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The P I A B A Quarterly

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December 2000 Volume 7 Number 4

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The

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The Newsletter of the Public Investors Arbitration Bar Association

December, 2000

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Editor's Notes

In this issue of the *Quarterly*, Timothy Canning and Neal Blaher discuss Fiduciary Duty in California and Florida, respectively.

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

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LETTER FROM THE PRESIDENT

Seth E. Lipner
Garden City, New York

When I became President last Fall, I thought it would be like putting on an old slipper, comfortable and familiar. Instead, I discovered that the job had changed, because PIABA has changed. We are, of course, bigger and more influential than we were in 1995, when I first served as President. But there are other differences. There are more issues, and we are a more diverse organization handling a wider variety of cases. But most of all, the biggest difference is that the business of PIABA goes on 24 hours a day, and it is so much harder to keep out in front. I have more respect for Mark Maddox, our out-going President, than ever before.

All that said, I look forward to a year of good work and favorable outcomes. As the year 2000 drew to a close, we could happily look back on several accomplishments - the elimination of traveling arbitrators; the improved initial pre-hearing conference script (which will be in use by the time of this publication); the soon-to-be-unveiled self-service rule at the NASD, and the somewhat-later-to-be-unveiled improvements to NLSS (a second list after exhaustion). Under "unfinished business", we have the expertise function of NLSS and our assault on expungement and the weaknesses of the CRD system. We will of course continue to work hard on these two important issues.

As I outlined at the Annual Meeting in San Antonio, our goals for 2001 must include two important areas - arbitrator training and the definition of public arbitrator. Subcommittees have formed, and proposals and action are right behind. I commend the many of you who have gotten involved, and urge everyone to join and work in our committees.

We are already in the process of preparing the agenda for our 10th Annual Meeting. Phil Aidikoff chairs the committee. If you have ideas, please let him know. The venue for the meeting, the Ritz Carlton in Amelia Island Florida, was recently rated (by Travel and Leisure Magazine) as the 18th best hotel in the world. When you combine that with the world's best professional meeting, how can you go wrong? I am optimistic this year we will set a record for attendance.

I want to congratulate Pat Sadler on being nominated (and appointed) to a three-year term on the NASD's National Arbitration and Mediation Committee. And I again want to thank Diane Nygaard and Bill Lapp, who retired from their seats on the Board after years of great service. Their successors, Chuck Austin and Bob Banks, will certainly fill those positions ably. And of course its great to have Stu Goldberg back.

I look forward to working with all of you in our continuing fight to level the playing field.

See you in Cyberspace.

Seth

FIDUCIARY DUTY IN CALIFORNIA

Timothy A. Canning, Esq.
San Francisco, CA

[Editor's Note: This is a portion of a brief submitted by Mr. Canning in response to a motion to dismiss, which has been edited for inclusion in this publication.]

A. Fiduciary Obligation

Respondents were fiduciaries to the claimants. Respondents were therefore obligated to perform their duties with the utmost good faith and integrity. See, e.g., *Twomey v. Mitchum, Jones & Templeton, Inc.* (1968) 262 Cal.App.2d 690, 69 Cal.Rptr. 222; *Duffy v. Cavalier* (1989) 215 Cal.App.3d 1517, 264 Cal.Rptr. 740; and *Laraway v. First National Bank of La Verne* (1940) 39 Cal.App.2d 718, 728.

In *Twomey*, the court of appeal held that the stockbrokers were acting in a confidential and fiduciary capacity toward the plaintiff, that each of them breached that duty, and that the breaches of their duties as fiduciaries constituted constructive fraud.

> "Confidential and fiduciary relations are, in law synonymous, and may be said to exist whenever trust and confidence is reposed by one person in the integrity and fidelity of another. The very existence of such a relation precludes the party in whom the trust

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> and confidence is reposed from participating in profit or advantage resulting from the dealings of the parties to the relation." . . . [T]he defendants and the partnership had undertaken to act for [plaintiff] as agents, and more particularly as investment counselors and stock brokers. "An agent is a fiduciary. His obligation of diligent and faithful service is the same as that imposed upon a trustee." "The relationship between broker and principal is fiduciary in nature and imposes on the broker the duty of acting in the highest good faith toward the principal." With respect to stockbrokers it is recognized, "The duties of the broker, being fiduciary in character, must be exercised with the utmost good faith and integrity."

Twomey, 262 Cal.App.2d at 708, 69 Cal.Rptr. at 236 (citations omitted).

A stockbroker has a duty to give his or her customer all information, which is relevant to affairs entrusted to the broker of which the broker has notice. *Merrill Lynch, Pierce Fenner & Smith, Inc. v. Cheng*, 901 F.2d 1124, 1128 (D.C.Cir. 1990) [holding that brokers breached their duty to inform their customers of their right to disavow unauthorized trades, and that customers did not ratify the transactions because the customers were not fully informed of all of their reasonable choices]. Stockbrokers are "bound to exercise the utmost good faith to make the best bargain fairly obtainable for their principal." *Laraway v. First National Bank of La Verne* (1940) 39 Cal.App.2d at 726 [stockbrokers breached their fiduciary duties by telling customers speculative securities were "good, safe bonds"].

Respondents' fiduciary duty embraces the obligation to render ongoing full and fair disclosures to their customers of all facts which affect the customers' rights and interests. Where there is a duty to disclose, the disclosure must be full and complete. Any material concealment or misrepresentation amounts to fraud. *Pusateri v. E.F. Hutton* (1986) 180 Cal.App.3d 254. Where an investment advisor himself does not understand the investment he recommended, the broker cannot escape liability by contending that the investor should have read the prospectus. *Geisenberger v. John Hancock Distributors, Inc.*, 774 F.Supp. 1045, 1051 (S.D. Miss. 1991) [broker's admission that he did not know whether a "high income trust" contained junk bonds demonstrated that the prospectus may not have fully and adequately disclosed relevant information; investors' reliance on broker's representations may therefore have been justified].

Here, respondents' fiduciary duties required them to study the recommended investments sufficiently so as to become informed as to the investments' nature, price and financial prognosis, and then disclose to the claimants every materialfact relevant to those investments. Whether directly or vicariously, respondents undertook the obligation to inform claimants of the true nature and risks of the investments, including providing accurate information about the investments' performance and prospects.

The principals also had affirmative duties to disclose material information to these claimants. Where the president of a broker/dealer obtains information material to the customers' investments, the broker/dealer and its president are obligated to disclose that information to their customers. Even if the president cannot call each customer personally, he at least has the duty to instruct the broker/dealer's salesman to make the appropriate disclosure to the customers. *Eichler v. S.E.C.*, 757 F.2d 1066, 1070 (9th Cir. 1985) [affirming NASD sanction imposed on president and head of trading department on grounds that the broker/dealer's disclosure to its customers that it could not fill the customers' orders was inadequate].

Respondents' breaches of those fiduciary duties were constructive frauds, regardless of whether respondents had fraudulent intent. Civil Code § 1573. *Twomey v. Mitchum, Jones & Templeton, supra*, 262 Cal.App.2d at 708; and *Leib v. Merrill Lynch, Pierce, Fenner & Smith*, Inc. 461 F.Supp. 951, 953 (E.D. Mich. 1978).

Because respondents were fiduciaries, they have the burden of proving, by clear and convincing evidence, that claimants were not defrauded; that claimants received full and adequate consideration for their money; and that claimants suffered no loss. Respondents must prove by "clear, positive, uncontradicted, convincing and satisfactory" evidence that their dealings with claimants were in every respect fair and regular, without undue influence, accompanied by full disclosure of every relevant and truthful fact, and caused no damage. *Kent v. Trust Savings Bank of Pasadena*, 101 Cal.App.2d 361, 371-72.

B. Joint & Several Liability

The fiduciary obligations discussed above are imposed on the broker/dealer, the principals of the broker/dealer, and all those who were involved in the sale of the investments to these claimants, under the doctrine of joint and several liability. Further, the principals of broker-dealers are responsible for ensuring that material information regarding investments sold by the broker-dealer is communicated to their customers. The principals are also liable for its employees' conduct within the course and scope of employment and for the benefit of the broker-dealer.

Under California law, all those who contribute to a plaintiff's economic injury are jointly and severally liable for the entire economic damage plaintiff suffered, regardless of whether they acted jointly, concurrently, or successively. See, e.g., *Gray v. Sutherland* (1954) 124 Cal.App.2d 280, *Shea v. San Bernardino* (1936) 7 Cal.2d 688; and 5 Witkin, *Summary of California Law*, Torts, §48 (9th ed. 1988).

Persons are "joint tortfeasors" where they act in concert to accomplish some common purpose or plan, and whose concerted action causes harm. Those who order, direct or permit others to inflict harm and those who give assistance or encouragement are also joint tortfeasors, and are thereby jointly liable for all economic damages a plaintiff suffers. Rest.2d, Torts, §§876, 877; 5 Witkin, *Summary of California Law*, Torts, §43 (9th ed. 1988).

Where independent acts of several persons contribute to an injury, those persons also are jointly liable for all economic damages, even though they may be classified as concurrent tortfeasors or successive tortfeasors. 5 Witkin, *Summary of California Law*, Torts, §47 (9th ed. 1988). Should a defendant seek to avoid liability for plaintiff's entire damage, and pin the blame on another defendant, the burden is on that defendant to prove that he or she is responsible for only a limited, specified portion of plaintiff's economic damages. If a defendant fails to so prove, that defendant is liable for plaintiff's entire economic damage. *Summers v. Tice* (1948) 33 Cal.2d 80. 85; 5 Witkin, *Summary of California Law*, Torts, §50 (9th ed. 1988).

Similarly, all members of a joint venture are liable for torts of one member committed in furtherance of the enterprise. 9 Witkin, *Summary of California Law*, Partnership, §21(2) (9th ed. 1988); see *Grant v. Weatherholt* (1954) 123 Cal.App.2d 34. (A joint venture resembles a partnership, in that its members associate together for a common enterprise [*Id.*].)

Under traditional agency law, the principals of a broker-dealer can be liable for the misdeeds of the broker's employees. Three basic definitions of liability have been articulated. Section 219 of the Restatement (Second) of Agency permits a finding of liability where "[a] master is subject to liability for the torts of his servant committed while acting in the scope of the employment." (Restatement (Second) of Agency §219 (1957)). Restatement Section 257 states in applicable part: "[a] principal is subject to liability for loss caused to another by the other's reliance upon a tortuous representation of a servant or other agent, if the representation is: (a) authorized; (b) apparently authorized; or (c)with the power of the agent to make for the principal." (Restatement (Second) of Agency §257 (1957)). Finally, Restatement section 261 imposes liability where: "[a] principal who puts a servant or other agent in a position which enables the agent, while apparently acting within his authority to commit a fraud upon third persons is subject to liability to such third persons for the fraud." (Restatement (Second) of Agency §261 (1957)).

Under these doctrines, principals of a broker-dealer are liable for the tortious acts of their employees, which occurred during the course and scope of their employment. See *Grubb & Ellis Co. v. Spengler* (1983) 143 Cal.App.3d, 890, 895, 192 Cal.Rptr. 637, 640. Accordingly, the employers are liable for their employees' fraudulent misrepresentation and breach of fiduciary duty. See *Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 803 F.2d 454, 461 (9th Cir. 1986).

The fact that an act may be outside the authority of an employee or agent, or even directly contrary to the employer's instructions, does not shield the employer from liability. *Davidson v. Welch* (1961) 270 Cal.App.2d 220, 227, 75 Cal.Rptr. 676, 681.

California's Corporations Code also imposes joint and several liability on any person who materially aids in an act or transaction which violates the prohibition on offering or selling a security by means of any written or oral communication which includes and untrue statement of material fact. Similarly, every principal executive officer or control person of a corporation is jointly and several liable with the corporation for any untrue statement of material fact, regardless of whether that principal executive or control person materially aided in the act or transaction. Cal. Corp. Code § 25504.

The federal securities law imposes similar liability. The principals are liable as control persons for their employees' violations of Section 12(2) of the 1933 Securities Act and Section 10(b) of the 1934 Securities Exchange Act by virtue of their status as controlling persons, pursuant to Section 15 of the 1933 Securities Act (15 U.S.C. §77l) and Section 20(a) of the 1934 Securities Exchange Act (15 U.S.C. §78t(a)). *Vucinich*, 803 F.2d at 461. The principals had both the power to control or influence their brokers and were culpable participants in their fraudulent activity. See *Wool v. Tandem Computers Inc.*,818F.2d1433,1440(9thCir.1987).

C. Damages

Under California law, several statutory standards of the measure of damages potentially apply to this case.
Civil Code section 1709 provides the measure of damages for deceit:

> One who willfully deceives another with intent to induce him to alter his position to his injury or risk is liable for any damage which he thereby suffers.

Civil Code section 3333 states the general tort measure of damages:

> For the breach of an obligation not arising from contract, the measure of damages, except where otherwise expressly provided by this code, is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not.

The damages awardable under sections 1709 and 3333 are sometimes referred to as the "benefit of the bargain" measure of damages. This is the difference between the actual value of what the claimants received and what they expected to receive. *Overgaard v. Johnson*, 68 Cal. App. 3d 821, 823, 137 Cal.Rptr. 412 (1977).

In contrast with Civil Code sections 1709 and 3333, Civil Code section 3343(a) states:

> One defrauded in the purchase, sale or exchange of property is entitled to recover the difference between the actual value of that with which the defrauded person parted and the actual value of that which he received, together with any damage arising from the particular transaction, including any of the following: . . . .

Walsh v. Hooker & Fay, 212 Cal. App. 2d 450, 459, 28 Cal.Rptr. 16 (1963), held that the broader measure of damages under Civil Code section 3333 applies in the sale of securities by a stockbroker. The court rejected an argument that Civil Code section 3333 was limited to a situation in which the stockbroker made a secret profit in the transaction. Instead, the "benefit of the bargain" damages apply. The court stated:

> To hold to the measure of damage rule contended for by appellant [the stockbroker] would work a manifest injustice. Where a stock is traded on an established stock exchange or is actively traded in "over the counter" transactions, its value at any particular time is ordinarily determined by the price at which it is then being bought and sold.
>
> Such a rule would allow a stockbroker to fraudulently induce his clients to buy a certain stock and escape liability in damages, except for the amount of the commission, by simply showing that, *at the time of the purchase*, "the actual value of that which he received" was equal to "that with which the defrauded person parted." We do not think that this should be the law.

Id., 212 Cal. App. 2d at 461 [emphasis in original].

Numerous cases award the "benefit of the bargain" damages under sections 1709 and 3333 where fiduciaries are involved. See, for example, *Pepitone v. Russo*, 64 Cal.App.3d 685, 688, 134 Cal. Rptr. 709 (1976), *Ford v. Cournale*, 36 Cal.App.3d 172, 111 Cal. Rptr. 334 (1973).

As applied in the investment context, the measure of damages to which claimants are entitled is the difference between the amount paid for the investment, plus interest (as discussed below), and less any distributions or sales. The purpose of this rescisionary measure of damages is to restore claimants to the *status quo* before they purchased their investments from respondents. See also, Cal. Corps Code section 25501.

Claimants are entitled to an award of prejudgment interest. Prejudgment interest is allowed for breach of fiduciary duties and for every case of oppression, fraud, and malice. Civ. Code §3288. That rate should be compounded because the claim is for breach of fiduciary duty. *Michelson v. Hamada*, 29 Cal.App.4th 1566, 1585-86, 36 Cal.Rptr. 2d 343, 352-53 (1994). That case held that the applicable legal rate for breach of fiduciary duty was seven percent, compounded.

> As we have previously discussed, Hamada stood in a fiduciary relationship with Michelson and the jury found that he breached his fiduciary duty. These cases confirm that an award of compound interest *is appropriate* in this type of case.

Id., 29 Cal.App.4th at 1586, 36 Cal. Rptr.2d at 353 [emphasis in original].

The time value of money is an element of damages awardable in actions for breach of fiduciary duty. *Nordahl v. Department of Real Estate,* 48 Cal. App. 3d 657, 665, 121 Cal. Rptr. 794 (1975), quoted in *Michelson v. Hamada*, is applicable here:

> The inclusion of interest in the verdict pursuant to section 3288 is not the granting of damages in excess of the loss incurred. When, by virtue of the fraud or breach of fiduciary duty of the defendant, a plaintiff has been deprived of the use of his money or property and is obliged to resort to litigation to recover it, the inclusion of interest in the award is necessary in order to make the plaintiff whole. It is for this reason that it is proper to have such interest run from the time the plaintiff parted with the money or property on the basis of the defendant's fraud.

Id. at 665.

Hence, claimants are entitled to an award of prejudgment interest on their claim.

D. Time Bar Defense: Statute of Limitations

Respondents have previously demanded that this arbitration be dismissed, contending that too much time passed before claimants filed this arbitration. That contention has already been rejected by the arbitrators in this proceeding. In anticipation that respondents will try to raise the time bar defense yet again, the following sections address the law of the "six-year" rule under the NASD Code, and the applicable principles of statute of limitations under California law.

Because respondents actively discouraged claimants from bringing their claims, and concealed information about their own role in causing claimants' losses, respondents cannot rely on the statute of limitations to escape liability. Yet, even if respondents could assert a statute of limitations defense, under the appropriate statute of limitations claimants timely filed their claim.

Respondents contend that they cannot be liable for lying to claimants about the investments at issue in this case because claimants did not timely bring this action. However, where a delay in bringing a claim is induced by a fiduciary's representations to a claimant, the fiduciary is estopped from raising the statute of limitations as a defense. *Laraway v. First National Bank of La Verne* (1940) 39 Cal.App.2d 718, 729-730. Another California decision also clearly states that a fiduciary cannot defend a breach of his duty to disclose on the grounds that no one caught him in time:

> [Defendant's] argument overlooks the principle that "as fiduciaries it was the duty of defendant to make a full and fair disclosure to plaintiffs of all facts which materially affected their rights and interests." [Citation.] . . . "Where a fiduciary relationship exists the plaintiffs' usual duty of diligence to discover facts does not exist." [Citation.] Put simply, if the "delay in commencing an action is induced by the conduct of the defendant, he cannot avail himself of the defense of the statute of limitations." [Citation.]

Cross v. Bonded Adjustment Bureau (1996) 48 Cal.App.4th 266, 55 Cal.Rptr.2d 801.

> [Fiduciaries] can hardly expect relief from their own deceit because neither the [plaintiffs] nor their lawyers caught them earlier in a lie. There is no reward for being slick, . . .

Parsons v. Tickner (1995) 31 Cal.App.4th 1513, 1529, 37 Cal.Rptr.2d 810.

The evidence to be presented at the hearing will show that respondents repeatedly encouraged claimants to rely on their advice, and led claimants to believe that they would protect their financial interests. Respondents lulled claimants into a false sense of security and repeatedly induced them not to act to protect themselves. Respondents cannot now contend that claimants should have filed their claim earlier.

Even if respondents are not estopped from relying on the statute of limitations, the claim here was filed within the applicable time period

In light of the fiduciary relationship between Claimants and Respondents, the statute of limitations applicable to this claim is four years from the date Claimants' claim accrued, plus any applicable tolling. California Code of Civil Procedure section 343, the four-year general statute of limitation, applies to all actions founded upon a breach of fiduciary duty. *Robuck v. Dean Witter & Co., Inc.* 649 F.2d 641, 644 (9th Cir. 1980). Even the shorter, three year statute of limitations for fraud under Code of Civil Procedure section 338(4) is extended to the four year period of limitations under Section 343, for where both Section 343 and Section 338(4) can arguably apply, the longer statutory period takes precedence. *Robuck v. Dean Witter & Co., Inc.*, 649 F.2d at 645, n.2; *Davis & Cox v. Summa Corp.* 751 F.2d 1507, 1520 (9th Cir. 1985).

The four-year statute of limitations applies even if Respondents' breaches had been negligent, rather than intentional. *Federal Deposit Ins. Corp. v. McSweeney*, 772 F.Supp. 1154, 1156-57 (S.D. Cal. 1991) (rejecting the application of the two year statute for negligence). "Indeed, since *Robuck*, no federal or state court has applied anything other than the four-year period to such claims." *Id.*, 772 F.Supp. at 1157, fn. 6.

Respondents had an ongoing duty to disclose all facts relevant to the investments to claimants. Thus, the claims asserted in this proceeding did not "arise from" a single event at a single point in time. Respondents had a duty to keep claimants informed about every investment they purchased through them.

> The fiduciary relationship carries a duty of full disclosure, and application of the discovery rule "prevents the fiduciary from obtaining immunity for an initial breach of duty by a subsequent breach of the obligation of disclosure."

Parsons v. Tickner (1995) 31 Cal.App.4th 1513, 1526, 31 Cal.Rptr. 810 (citation omitted) (holding that statute of limitations had not expired on fraud claim even though original transaction occurred sixteen years before complaint filed, as a result of defendants' concealment of facts).

The relationships of trust and confidence between claimants

and respondents required respondents to communicate full and complete information regarding the subject of their dealings with Claimants. Any concealment, misrepresentation or failure to disclose was a new breach of respondent's fiduciary duties. Fraudulent concealment of the true facts by a fiduciary is as much as a fraud as if respondents had expressly denied the existence of the truth or made affirmative misrepresentations.

Because respondents were fiduciaries, any duty of inquiry claimants may otherwise have had was relaxed. *Eisenbaum v. Western Energy Resources, Inc.* (1990) 218 Cal.App.3d 314, 324-25, 267 Cal.Rptr. 5. Claimants had no duty to inquire whether their money had been improperly invested or not, but were entitled to rely on "the assumption that his fiduciary is acting in his behalf." *Id.* at 325. See also, *Sherman v. Lloyd* (1986) 181 Cal.App.3d 693, 697-98, 226 Cal. Rptr. 495, in which the court rejected a statute of limitations defense in a claim for failure to qualify a security for sale because, in part, the plaintiff was "entitled to rely on the statements and advice provided by the fiduciary." *Id.*

If claimants had filed their claims when they bought the investments, they could not have proven that they suffered damages because they did not know the truth about the speculative or fraudulent securities respondents sold to them. They were at risk when they bought, but the threat of future harm which had not yet been realized did not create a cause of action. See, e.g., *United States Liability Insurance Co. v. Hadinger-Hayes* (1970) 1 Cal.3d 586, 597, 83 Cal.Rptr. 418; and *Walker v. Pacific Indemnity Co.* (1960) 183 Cal.App.2d 513, 6 Cal.Rptr. 924.

Respondents have previously contended that the filing of a bankruptcy petition by the managing partner of one investment was sufficient to put claimants on notice of their broker's fraud. The claim here is not against the managing partner or a director or officer of the managing partner (as was the situation in the case cited by respondents, *Steel Warehouse v. Leach*, 1999 U.S.Dist. Lexis 16994 (N.D. Cal. 1999)). There is nothing in fact or logic which would have put claimants on notice of respondents wrongdoing simply because the general partner in one investment was having financial problems. *Gray v. First Winthrop Corp.* (9th Cir. 1996) 82 F.3d 877 (knowing that an investment lost money is not the same as knowing that fraud existed). As the court there observed, in reversing the district court's grant of summary judgment against an investor on timeliness grounds:

It is well settled that poor financial performance, standing alone, does not necessarily suggest securities fraud at the time of the sale, but could also be explained by poor management, general market conditions, or other events unrelated to fraud, creating a jury question on inquiry notice.

Gray, 82 F.3d at 881.

Under the applicable statute of limitations, and particularly in light of respondents' conduct in affirmatively discouraging claimants to bring this claim, claimants timely commenced this proceeding.

Fiduciary Duty in Florida

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[Editor's Note: This is a portion of a brief submitted by Mr.Blaher, which has been edited for inclusion in this publication.]

Breach of fiduciary duty has long been available as a cause of action under the common law of Florida. *See Quinn v. Phipps*, 93 Fla. 805, 113 So. 419 (1927); *Dale v. Jennings*, 90 Fla. 234, 107 So. 175, 179 (1925).

> "The term 'fiduciary or confidential relation' is a very broad one. It exists, and relief is granted, in all cases in which influence has been acquired and abused, and in which confidence has been reposed and betrayed. The origin of the confidence is immaterial. The rule embraces both technical fiduciary relations and informal relations that exist wherever one man trusts and relies upon another."

Atlantic Nat'l Bank of Florida v. Vest, 480 So.2d 1328, 1332 (Fla. 2d DCA 1985) (citations omitted).

A broker owes a fiduciary duty of care and loyalty to his customer. *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987); *Csordas v. Smith Barney, Harris Upham & Co., Inc.*, Fed.Sec.L.Rep. (CCH) ¶97,230, at 94,998, 94,999 (Fla.Cir.Ct. July 16, 1992). As the court pointed out in *Duffy v. Cavalier*, 215 Cal.App.3d 1517, 264 Cal.Rptr. 740 (1989):

> ""The relationship between broker and principal is fiduciary in nature and imposes on the broker the duty of acting in the highest good faith toward the principal. . . ." . . . With respect to stockbrokers it is recognized, "The duties of the stockbroker, being fiduciary in character, must be exercised with the utmost good faith and integrity . . . ."' 264 Cal.Rptr.

at 749 (quoting *Twomey v. Mitchem, Jones & Templeton, Inc.*, 262 Cal.App.2d 690, 708-09, 69 Cal.Rptr. 222 (1968)) (other citations omitted).

When a customer has placed his trust and reliance on a broker's expertise, the broker owes a fiduciary duty to the customer even though the account is nondiscretionary (requiring the customer's authorization for each transaction). *MidAmerica Federal Savings & Loan Ass'n v. Shearson/American Express, Inc.*, 886 F.2d 1249, 1258 (10th Cir. 1989); *Duffy*, 264 Cal.Rptr. at 749. As the court stated in *MidAmerica Federal*,

> "Although the fact that MidAmerica's account with Shearson was nondiscretionary would generally cut against the finding of a fiduciary relationship, here that fact is not sufficient to defeat MidAmerica's claim. Although Shearson did not execute any orders beyond those authorized by MidAmerica, *MidAmerica's authorization stemmed from its reliance upon Crow's misrepresentations*. We therefore hold that sufficient evidence exists to support the jury's conclusion that a fiduciary relationship existed between Shearson and MidAmerica and that Crow, on behalf of Shearson, took unfair advantage of that relationship in breach of his fiduciary duties." 886 F.2d at 1258 (emphasis added).

See also Davis v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 906 F.2d 1206, 1218 (8th Cir. 1990) ("if for all practical purposes the broker exercised de facto control over a nondiscretionary account and the client routinely followed the recommendations of the broker, then a finding of fiduciary duty may be warranted").

In *Csordas, supra*, Judge Powell observed that

> "[w]here the customer is generally unsophisticated with regard to investment matters, the broker will have to define the potential risks of a particular transaction carefully and cautiously. In other words, . . . the broker must explain to the customer the risks of purchasing a security in such a way that would enable the customer to relate the risks of the transactions to his risk threshold and thus make the independent determination himself of whether or not to purchase the security." *Id.* at 94,999 (citations omitted).

The fact that a customer may have understood the risks of the trading does not necessarily render him sophisticated or otherwise diminish the broker's fiduciary duty, for if the customer fully trusts the broker, he will follow the program confidently touted by the broker as having no more than minimal risk.

> "[T]hese facts [do] not compel the conclusion that she was 'competent to evaluate the extent of the risk she was taking or the propriety of one of her financial condition so doing. The fact that she had . . . prior transactions with other brokers, and that she had improvidently invested in one speculative security on her own initiative might justify a finding of knowledgeableness and lack of reliance, but they do not compel that result. . . . The receipt of confirmation slips and accounts, and her ability to chart the cost and price of her securities are facts of the same tenor. They may permit, *but they do not compel* findings that plaintiff knew she was engaged in a course of trading and purchasing securities of a type that were unsuitable for one of her financial situation and needs. . . .'" *Duffy*, 264 Cal.Rptr. at 751 (quoting *Twomey*, 262 Cal.App.2d at 722)(emphasis in original).

The court in *Duffy* thus concluded that "the relationship between a stockbroker and his customer is fiduciary in nature; the distinction between a 'sophisticated' investor and an 'unsophisticated' one is not controlling in this regard." 259 Cal.Rptr. at 170. Lest there be any doubt, the court added that "the existence of a stockbroker's fiduciary duty to a customer does *not* depend on a showing of 'special facts,' including whether or not the stockbroker serves as an investment advisor or controls the account." *Id.* at 170-71 (emphasis added).

Even in the unusual situation where the customer wants to speculate, a broker's duties are threefold:

> "[T]he stockbroker has a *fiduciary duty* (1) to ascertain that the investor understands the investment risks in the light of his or her *actual* financial situation; (2) to inform the customer that *no* speculative investments are suitable if the customer persists in wanting to engage in such speculative transactions without the stockbroker's being persuaded that the customer is able to bear the financial risks involved; and (3) to refrain completely from *soliciting* the customer's purchase of any speculative securities which the stockbroker considers to be beyond the customer's risk threshold." *Duffy*, 264 Cal.Rptr. at 750 (citing *Twomey*, 262 Cal.App.2d at 721) (emphasis in original).

See *Matter Of Application Of Gordon Scott Venters*, 51 S.E.C. 292 (Jan. 29, 1993) and *Matter Of Application Of John M. Reynolds*, 50 S.E.C. 805, 809 (Dec. 4, 1991), where the SEC held that, as a fiduciary, a broker is required to counsel a customer in a manner consistent with the customer's

financial situation, and thus make recommendations that are in the best interests of the customer, even if contrary to the customer's stated wishes.

Proof of the elements of a federal securities law violation establishes liability for breach of fiduciary duty "in most or perhaps all cases." *Miley v. Oppenheimer & Co., Inc.*, 637 F.2d 318, 324 (5th Cir. 1981). However, common law breach of fiduciary duty is an independent cause of action; therefore, a finding of either a federal or Florida securities law violation is *not* required in order for there to be a breach of fiduciary duty, nor is it necessary that there be common law fraud. *Gochnauer*, 810 F.2d at 1048-49.

RECENT ARBITRATION DECISIONS

NASD AWARDS

Adamson v. Fahnstock, Todd M. Nejaime, Gilford Securities and Reich & Co., NASD No. 99-03005

Claimants asserted breach of contract claims against Gilford; breach of fiduciary duty claims against Nejaime and Gilford; violation if NASD Rules 3010, IM 2310-Z and 2120; violation of rule 10-b-5 and successor liability against Fahnstock. Claimants requested compensatory damages of $1,889,846.00 and punitive damages of $300,000.00.

Respondents raised statute of limitations defenses, and alleged that Claimants made their own investment decisions and continued to use Nejaime as their broker after the alleged wrongdoing.

The Panel granted Fahnstock's motion to dismiss because it found that Claimants had failed to provide evidence of the corporate structure of Reich Fahnstock, and did not establish Fahnstock was the corporate successor of Reich. Reich was dismissed because it was not properly served. Nejaime was found liable to Claimants for $200,000.00 and ordered to pay Claimant an additional $300,000.00 which appeared to be punitive damages. Claimants were represented by Sean O'Shea, Esq. of New York, N.Y.

***Alcala and Cameron v. Bear Stearns & Co.*, NASD No. 00-05634**

Claimants alleged that they maintained an account at Dawson & Associates which used Bear Stearns to clear its trades on a fully- disclosed basis, that Dawson placed unauthorized trades in Claimants accounts; that the trades were then canceled and rebilled into the account of one of Dawson's principals; and that Bear Stearns then reversed these trades and placed the securities back in the Claimants accounts. Claimants alleged that these trades being placed back in their accounts constituted unauthorized trading by Bear Stearns. Claimants sought damages of $2,042,891.00, plus punitive damages and attorneys fees.

Bear Stearns asserted that its actions were consistent with NYSE Rule 382 and its clearing agreement with Dawson and denied any liability to Claimants.

The Panel denied the claim but awarded the Claimants $25,000.00 in sanctions against Bear Stearns plus $9,897.00 in costs. Claimants were represented by Lloyd Kadish, Esq. of Chicago, IL.

***Fleder v. Prudential Securities and Robert Zucker*, NASD No. 00-01336**

Claimants alleged that he opened an IRA rollover account with Respondent and requested that the account be invested in bank CD's; that his instructions were ignored and that instead he was placed in three preferred stocks and a bond with a below average rating and a forty year maturity. Claimant alleged that these investments were unsuitable and claimed damages of $25,000.00, plus unspecified punitive damages, costs and attorneys fees.

The Respondent asserted that the Claimant was an experienced investor with 30 years of background in trading equities bonds and mutual funds and that the investments were suitable for him based on his investment experience and significant net worth and investment objectives of income and growth.

The arbitrator noted in the award that the Respondent's contention that the Claimant was an experienced investor was based on the information on the client new account record which was prepared by the broker and signed by the broker and his manager, but not signed by the Claimant. The arbitrator further noted that the Respondent's contention that the Claimant's investment objective was growth was also based on the client account record.

The arbitrator awarded the Claimant $21,870.73, the difference between the sum invested and the sale proceeds, denied punitive damages, and awarded attorneys fees as determined by a court of competent jurisdiction. The Claimant was represented by Mark A Tepper, Esq. of Fort Lauderdale, FL.

***Glenn v. E.C. Capital, Ltd, et al.*, NASD No. 99-00666**

Claimant alleged causes of action based on securities and common law fraud, RICO, unauthorized trading, and breach

of contract, in the trading of Diplomat, Compu-Dawn, Response USA, Sirco International, and Paradise Holdings. Claimant sought compensatory damages of $710,829.00 and punitive damages of $500,000.00, plus costs and attorneys fees.

Respondent denied all allegations and asserted that the claims were barred by waiver, estoppel and ratification, and by the Private Securities Reform Act.

The Panel awarded the Claimant $220,380.79 plus interest at 6% from the date of investment but denied the punitive damages and attorneys fees claims. The Claimant was represented by Mark D. Schorr, Esq. of Trenton, N.J.

***Hoffman, Lunar Tool & Mold, and Lunar Tool & Mold Pension Plan v. Olde Discount*, NASD No. 98-1999**

Claimants asserted causes of action based on breach of fiduciary duty, breach of contract, fraud and gross negligence. The basis of the claims related to allegations of churning, unsuitable investments, and failure to supervise. Claimants requested damages of $691,000.00, punitive damages of $1 million, costs and attorneys fees.

Respondent asserted that the claims were barred by waiver and/or ratification; that Claimants assumed the risk and/or were contributorily negligent; and that there was neither a factual or legal basis for Aexemplary@ damages.

The Panel awarded Hoffman $100,000.00 and Lunar Tool & Mold $100,000.00, but denied the claims of the Lunar Tool & Mold Pension Plan. The Panel denied the request for punitive damages and attorneys fees. Claimants were represented by David G. Weibel, Esq. of Cleveland, Ohio.

***Maderazo v. Piper Jaffray*, NASD No. 99-05125**

Claimants alleged that Respondents broker convinced them to sell a $2.5 million mutual fund and blue chip stock portfolio and invest the proceeds in a mutual fund wrap account; that less than nine months later the broker recommended the sale of the mutual funds and the investment of the proceeds in a separate stock wrap account; that the Claimants incurred deferred sales charges of over $21,000.00 on the premature sale of the mutual funds; that if Claimants had not been persuaded to liquidate their initial mutual fund and stock positions, they would have realized about $249,000.00 over their ending account value when they closed their Piper Jaffray account. Claimants requested damages of disgorgement of all commissions and fees and the return they would have received had their account been properly managed, plus punitive damages and attorneys fees.

Respondents asserted that the investments made were consistent with the Claimants' investment objectives; that all fees and commissions were properly disclosed; and that the accounts were structured to minimize fees and expenses.

The Panel awarded Claimants $78,000.00 which included interest, $36,000.00 as attorney fees and $24,900.00 as witness fees. Claimants were represented by Richard G. Himelrick, Esq. of Phoenix, AZ.

***Roach v. E-Trade Securities*, NASD No. 99-05665**

Claimants alleged that Respondent was negligent and breached its fiduciary duty in connection with the purchase of call options and/or stock in Netscape and AOL. Claimants requested $28,000.00 in damages, plus punitive damages, costs and attorneys fees.

Respondent denied all claims and asserted a counterclaim in the amount of $3,323.31 which was the debit balance in the Claimants' account which they had refused to pay.

The Panel awarded the Claimants $21,395.14 in damages plus $2,159.51 in accrued interest, $13,022.00 in attorneys fees, pursuant to the E-Trade customer agreement, and $1,500.00 in expert witness fees. Claimants were represented by Ryan K. Bakhtiari, Esq. of Beverly Hills, CA.

***Serwas v. Ameritrade*, NASD No. 99-04720**

Claimants alleged violations of Florida and Federal securities acts and NASD rules, and negligence and breach of contract relating to the purchase of shares in the Claimants' account of The Globe.com and the unauthorized liquidation of other securities in the Claimants' account. Claimants requested damages of $100,000.00 plus interest, lost profits from the forced sales of other securities, attorneys fees and costs.

Ameritrade asserted that it only executed the market orders placed by the Claimants and that it had the legal right to liquidated other securities when it became apparent that the Claimants' decision to purchase the shares, at a price which was unknown at the time, placed the Claimants' accounts in jeopardy.

The Panel awarded the Claimants $46,000.00, with prejudgment interest specifically excluded, and denied all other relief. Claimants were represented by Stephen D. Spivey Esq. of Ocala, FL.

***Wenger v. Ameritrade*, NASD No. 99-02064**

Claimants alleged causes of action based on breach of contract and violations of the Pennsylvania Unfair Trade

Practices Act, relating to the cancellation of the Claimants' order to sell 3,000 shares of Books-A-Million stock. Claimants sought damages of $108,506.00, interest, attorneys fees and costs.

Respondent asserted that Claimants failed to prove damages, in that, they could have sold their shares at a profit when they first realized that the order had been canceled.

The Panel awarded Claimants $51,000.00, plus interest at 6%. Claimants were represented by Paul Crowley, Esq. of Dowingtown, PA.

***Ahee v. Quick & Reilly*, NASD No. 99-04389**

Claimant alleged that Respondent was negligent in failing to advise him that Respondent required 65% equity for the purchase of CMGI stock on margin. Claimant requested $58,500.00 in damages, plus attorneys fees and costs.

Respondent admitted that it failed to advise Claimant of the higher equity requirement but asserted that Claimant's damages should be limited to $11,817.00, which was the loss on the 606 additional shares that Claimant bought, not on the entire number of shares purchased. Respondent asserted that Claimant would have made a purchase for 2,394 shares, based on his history of using maximum margin, even if he had known of the 65% equity requirement. Respondents further argued that the Claimant sold all shares of CMGI against their advice and without giving them a chance to get the margin requirement reduced.

The Panel awarded the Claimant $14,758.75, and costs of $7,531.81. Claimant was represented by Eugene Zlaket, Esq. of Tucson, AZ.

***Allen v. FFP Securities*, NASD No. 99-04727**

Claimant alleged that Respondent failed to adequately advise Claimants on the income tax implication of selling certain securities to purchase bonds; that Respondent recommended that Claimant sell dividend paying securities to purchase CMO's which were not suitable; and that Respondent's actions violated Arizona securities laws. Claimant sought damages of $100,000.00, plus punitive damages, costs and attorneys fees.

Respondent asserted that the CMO's were suitable for Claimant based on her investment objectives of conservation of principal and income.

The Panel awarded Claimant $109,155.00, plus interest at 10% and attorneys fees of $15,000.00. Claimant was represented by J. Emery Baker, Esq. of Tucson, AZ.

***Burton v. Wheat First Securities*, NASD No. 99-03729**

Claimants alleged violations of Idaho and Federal securities laws, fraud, breach of fiduciary duty and unsuitability regarding the short sale recommendations in Amazon, AOL, Dell and Yahoo. Claimants sought damages of $500,000.00, plus punitive damages, attorneys fees and costs.

Respondents asserted that Claimants ratified all trades after they were advised of all the risks of the transactions.

The Panel, by majority decision, awarded Claimants $184,452.37, plus $20,322.76 in interest, and $16,678.90 in attorneys fees and expenses. The Chairperson, George M. Wiener, Esq., dissented from the award, stating that the award was not supported by the facts and was in manifest disregard of the law. In response to the dissent, the concurring majority wrote a detailed decision explaining the award. Claimants were represented by Laurel H. Siddoway, Esq. of Spokane, WA.

Georges v. CIBC Oppenheimer and Richard B. Fee, NASD No. 98-03690

Claimant alleged causes of action of breach of contract and fiduciary duty, intentional affliction of emotional distress, negligent supervision and negligent hiring/retention. Claimant requested damages of $500,000.00, punitive damages of $750,000.00, plus attorneys fees and costs.

Respondent asserted that any actions by the broker Fee were outside the scope of his employment and not capable of detection by Oppenheimer's supervisory safeguards. Fee contended that all funds that had been misappropriated had been paid back to Claimant.

The Panel awarded Claimant $370,245.00 jointly and several against Oppenheimer and Fee, and $75,000.00 in punitive damages against Fee. The authorities for punitive damages listed by the Panel in the Award were *Block v. Barnowski*, 959 F. Supp. 172; *Americorp v. Sager*, 656 N.Y.S. 2d 762; *Merrill Lynch v. Adler*, 651 N.Y.S. 489; *Mulder v. Donaldson, Lufkin, & Jenrette*, 648 N.Y.S. 2d 535. The Claimant was represented by John H. West, Esq. of Baltimore, MD.

Rintels v. Olde Discount, NASD No. 98-04829

Claimant alleged that Respondent breached its fiduciary duty and violated the Florida Securities Act by ignoring the

Claimant's conservative investment objectives and churning the Claimant's account to generate commissions; that over $22 million of securities were purchased in the account with holding periods of only a few days. Claimant sought $540,000.00 in damages plus punitive damages, interest, costs and attorneys fees.

Respondent asserted that the Claimant's account was not churned and that no misrepresentations were made; that Respondent professionally performed all their duties; that the claims were barred by the statute of limitations, and that Claimant had no right to recovery exemplary damages or attorneys fees under applicable state law.

The Panel awarded Claimant $115,000.00, with prejudgment interest specifically excluded. The Panel denied the Claimant's request for attorneys fees and punitive damages. Claimant was represented by Laurence S. Schultz, Esq. of Troy, MI.

***Wood v. Merrill Lynch*, NASD No. 00-01203**

Claimant alleged that Respondent made unauthorized trades in his account, sold securities based on misrepresentations and omissions, and executed options transactions which were different from the Merrill Lynch research recommendations at the time. Claimant sought $49,900.00 in damages, plus costs and attorney fees.

Respondent asserted that the Claimant was an experienced businessman who understood the risks involved in the investments at issue and that the Claimant had a significant net worth and liquid net worth.

The Panel awarded $26,876.38, plus interest of $4,300.22, and $8,958.79 in attorneys fees. Claimant was represented by Thomas A. Hargett, Esq. of Indianapolis, IN.

***Woodrow v. A.E. Edwards & Sons*, NASD No. 99-01432**

Claimant alleged that Respondent margined the Walmart stock that constituted virtually all of Claimant's retirement savings, and, over a period of six years, traded options and commodities in Claimant's account; that when Claimant sent a written request to halt all trading and sell enough Walmart stock to pay off the margin debt, these written instructions were ignored. Claimant sought $865,000.00 in damages, punitive damages, plus interest, costs and attorney fees.

Respondent asserted that Claimant's investment objective was speculation; that Claimant executed all the proper risk disclosure documentation; that in response to Claimant's letters, Respondent gave Claimant a detailed profit and loss statement and offered to provide Claimant a financial plan which Claimant refused; that Claimant subscribed to a commodities future trading service and received his own "real time" commodities quotes; and that the claims were time-barred and ineligible for arbitration.

Respondents filed a motion to dismiss under the applicable statute of limitations and under section 10304 of the NASD Code of Arbitration Procedure. The Panel ruled that the statute of limitations was tolled but that Section 10304 was applicable, and limited Claimant's claims accordingly. During the course of the arbitration, arbitrator Joseph E. Meyer's arbitration classification was changed from industry to public.

The Panel awarded the Claimant $146,303.00, plus interest at 10%, and costs in the amount of $44,356.53. Claimant was represented by Joel A. Goodman, Esq. of Clearwater, FL.

NYSE AWARDS

***Weinberg v. Bear Stearns*, NYSE No. 2000-08216**

Claimants brought the arbitration to rescind a settlement agreement which they alleged had been procured under duress and by fraud and to recover full damages for unauthorized trading.

The Panel granted the Claimants' request to have the settlement agreement rescinded but denied their claim for unauthorized trading. Claimants were represented by Leonard Steiner, Esq. of Beverly Hills, CA.

***Larisey v. Charles Schwab, Mayer & Schweitzer and Charles Schwab*, NYSE No. 1998-07233**

Claimants alleged failure to provide best execution and front running against the firms and the Chairman of the Board. Claimants sought $3 million in damages.

The Panel awarded the Claimant $211,000.00 to be paid by the Respondent firms, which represented $210,000.00 in damages and $1,000.00 as a return of the hearing deposit, and assessed the forum fees of $ 27,000.00 to be paid by the Respondents. The Claimants were represented by Philip Aidikoff, Esq. of Beverly Hills, CA.

***Messa v. Gruntel & Co., Inc.*, NYSE No. 1999-07989**

Claimants alleged that the Respondent's broker recommended an unsuitable investment in AFG Investment Trust D, an equipment leasing trust. Claimants sought damages of $170,000.00.

The Panel's award allowed the Claimant to deliver 8,000 units of the AFG Investment Trust to Respondent which would then pay to Claimants the sum of $90,000.00. The Claimants were represented by Seth E. Lipner of Garden City, NY.

***Chau v. Waterhouse Securities*, NYSE No. 2000-08362**

Claimant alleged that Respondent accepted orders for two securities in her account when there were insufficient funds in the account to pay for the purchases; that Respondent should have blocked the purchases; that as a result of a margin call the account had to be liquidated; and that shares of Alpha Trade.com were liquidated at lower prices after the firm confirmed the sale at a higher price. Claimant sought damages of $110,738.00.

The Panel found for the Claimant but only in respect to her claim concerning the Respondent's execution of her sell order on Alpha Trade.com. The award was $57,233.00. The Claimant was represented by Steven B. Caruso, Esq. of New York, NY.

RECENT COURT DECISIONS

***Mahant v. Lehman Brother*, 2000 U.S. Dist. Lexis 16966, (11/14/00 S.D.N.Y.)**

The plaintiff sued defendant former employer for violating the Age Discrimination in Employment Act, 29 U.S.C.S. § 621 et seq., Title VII of the Civil Rights Act of 1964, 42 U.S.C.S. § 2000e et seq., and state law. Defendant moved to compel arbitration and to dismiss or stay the action.

After the plaintiff was transferred to defendant employer, defendant allegedly required her to sign an employment application without reading it. The application contained a clause requiring arbitration of employment-related disputes, including termination. The plaintiff's contended that the arbitration provision was unenforceable because she signed the application under duress.

The Court held that, because all of plaintiff's allegations supporting her duress claim relate to the enforcement of the employment application generally, not the enforcement of the arbitration provision alone, the plaintiff's duress claim therefore must be resolved in arbitration. The Court further pronounced that federal courts are required to "'construe arbitration clauses as broadly as possible'" and to enforce arbitration agreements "'unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.'" *McMahan Sec. Co. v. Forum Capital Markets*, 35 F.3d 82, 88 (2d Cir. 1999).

***Coleman & Company Securities, Inc. v. The Giaquinto Family Trust*, 2000 U.S. Dist. Lexis 16215 (11/9/00 S.D.N.Y.)**

Respondents moved to dismiss petitioner's request for a permanent stay of certain claims in the arbitration proceedings.

Respondents opened securities accounts at petitioner broker-dealer by signing standard form customer agreements that contained both an arbitration clause and a general New York choice of law provision. Respondents commenced an arbitration proceeding alleging claims against defendant arising out of trading in respondents' accounts. After defendant moved for a stay of the arbitration proceedings in state court, a temporary stay of the proceedings was ordered. Respondents removed the case to federal court on the basis of diversity jurisdiction. Respondents' moved to dismiss the petition on the grounds that the arbitrators must decide whether claims submitted to arbitration were time-barred. The court found that by expressly providing for New York law to govern the arbitration, the parties intended for the court to decide petitioner's statute of limitations defenses. The parties selected both the Federal Arbitration Act, 9 U.S.C.S. § 1 et seq., and New York law to govern their arbitration. Therefore, the parties intended to be bound by New York's arbitration rules, including the rule limiting the power of the arbitrators to hear preliminary questions of timeliness.

Respondents' motion to dismiss was denied, as respondents and petitioner were parties to agreement that contained both arbitration clause and general New York choice of law provision and, therefore, they intended for the court, rather than arbitrators, to decide preliminary questions of timeliness.

***Green v. Progressive Management, Inc.*, 2000 U.S. Dist. Lexis 15079, (10/13/00 S.D.N.Y.)**

Petitioner moved for relief from the Court's Order denying her petition to vacate an arbitration award issued by an NASD arbitration panel following a two-day hearing. The Court noted that the petitioner had the burden of showing that the panel's determination was based on a "manifest disregard" of the law or evidence. The Court concluded that:

> The evidence submitted by the petitioner does not even in itself raise a serious question as to the merits of her claims, and the wisdom of the Panel's determination. The Panel may have chosen to credit the testimony of [the respondent broker] that he had frequent discussions with [the petitioner] about her account, and his opinion that she understood the risks involved in her investments, and that her portfolio was appropriate for her stated investment objectives. Although the record contains evidence favorable to [the petitioner], this Court may not usurp

Panel's discretion to give to the testimony it heard the weight it deemed appropriate. Where "a ground for the arbitrator's decision can be inferred from the facts of the case," the Court cannot vacate the award, "even if the ground for their decision is based on an error of fact or an error of law." *Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp.*, 103 F.3d 9, 13 (2d Cir. 1997). The record contains ample grounds for the Panel's decision.

The Court denied the petitioner's motion for relief from the arbitration award under Rule 60(b) of the Federal Rules.

***Kingston v. Ameritrade, Inc.*, 2000 Mont. Lexis 274; (10/26/00 Mont. S. Ct.)**

Plaintiffs opened an account with the defendant on-line stockbroker. The application mentioned arbitration provisions contained in a terms and conditions booklet that was never sent to them, terms which made arbitration binding.

The application promised constant accessibility to the online trading service, but lack of access caused plaintiffs to suffer losses through inability to make trades. The Montana Supreme Court reasoned that, although the Federal Aviation Act, 9 U.S.C.S. § 1 et seq., and nearly identical Montana statutes expressed a policy favoring arbitration pursuant to contract, Mont. Code Ann. § 27-5-115 (1997) made it clear that courts were obliged to rule on claims that an arbitration clause was not valid. Looked at from plaintiffs' perspective, the Court found that the plaintiffs raised an issue of whether they were bound by terms and conditions they never saw, denying them access to courts.

The Court held that the state trial court erred in dismissing plaintiffs' claim for lack of jurisdiction and in ordering arbitration. The court reversed and remanded for further proceedings, because the trial court erred in determining it lacked jurisdiction where plaintiffs' pleadings raised a bona fide dispute over whether a valid arbitration agreement existed. The Court cited Mont. Code Ann. § 27-5-114, -115 (1997) which requires the enforcement of pre-dispute arbitration clauses, except upon grounds that exist at law or in equity for the revocation of a contract. However, the Court acknowledged that there were exceptions to the general rule dictating enforcement of an arbitration agreement. The Court stated:

Generally, these provisions require a court to follow a liberal policy in enforcing arbitration agreements, including resolving any doubts concerning the scope of arbitrable issues in favor of arbitration. Yet, under the provisions of Mont. Code Ann. § 27-5-115 (1997), a trial court may not order arbitration if there is a substantial and bona fide dispute over whether there exists an agreement to arbitrate.

LEGAL SHORTS

In re Paul C. Keller, 51 S.E.C. 30, (an unsuitable frequency of trading violates NASD suitability standards; i.e., constitutes quantitative unsuitability);

In re John M. Reynolds, 50 S.E.C. 805 (1992); *In Re Gordon Scott Venters*, 51 S.E.C. 292 (1993), (even if customer wanted to engage in speculative trading, broker was obliged to abstain from making recommendations that were inconsistent with the customer's financial situation);

In re Clinton Hugh Holland, 52 S.E.C. 562 (1995), aff'd 105 Fed 665 (9th Cir. 1997), (over-concentration of speculative securities is unsuitable);

In re Alstead Dempsey & Co., 47 S.E.C. 1034 (1984), (the mark-up is the difference between the retail price and the prevailing market price of a security);

Reeves v. Ernst & Young, 494 U.S. 56, (1990), (definition of a security).

Practice Pointer – Subpoenas in Arbitration

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The issue of attorney-issued subpoenas to non-parties arises with some frequency in arbitration. The respondent firms have used such subpoenas to fish and harass. Here is a quick primer on the law:

1. The NASD and NYSE Rules give attorneys the power to issue subpoenas "as provided by law." The Rules thus do not create any non-statutory bases upon which an attorney may subpoena.

2. The FAA says that "the arbitrators, or a majority of them, may [subpoena]" (9 U.S.C. 7), implying that the attorneys have no such power. The Federal Rules, which authorize third-party subpoenas in litigation, apply only in the District Courts, so the subpoena power cannot be found there.

3. Some states authorize attorneys to issue third-party subpoenas for documents sua sponte, others do not. Florida, for instance, requires 10-day notice to the other

side before issuance, giving the adversary an opportunity to seek to quash before the damage is done. N.Y. law is ambiguous - in one place it seems to give attorneys a right to subpoena in arbitration (CPLR 7505); in another, it requires a court order for third-party discovery of documents (CPLR 3120(b)).

4. On the "enforcement" side, under a recent 8th Circuit case, the geographical scope of *arbitrator-issued* subpoenas is nationwide, and the remedy for non-compliance is in the District Court. Under state law, however, there is no "long arm jurisdiction" for subpoenas, so, if the subpoena is out-of-state, it may be necessary to get the arbitrator's signature before serving (an otherwise valid) attorney-issued subpoena out of state. (See, *In the Matter of Arbitration Between, Security Life Insurance Company of America; Congress Life Insurance Company; Appellees, and Duncanson & Holt, Inc.; The Multiple Employers Trust Quota Share Line Slip; Transamerica Occidental Life Insurance Company, Appellants*; 228 F.3d 865 (No. 99-3523, 8th Cir. 10/2/00)).

PRACTICE POINT: If you fear your adversary will start a wild subpoena fest - bring it up at the IPHC. I usually propose the Florida approach - that before a flurry of subpoenas goes out, Respondent must give advance notice to us, giving us an opportunity to object in writing, with the arbitrator deciding whether to quash "on the papers" only - avoiding a costly pre-hearing conference. Most arbitrators will go along.

PIABA 10TH ANNUAL MEETING

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