appeals court held that in determining the validity of the arbitration clause in the customer's securities agreement, issues concerning arbitrability of the clause are governed by Federal law, but that state law generally governs issues concerning the validity, revokability, and enforcement of the Arbitration agreement. The court further noted that the deceased customer's securities agreement provided that the substantive law of Virginia applied to the contract.

The court held that, under Virginia law, if the parties entered into an arbitration agreement, the death of one party before the arbitrators' award revoked the submission agreement and terminated the power and authority which had been granted the arbitrator under the arbitration agreement. However, the court further found that the general law of Virginia regarding the death of one of the parties in the arbitration agreement was not applicable in this case because the arbitration agreement between Wheat First and the deceased customer contained a clause concerning the death of the party. The court found that the language of the arbitration agreement did not acknowledge that the agency extended past the death of one of the parties. The court held that it follows that the arbitration clause contained in the securities agreement also terminated and that, therefore, the trial court had properly denied Wheat First's motion to compel arbitration.

Secondly, Wheat First contended that the arbitration agreement existed since the disputed issue arose based out of activities which occurred after the death of the customer and was therefore within the subject matter of the money market account agreement which was signed after the customers death by his estate.

The court also rejected that argument, finding that the agreement signed after the death of customer was between the customer's estate and Wheat First and since the activities at issue were occurred in an account which was opened before the death of the customer, that the money market account agreement was not the basis to support a motion to compel arbitration since the money market account agreement dealt with a separate account opened by the estate after the death of the customer.

California Court Denies Customer's Attempt to Arbitrate Before A Private Arbitration Service

In ***Maggio v. Winward Capital Management***, (96 Cal. Rptr.2d 168, 5/23/00), a public customer attempted to bring an arbitration at a private alternative dispute resolution service rather than the American Arbitration Association pursuant to the terms of the customer agreement.

The arbitration provision of the parties' agreement stated that any claim or controversy arising from the agreement will be settled by arbitration in accordance with AAA's code of commercial arbitration. The customer contended that the private arbitration service was prepared to arbitrate the dispute pursuant to the commercial dispute resolution procedures published by the AAA and that the agreement between the parties did not specify that the arbitration was to be performed by the AAA, but rather simply under its rules.

The trial court agreed with the customer and refused to order arbitration. However, the appeals court reviewed the commercial dispute resolution procedures of the AAA and quoted from the procedures:

> "When parties agree to arbitrate under these rules or when they provide for arbitration by the AAA and an arbitration is initiated under these rules, they thereby authorize the AAA to administer the arbitration."

The court also quoted from the AAA's commercial rules which state:

> "The Claimant shall file at any office of AAA two copies of the demand and two copies of the Arbitration provisions of the contract."

The court interpreted that to mean that by agreeing to the commercial arbitration rules of AAA that the proceeding should also be held by the AAA.

While the trial court had found that the language in the arbitration agreement was ambiguous and held it against it against the brokerage firm which drafted the agreement, the appeals court held that there was no ambiguity in the contract and compelled arbitration.

U.S. Sixth Circuit Narrowly Interprets Manifest Disregard of the Law

In ***Dawahare v. Spenser, Dean Witter and Smith Barney***, 210 7.3d 666 (6th Cir. 4/27/00), the U. S. Sixth Circuit Court of Appeal was called on to review an arbitration award. The Claimant argued that: i) because the damages awarded were grossly inadequate and bore no relationship to the evidence submitted, the award itself showed evident partiality; and ii) that the arbitrators manifestly disregarded the law on damages.

The Claimant opened an account at Dean Witter where the broker engaged in the buying of large short positions. The account had declined in value by almost $500,000.00, and after the Claimant's son complained to Dean Witter, the broker was dismissed. The account was then transferred to Smith Barney. The arbitration panel heard testimony from the Claimant's expert that the damages were in excess of $600,000.00. The arbitration panel denied the Claimant's claims against Smith Barney but found against Dean Witter, awarding the Claimant in compensatory damages and $24,000.00 in punitive damages. The arbitrators also found the broker liable in the amount of $1,000.00.

Citing ***Anderson's, Inc. v. Horton's Farms, Inc.***,166 F.3d 308 (6th Cir.1998), the Court held that the Federal Arbitration Act presumes that arbitration awards will be confirmed and that a court may vacate an arbitration award only i) where the award was procured by fraud; ii) where the arbitrators were evidently partial or corrupt; iii) where the arbitrators misbehaved so that a parties' rights were prejudiced; iv) where the arbitrators exceeding their powers or executing them so that a final definitive award was not made; or v) were the arbitrators have manifestly disregarded the law.

The Claimant argued that the discrepancy between the damages awarded and the damages alleged show evident partiality. The Court countered by stating that:

> The alleged partiality must be direct, definite, and capable of demonstration, and the party asserting it must establish specific facts that indicate the improper motives on the part of the arbitrator.

The Court held that, because the Claimant pointed to nothing but the amount of the award to establish evident partiality, there was no basis to vacate the award on that ground.

As to the manifest disregard standard, the Court said that an arbitration panel acts in manifest disregard if i) the applicable law principal is clearly defined and is not subject to reasonable debate; and ii) the arbitrator refused to heed that legal principal. The Sixth Circuit pointed out that since the U.S. Supreme Court instituted the manifest disregard of the law standard in ***Wilko v. Swan,*** 346 U.S. 427 (1953), only two federal court of appeals have used it to vacate arbitration decisions.

The Sixth Circuit agreed with the Claimant's assertion that the award of punitive damages would only be awarded for egregious conduct by Dean Witter and that a compensatory award of less than 5% of the damages alleged is likely too low. However, to show manifest disregard, the Court noted that a party must show more than a mere error in an interpretation of the application of the law, but rather, that the arbitrators were aware of the relevant law and that they chose to ignore the law.

The Sixth Circuit also countered the Claimant's assertion that his expert's opinion that the Claimant sustained damages in the excess of $600,000.00 was uncontroverted since the Defendants presented no damage expert. The Court noted that "expert testimony, even if uncontroverted, may be believed in its entirety, in part, or not at all." (*Quoting* ***Quinones-Pacheco v. American Airlines, Inc***.*,* 979 F.2d1(1st Cir.1992)). The Court found no manifest disregard of the law and confirmed the arbitration award.

RECENT NASD ARBITRATION AWARDS

Bagwell v. Foresight Analysts, Capital Analysts, Royal Alliance and Daniel Isard, NASD Case No. 98-00093

Claimants alleged that Isard, acting as a registered advisor, together with Foresight Analyst, Inc. recommended that they place more than 80% of their retirement funds in limited partnerships, an amount in excess of $800,000.00. Prior to the hearing, claims against broker dealers Capitol Analyst, Inc., Royal Alliance Associates, Inc., and Forest Investors, Inc., were settled. The case was arbitrated on the issues of whether Isard acted negligently or breached fiduciary duties in recommending further purchases of limited partnerships, and in providing written reports that improperly reported on the value and yield of the limited partnership portfolio.

Respondent contended that he did not act negligently or breach fiduciary duties in recommending additional limited partnerships and that the limited partnerships were suitable for the Claimants stated needs and desires, and that the risks of the investments were fully disclosed.

Claimants originally requested an award and damages in the amount of $900,000.00. The panel award $55,000.00 as compensatory damages and held that the parties should each bear all costs of expenses incurred by them, including attorney fees. Claimants were represented by Rosemary Shockman, Esq. of Scottsdale, Arizona.

Crossley v. Bear Stearns and Adam Lieberman, NASD Case No. 97-027-42

Claimant alleged that Bear Stearns engaged in a scheme to defraud the investing public in their capacity as market makers; that Respondents sold 5 IPO's at artificially inflated prices that bore no reasonable relationship to the then current market price of the IPO; that Respondents induced Claimants to purchase the IPO's by misrepresentation of facts; that Respondents charged excessive and undisclosed markups on the IPO's'; and that Respondent's investments for Claimant's account were unsuitable and risky and against Claimants investment objectives.

Respondent Bear Stearns denied all facts or allegations and contended it served only as a clearing firm on a fully disclosed basis for the Claimants introducing firm Sterling Foster; that Respondent had no fiduciary duty to Claimants and that Respondents only had ministerial and administrative responsibilities to Claimant which were disclosed in the Claimant's customer agreement. Respondent Lieberman denied any and all allegations and that he executed instructions given to him by Claimants in a reasonable and prudent manner and acted in accordance with the procedures and standards in the securities business.

Claimant requested damages in the amount of $350,000.00 plus punitive damages and attorney fees. Bear Stearns' Motion to Dismiss was granted and Claimant's claim against Bear Stearns was dismissed in its entirety upon full hearing. Claimant was represented by George L. Mahr, Esq. of Madison, New Jersey.

Demas v. Schwab, NASD Case No. 99-00700

Claimants contended that Respondent was estopped to enforce provisions of the account agreement concerning liquidation without notice and the resetting of margin requirements without notice. Claimant alleged that, for the seven years that the account in question was open, Claimants' account was always given notice and a reasonable time to respond when the account was in a maintenance call position; that Respondent was obligated to provide oral and written notice before selling stock to take the account out of maintenance; that Respondent intended that its prior conduct would encourage Claimants to make additional purchase on margin; and that Respondent's conduct caused Claimants to reasonably believe that Respondent intended to encourage Claimants to make additional purchases of stock or margin. Claimants also contend that Respondents sold stocks substantially in excess in the amount needed to take the account out of maintenance. As a result of such conduct, the Claimants contend that they were damaged in an amount in excess of $120,000.00.

Respondent maintained that all of its actions in connection with the liquidation of the securities in question were done in accordance with the terms of its written agreement with the Claimants, applicable regulation rules and industry standards, and in compliance with its own internal policies and procedures. Respondents further contended that Claimants' losses came from their failure to contact Respondent at a time when Claimants actually knew of the deficient equity balance in their account.

Claimants requested actual damages of $420,000.00. The arbitration panel dismissed all claims asserted in the statement of claim. Claimant was represented by George G. Benetatos, Esq. of San Francisco, California.

Dietrich v. CIBC Oppenheimer and Donald Giello, NASD Case No. 99-01448

Claimant alleged that Respondents made investments which violated the Claimants investment objectives and churned Claimant's account.

Respondent contends that its broker discussed with Claimant an investment strategy that focused on small to mid cap growth stocks and that Claimant consented to apply that strategy to his own account; that the account performed well during the first year of following Claimant's investment decision but that in May of 1996 the decline in the NASDAQ market had an adverse effect on the account; and that at no time did Respondent execute a transaction Claimant's account without the Claimant's authority.

Claimant alleged losses of $128,000.00. The panel awarded the Claimant $54,000.00 and held that the parties each would bear their own costs and expenses, including attorney fees. Claimant was represented by David C. Anson, Esq. of Tucson, Arizona.

DiMarco V. Ameritrade, NASD Case No. 98-02968

Claimants charged Respondents with false, misleading and deceptive advertising regarding trade execution times and constructive fraud in that Respondent intentionally failed to disclose to the customer insufficient system capacity to provide promised levels of service.

Respondent alleged that it made no guarantee or promise regarding execution time and has provided disclosures to all customers; that orders may be reviewed by Respondent prior to forwarding the order to the market for execution; and that the SEC has informed traders that there are no SEC regulations that require a trade to be executed within a specific period of time.

Claimants requested $20,375.00 in losses. The arbitrators found in favor of Respondent on Claimants' charges of constructive fraud, but regarding Claimants charges of misrepresentation, the arbitrators awarded Claimants $23,200.00, but denied Claimants claim for punitive damages and attorney fees. Claimants were represented by Michael G. DeMarco, Esq. of Payallup, Washington.

Glass v. Legg Mason and William H. Langeman, NASD Case No. 99-00962

Claimant asserted that he opened a discretionary account with Respondents with a net value of $158,000.00 in December 1994; that by December 1997, the net value of the account showed a net loss of $140,000.00; that during the 3 year period Respondent earned $65,000.00 in commissions; that the account was turned over 6.3 times a year and that the combined commission and margin interest charges required that the account yield 25% annually to break even. Claimant alleged claims for breach of fiduciary duty and churning based on gross negligence and recklessness disregard of the Claimant's interests.

Respondents denied liability based on estoppel, ratification, failure to act reasonably to mitigate damages, failure to exercise care, and that the Claimant had waved any claim for liability based on his own negligence.

Claimant requested damages in the amount of $405,000.00, plus attorney fees. The arbitrators awarded damages in the amount of $58,200.00, plus attorney fees in the amount of $15,000.00 and directed Respondents to pay Claimant in the amount of $7,500.00, representing the expert witness fee. Claimant was represented by Randall A. Smith, Esq. of New Orleans, Louisiana.

Mansour v. First of Michigan and Patrick Jordan, NASD Case No. 98-00761

Claimant asserted causes of action of mishandling of specific trades by Respondent, unauthorized trading, churning, omissions of fact, and failure to execute involving trades in Global Marine, Amazon .com, and General Motors in Claimant's account.

Respondents alleged that Claimant exercised control over his account and all the investments in the account; that the alleged acts of Respondent were not the proximate cause of the injury; that the Respondent exercised due care and acted in good faith; and that Claimant's failure to give notice of the acts complained of waived a right to action.

Claimant requested damages in the amount of $213,000.00, plus interest, attorney fees, and punitive damages. The arbitration panel made an award of $146,000.00, plus interest, and attorneys fees in the amount of $54,000.00. Claimant was represented by Edward C. Cutlip, Esq. of Detroit, Michigan.

McCafferty v. Prudential Securities and Hank Mark Werner, NASD Case No. 99-01941

Claimant maintained that the Respondent broker recommended the purchase of Pilgrim Adjustable Rates Securities Trust as a safe, conservative, alternative to certificates of deposit. Claimant alleged Respondent failed to disclose as a degree of risk associated with the investment.

Respondent denied the allegations and asserted it had disclosed all pertinent risks.

Claimant request damages in the amount of $14,000.00. The arbitrator awarded $14,000.00, plus interest but denied Claimants request for attorney fees. Claimant was represented by Charles W. Austin, Esq. of Richmond, Virginia.

Mihesh v. Prudential Securities and John Bud Larsen, NASD Case No. 99-01814

Claimant maintained that the Respondent broker recommended the purchase of Pilgrim Adjustable Rates Securities Trust as a safe, conservative, alternative to certificates of deposit. Claimant alleged Respondent failed to disclose as a degree of risk associated with the investment.

Respondent denied the allegations and asserted it had disclosed all pertinent risks.

Claimant request damages in the amount of $14,000.00. No award was granted. Claimant was represented by Charles W. Austin, Esq. of Richmond, Virginia.

Najai v. Olde Discount and Scott Robertson, NASD Case No. 99-1102

Claimants alleged that Respondents misled Claimants concerning commission free trading on stocks with wide margins which offset commissions savings, by recommending unsuitable investment for Claimants and by misrepresenting the characterization of Claimants' investment goals as aggressive. Claimants further alleged that Respondents abused the use of margin in Claimants' account and recommended securities in which Olde made a market irrespective of Claimants' best interest in order to qualify for commission incentive plans offered by Olde.

Respondents contended that Claimants claims were barred by laches, waiver, estoppel, and ratification; that the Claimants assumed the risk of their investment transactions; and that the investment related losses that were incurred were caused by market fluctuations.

Claimants requested damages in the amount of $125,000.00 plus interest, attorney fees and punitive damages. The panel denied Respondents' motion to strike exhibits. At the hearing, Respondents moved to dismiss based on failure to state a claim and panel granted Respondents' motion to dismiss. Claimants were represented by Anthony V. Trogan, Esq. of Bingham Farms, Michigan.

Southwest Cardiology Assoc. v. Bear Stearns, NASD Case No. 98-02316

Claimant alleged that it was a qualified plan which had an account at Bear Stearns being managed on a discretionary basis by the Bear Stearns broker; that Respondent churned the account and purchased unsuitable investments; that Respondent was a fiduciary of the account under ERISA; that Respondent failed to manage and diversify the investments of the account as required by ERISA; and that Respondent made fraudulent and negligent misrepresentations which Claimant relied on to its detriment.

Respondent contended the Claimant's losses derived nearly entirely from the decline the price of the stock of Shiva Corp. and that the decline of that stock was as a result of unexpected revision of its earnings estimates. Respondents further alleged that the trustee of the Claimant's plan was fully aware of the purchase of Shiva Corp.; that the trustee was an extremely sophisticated investor who understood the risk inherent in the investment; that the Claimant represented that the purchase conformed to its instated investment objectives; and that Respondents did not breach any fiduciary duties or engage in any deceptive trade practices.

Claimant requested compensatory damages in the amount of $150,000.00 and punitive damages of $300,000.00, interest and attorney fees. The arbitration panel awarded Claimant $112,480.00 in compensatory damages and $25,000.00 in attorney fees. The panel also, as part of the award, found that, under ERISA, the Texas Securities Act, the Rules of Law and Equity, the Respondent, its successes and assigns, shall have no right or claims of subsequent actions and indemnification against the Claimant, its trustees, officers, employees, or participants of the plan for any amount which was awarded to Claimant. Claimant was represented by P. Randall Crump, Esq. of Houston, Texas.

Sptiz v. HD Brous & Co., and David Alan Yungkau, NASD Case No. 98-02315

Claimants alleged that Respondents made unauthorized, unsuitable, and fraudulent trades in their account, specifically, involving the purchasing of approximately $172,000.00 of Molten Metals Bonds and trades in LA Gear, and that Respondents continued to purchase stocks in Claimants account on margin after Claimants requested that margin amounts be paid off.

Respondents denied the allegations in the statement of claim specifically stating that all trades placed in the accounts were authorized by the Claimant who was fully informed and consulted regarding all trades and that the Claimants' claims regarding unauthorized trades only came months after the trades actually took place.

Claimants requested an award of compensatory damages of $150,000.00 and punitive damages of $150,000.00, plus cost and attorney fees. The panel awarded Claimants $90,000.00, including interest, and denied their claim for punitive damages and attorney fees. Claimant was represented by Robert A. Klingler, Esq. of Cincinnati, Ohio.

Walker v. Raymond James, NASD Case No. 99-01630

Claimants alleged that Respondent engaged in a pattern of unauthorized and unsuitable trading and churned the Claimants account which they had entrusted to Respondent's management. Claimants alleged that the trades were unsuitable based on their status as retired individuals whose stated investment objectives were income and long-term growth.

Respondent alleged that the Claimant was sophisticated investor who understood the transactions in the accounts and accepted the risks that were incurred; that all the transactions in the account were ratified by the Claimant; and that any losses in the account were due to normal market fluctuations and the risk inherent in investing.

Claimants requested damages of $3,000,000.00 which was comprised of actual damages, punitive damages, costs and attorney fees. The arbitration panel awarded Claimants $395,000.00 and denied their request for punitive damages and attorney fees. Claimants were represented by Earle Lee Butler, Esq. of Ft. Lauderdale, Florida.

Cordes v. Adams Davis Co., NASD Case No. 99-00087

Claimants alleged they were conservative investors and that Respondent's broker ignored their stated investment objectives and leveraged their account using unsuitable high risk investments and churned their account.

Respondent denied the allegations in the statement of claim and asserted that the Claimants were explained a trading strategy which involved investments in quality technology stocks which were trading below historical levels due to negative developments. Respondents further alleged that it reasonablely believed, based on the Claimants' education and investment background, that the Claimants understood the risks relating to the strategy and that the Claimants were consulted prior to the execution of all transactions.

Claimants requested an award of $50,000.00, plus punitive damages and interest and costs. The arbitration panel awarded $24,069.00 plus interest at 8% and $3,667.00 as costs and denied Claimant's request for attorney fees and punitive damages. The Claimants were represented by William Shepherd, Esq. of Houston, Texas.

Estate of Kenneth T. Ralph v. Merrill Lynch, NASD Case No. 99-00953

Claimant alleged that the deceased, a long time investor with Respondent, had suffered a debilitating illness and obtained a power of attorney for his daughter to oversee his account at Respondent. Subsequent to the execution of the power of attorney, Claimant alleged that Respondent failed to evaluate and update the risky portfolio and failed to keep the agent aware of the situation in the account. Claimants further alleged that Respondent increased the risk in the account by using margin in the account and its failure to update the risky portfolio when the circumstances changed constituted a violation of Chapter 517 of the Florida statutes.

Respondent alleged that the drop in the value of the Claimant's account was caused by the decline of one stock, and that the Respondent had no duty to inform any of his customers of the markets performance of a particular investment because, as a broker-dealer, it does not have a fiduciary obligation to its customers.

Claimant requested compensatory damages of $89,000.00, market adjusted damages, punitive damages, interest, costs and attorney fees. The panel awarded Claimant $26,000.00, but denied his request for market adjusted damages, punitive damages, costs and attorney fees. The Claimant was represented by Delmer C. Gowing, III, Esq. of Delray Beach, Florida.

Pope v. Kenneth Leroy Mount, Richard Paul Granieri and Schneider Securities, NASD Case No. 98-02969

Claimant alleged the Respondents purchased hundreds of thousands of dollars in speculative stocks on margin in Claimant's accounts; that Respondents bought and sold stock without authorization; and that Respondent enticed Claimants into purchasing stock with reckless promises of rapid increases in the value of the stocks.

Respondents alleged that the Claimant had extensive history in investing in speculative securities, was a sophisticated trader, and that all transactions in the securities referenced in the statement of claim were approved and authorized by the Claimant prior to the transaction taking place.

Claimant requested damages of $500,000.00, plus punitive damages, and all other available relief. The arbitrators awarded Claimant the sum of $114,164.00 and denied all other requests for relief. The Claimant was represented by Michael J. Rovell, Esq. of Chicago, Illinois.

ANNOUNCEMENTS

James E. Beckley, "Golden Bow-Tie" Award

PIABA announces the creation of the *James E. Beckley Golden Bow-Tie Award*. The award is named for our late former president and colleague, whose untimely passing left a void in our organization and in our hearts.

Jim Beckley stood for integrity, for the highest standards of professionalism, and for fairness in arbitration. He was a role model for us all.

PIABA invites nominations for the first *James E. Beckley Golden Bow Tie Award*. PIABA wiil confer the award on the individual who represents and promotes the ideals for which Jim stood. PIABA intends to confer the award at this year's PIABA Annual Meeting in San Antonio.

The nominations should contain:

1. the name, address & phone number of the nominator;
2. the name, address & phone number of the nominee;
3. a brief description of the nominee's contribution to the fairness of securities arbitration; and
4. a brief statement of why the nominee exemplifies the standards of integrity, dedication and fairness for which Jim stood.

Nominees need not be PIABA members. Nominations must be submitted to PIABA, at its Norman, Oklahoma office, so as to be received by September 25, 2000.

Mail nominations to:

Public Investors Arbitration Bar Association
Attention: Robin Ringo, Executive Administrator
2241 W. Lindsey Street, Ste. 500
Norman, OK 73069
Fax: (405) 360-2063
E-Mail: rsringo@piaba.org or piaba@piaba.org

Updated Membership Rosters

Please take a moment to review the directory information listed for you on the PIABA website. You may access the web site at www.piaba.org.

If you find incorrect information, notify the PIABA Office at your earliest opportunity. *Note: PIABA sustained a major computer crash in early July. Every attempt has been made to restore all databases with correct information. However, if you submitted changes to your directory information after May 15, 2000, please verify that all information currently on file is correct.*

Members may print an updated membership roster from the Members Only area of the website. *Go to the Bulletin Board. Select Membership Roster*. The file may be opened with Adobe Acrobat. The document is formatted exactly like the Members Directory.

PIABA Quarterly's

All past issues of *The PIABA Quarterly* are not on-line at www.piaba.org. *Go to Members Only. Go to PIABA Quarterly.* This is a fully searchable database containing all articles previously appearing in *The Quarterly*. Issues have been edited for the on-line versions to exclude references to previous annual meetings, announcements, etc.

Future issues will be uploaded once they are completed and, will be available to members on the web site before they appear in print.

Communications Committee

The Communications Committee will meet at the 9th Annual Meeting in October. If you plan to attend the 9th Annual Meeting and are on the Communications Committee, please check with Robin Ringo as to the date and time. Every effort is being made to accommodate all schedules. If you would like to attend this meeting, feel free to join in. Specifically, the Committee will be discussing the new design for the web site. All suggestions are welcome. Please submit to Allan Fedor at attysfedor@aol.com, Tracy Stoneman at tstone1000@aol.com or Robin Ringo at rsringo@piaba.org.

PIABA 9th Annual Meeting & Securities 201

The hotel reservation period is extended until September 18. After that date, reservations are on an available basis only and the conference rate of $205 is not guaranteed. The deadline for advance registrations is October 1, 2000. Registrations received after October 1, are not guaranteed to appear on the Meeting Attendee roster printed in the materials. Make you plans now and see you in San Antonio! For more information, contact PIABA at 1-888-621-7484.