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An Association of Attorneys

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Honorable Arthur Levitt  
Chairman's Office  
U.S. Securities and Exchange Commission  
450 5<sup>th</sup> Street Northwest  
Washington, D.C. 20549

RE: Release No. 34-39371; File No. SR-NASD-97-47

Dear Chairman Levitt:

At the start of your second term as Chairman of the Securities & Exchange Commission, you claimed the SEC is "completely committed" to fighting penny stock fraud. You told the Wall Street Journal "I want the consequences of serious securities fraud to be similar to those of bank robbery." Unfortunately, by accepting the proposed rule by the NASD to cap punitive damages in securities arbitration claims at an amount equal to the lesser of two times the compensatory damages or \$750,000, you will renege on your promise to American investors, and the SEC will be aligned with the crooks the American people expect protection from.

This letter is meant to offer an opinion based on my experience as a former Commissioner of the Indiana Securities Division and now as an attorney who represents investors taken advantage of by their stockbrokers. I can state unequivocally that the single biggest threat facing the individual investor today is penny and micro-cap stock fraud. Capping punitive damages in securities arbitration cases will destroy the minimal progress made against penny stock firms over the last decade.

There is no diplomatic way to say it, so I'll just state it plainly: the SEC and the NASD lack the resources to address the penny stock problem. So, do not take from arbitrators, the ones who are in the trenches and see first hand the ramifications of penny stock fraud, the right to punish the penny stock criminals to the extent they see fit. Since the SEC and NASD have been unable to make a dent in the penny stock problem, please stand back and let those who are able do their jobs.

Punitive damages often serve as the only effective police mechanism against penny stock firms. With only one new regulator for every 588 new brokers, the SEC and NASD lack the manpower to effectively curb penny stock fraud. The rules of the New York Stock Exchange and other exchanges usually do not apply since the penny stock firms are almost never members. Therefore, almost all disputes between investors and penny stock firms end up in NASD arbitration. Unfortunately, even when regulators catch penny stock firms, you give them nothing more than a slap on the wrist and let them go on their merry way. Joseph Borg, director of the Alabama Securities Commission, testified before Congress that civil fines of several million dollars are merely considered a cost of doing business for penny stock operators.

Sen. Susan Collins (R., Maine) accurately stated last year "The subcommittee has information that penny stock fraud is roaring back." Investors lost an estimated \$6 billion in fraudulent penny stock schemes in 1996. The New York attorney general's office estimates final figures for 1997 may be 40% higher. The North American Securities Administration Association, which represents state securities regulators, reported a 30% increase in fraud complaints last year. The group estimates that securities fraud costs American investors \$10 billion a year, or \$1 million every hour.

It is crucial that arbitrators retain the ability to make appropriate punitive awards even if they do so infrequently and the award is more a matter of sending a message to the industry through punishment than of a windfall to investors. No runaway punitive damage problem exists in the securities industry, contrary to what your friends at the major brokerage firms tell you. In the overwhelming majority of securities arbitration cases, punitive damages are not warranted and are not awarded. On average, only 2% of arbitration cases that go to hearing result in punitive awards.

However, if the SEC would get down in the trenches with those who fight the battle against penny stock crooks, you would discover that in virtually every single penny stock fraud case punitive awards are warranted. No one can realistically question the appropriateness of the \$10 million punitive damage arbitration award against Stratton Oakmont. After weak regulatory settlements with the NASD and SEC, Stratton repeatedly ignored regulator's warnings to end customer churning and unauthorized trading and continued to make grossly unsuitable recommendations; all the while the firm's president allegedly earned up to \$7 million a year. Capping punitive awards takes away the arbitrator's ability to punish the most egregious penny stock firms like Stratton Oakmont and their corrupt employees.

The executives at the major brokerage firms tell you NASDR disciplinary referrals are enough to curb penny stock scams. However, it is our law firm's experience in handling hundreds of securities arbitration cases that in the overwhelming majority of cases, disciplinary referrals lead to nothing at all, or no more than a slap on the wrist and the scam artists are back to their same tricks immediately. A recent investigation by New York attorney general Dennis Vacco found many penny stock firms operating today are staffed by swindlers whose prior firms were driven out of business years before. Mr.

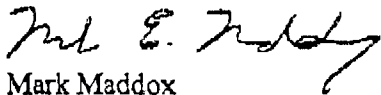
Borg of the Alabama Securities Commission noted that employees from two notorious former penny stock firms, First Jersey Securities and Investors Center, formed at least 14 other penny stock firms despite regulators best efforts to shut them down. This penny stock pedigree is highly valued in the micro-cap game.

Please remember Mr. Chairman, the people of Indiana never elected you or anyone at the SEC or NASD to legislate changes to the claims and remedies available to the investing public. Investors have no choice but to arbitrate their disputes. As such, at a minimum, the same remedies that are available in the courts should be available in arbitration. Nowhere is the SEC granted the authority by Congress to preempt state laws and limit the remedies available to individual investors despite what the NASD has told you.

The SEC's approval of the cap on punitive damages is inconsistent with the stated goal of complete commitment to fighting penny stock fraud. At a minimum, send the proposal back to the NASD for further discussion. Demand that the NASD perform a study to determine whether NASD disciplinary referrals lead to any significant disciplinary action.

Please reconsider your position on capping punitive damages. Show the securities industry that the "fix is not in" on this issue. Do not take from investors the last protection they have against penny stock criminals. Do not sell out to the interests of the big brokerage firms at the expense of the small investor. An arbitrator's power to impose on penny stock crooks the ultimate sanction of punitive damages must not be infringed upon.

Sincerely,



Mark Maddox

CC: Senator Susan Collins, Representative Edward Markey, Representative John Dingle, Commissioner Paul Carey, Commissioner Issac Hunt, Commissioner Norman Johnson, Commissioner Laura Unger, Attorney General Dennis Vacco, Director Joseph Borg, Ms. Mary Schapiro, Mr. Barry Goldsmith, Ms. Linda Feinberg, Mr. John Barlow, Mr. Justin Klein, Ms. Catherine McGuire, Ms. Diane Nygaard, Ms. Robin Ringo, Mr. Jack Katz.