

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

WEDBUSH MORGAN SECURITIES, INC.
(CRD No. 877),

Respondent.

Expedited Proceeding
No. ARB060035

Hearing Officer—Andrew H. Perkins

DECISION

March 15, 2007

In accordance with Article VI, Section 3(b) of NASD By-Laws and NASD Procedural Rules 9554 and 9559(n), Respondent's membership will be suspended for its failure to pay an arbitration award.

Appearances

For the Complainant: John S. Han, Regional Attorney, Los Angeles, CA.

For the Respondent: Jerry S. Phillips, Esq., LOEB & LOEB LLP, Los Angeles, CA.

DECISION

I. Introduction

NASD Dispute Resolution sent a letter to Wedbush Morgan Securities, Inc. (“Wedbush”) on November 9, 2006 (the “Suspension Notice”) notifying Wedbush that its NASD membership would be suspended pursuant to NASD Procedural Rule 9554 for its failure to comply with the arbitration award issued in the NASD arbitration *Bouse v. Wedbush Morgan Sec.*, NASD Arbitration No. 05-01410 (the “Award”). The Suspension Notice further stated that Wedbush could request a hearing on or before November 30, 2006.

On November 30, 2006, Wedbush requested a hearing pursuant to NASD Procedural Rule 9554(e). Wedbush contended that it had paid the Award in full. The Department of

Enforcement (“Enforcement”) on the other hand contended that Wedbush had incorrectly calculated the amount of accrued interest on the Award.

Enforcement submitted a Memorandum of Points and Authorities in Support of Enforcement’s Request to Suspend Respondent’s Registration along with 10 exhibits (CX-1 through CX-10). Wedbush submitted a Memorandum of Points and Authorities in Opposition to Intent to Suspend Membership, the Declaration of Jerry S. Phillips in Opposition to Intent to Suspend Membership, and 4 exhibits (Exhibit “A” through Exhibit “D”).

The Hearing Officer conducted a hearing by telephone on February 1, 2007, at which he admitted all of the exhibits and heard argument from counsel.

II. Findings of Fact and Conclusions of Law

A. Facts

Wedbush paid the principal amount awarded to the claimants. The issue in controversy is the calculation of post-award interest pursuant to NASD Code of Arbitration Procedure Rule 10330(h). There are no facts in dispute.

On May 26, 2006, a panel of arbitrators issued the Award against Wedbush, awarding 43 claimants compensatory damages and attorneys’ fees totaling \$3,801,933.¹ NASD Dispute Resolution then sent Wedbush notice of entry of the Award, which Wedbush’s attorney received on May 26, 2006.² The letter erroneously stated that the due date for payment of the Award was June 28, 2006.³ In fact, under Rule 10330(h), payment was due on or before June 25, 2006, 30 days after Wedbush received the Award.

¹ CX-1.

² Decl. of Jerry S. Phillips in Opp’n to Intent to Suspend Membership ¶ 2.

³ CX-2, at 1.

On June 27, 2006, Wedbush filed in the United States District Court for the Central District of California a Petition to Vacate Arbitration Award.⁴ The District Court Petition sought to vacate or correct \$2,351,635 of the total Award.⁵ At the same time, Wedbush paid the uncontested balance of the Award in the amount of \$1,450,298.⁶

On August 4, 2006, the United States District Court dismissed Wedbush's Petition.⁷

On November 7, 2006, Wedbush paid the claimant's attorneys \$2,351,635, the amount Wedbush unsuccessfully challenged in federal court. The claimants' attorneys then sent a letter to NASD that requested NASD to suspend or cancel Wedbush's membership for failure to pay the Award in full.⁸ The claimants asserted that they were owed an additional \$118,503.69 in post-judgment interest under California law.⁹

NASD Dispute Resolution notified Wedbush by letter dated November 9, 2006, that its membership would be suspended effective November 30, 2006, unless by that date it paid the Award in full or requested a hearing.

On November 30, 2006, Wedbush made a final payment of \$104,373.94 to the claimants' attorneys.¹⁰ Wedbush contends that this payment paid all of the accrued post-award interest due the claimants. At the same time, Wedbush timely requested a hearing, claiming that it had paid the Award in full.

⁴ Wedbush Ex. B.

⁵ *Id.*

⁶ Wedbush Ex. C; CX-3.

⁷ CX-5, at 5.

⁸ CX-6, at 1.

⁹ The Parties agree that at the time the applicable legal rate of post-judgment interest in California was 10% per year.

¹⁰ CX-9.

B. Discussion

Resolution of the dispute in this proceeding turns on the application of NASD Code of Arbitration Procedure Rule 10330(h), which provides in relevant part:

All monetary awards shall be paid within thirty (30) days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction. An award shall bear interest from the date of the award: (1) if not paid within thirty (30) days of receipt, (2) if the award is the subject of a motion to vacate which is denied, or (3) as specified by the arbitrator(s) in the award. Interest shall be assessed at the legal rate, if any, then prevailing in the state where the award was rendered, or at a rate set by the arbitrator(s).

Enforcement argues that Rule 10330(h) does not permit partial payments made within 30 days of receipt of an award to reduce the amount of post-award interest due.¹¹ According to Enforcement, Rule 10330(h) treats an arbitration award as a “single, undivided item.”¹² Hence, Enforcement contends that a partial payment does not meet the Rule’s requirement that an “award” be paid within 30 days of its receipt.

The Hearing Officer rejects Enforcement’s construction of Rule 10330(h). “Arbitration proceedings have dual goals, namely, settling disputes efficiently and avoiding expensive litigation.”¹³ In furtherance of those goals, Rule 10330(h) requires prompt payment of arbitration awards. Awards must be paid within 30 days of their receipt. If not so paid, interest accrues on the unpaid amount calculated from the date of the award. Thus, as Enforcement conceded at the hearing, if Wedbush had paid the Award in full on the 29th day following its receipt, no interest would have been due the claimants.¹⁴ The same logic should apply to a partial payment of that

¹¹ Tr. 8.

¹² Enforcement’s Mem. of P. & A. at 4.

¹³ *Department of Enforcement v. Bronzino*, 1998 NASD Discip. LEXIS 54, at *6 (N.A.C. June 29, 1998).

¹⁴ Tr. 9.

portion of an award that is not the subject of a motion to vacate.¹⁵ Giving credit to such partial payments encourages the losing party to pay the undisputed amount of an award, which benefits the prevailing party. If Enforcement's construction is applied, there is less incentive for the losing party to pay the undisputed portion of an award promptly. Accordingly, the Hearing Officer determines that no post-award interest would have accrued on the amount of the partial payment if Wedbush had made the payment within the time proscribed by Rule 10330(h). However, Wedbush did not make the first payment timely.

The Award is dated May 26, 2006. Thus, under Rule 10330(h), payment was due on or before June 25, 2006. But Wedbush did not make its first payment until June 27, 2006. Accordingly, interest accrued on the full amount of the Award from May 26, 2006, until June 27, 2006.

Wedbush contends that its partial payment on June 27, 2006, was timely because it relied on the notice it received from NASD Dispute Resolution staff that gave June 28, 2006, as the due date. Enforcement acquiesces in this argument. The Rule however is unambiguous—interest accrues if an award is not paid within 30 days of its receipt. Moreover, the staff's clerical error cannot alter the claimants' rights under the Award and Rule 10330(h). NASD Dispute Resolution staff lacks the authority to suspend or modify the Rule. Once the debtor fails to pay an award within the 30-day grace period, the creditor's right to interest on the unpaid amount vests as a matter of law.

Consistent with the foregoing ruling, the Hearing Officer determines that Wedbush has not paid the Award in full. As of June 27, 2006, Wedbush owed the claimants a total of

¹⁵ The motion to vacate stayed Wedbush's obligation to pay the challenged portion of the Award.

\$3,835,265.16, which amount includes \$33,332.16 in accrued interest.¹⁶ Thus, after Wedbush made the first payment, the remaining unpaid principal balance was \$2,384,967.16.

To calculate the current balance due the claimants, the Hearing Officer must resolve Wedbush's second argument that it was entitled under California law to designate that its first two payments be applied entirely to the payment of principal. Wedbush relies on California Civil Code Section 1479, which provides that a debtor who is obligated on more than one obligation to a creditor may select the obligation to which his payment or performance is applied. When the debtor's intention or desire is manifested to the creditor, the creditor must apply the payment or performance in accordance with the debtor's manifested intent. Enforcement on the other hand argues that California Civil Code Section 1479 does not apply to the payment of post-award interest and that California law requires that partial payments of arbitration awards first be applied to any accrued post-award interest.

Wedbush's reliance on California Civil Code Section 1479 is misplaced. As the Court of Appeal of California held in *Big Bear Properties, Inc. v. Gherman*, 95 Cal. App. 3d 908, 916, 1979 Cal. App. LEXIS 2020, at *14 (1979), Civil code Section 1479 "applies only to payment by a debtor who is 'under several obligations' to his creditor." This is not the case here. Wedbush is indebted on but one obligation—the Award—not on several obligations. "It is immaterial that the total amount due on the [Award] ... included [post-award] interest; the fact remains that the obligation evidenced by the [Award] was single and indivisible."¹⁷

Moreover, the Hearing Officer concludes that the question of the proper allocation of a partial payment between principal and post-award interest under Rule 10330(h) is not governed by state law. Although Rule 10330(h) states that the rate of interest assessed on awards shall be

¹⁶ Interest accrued at the rate of \$1,041.63 per day.

¹⁷ 1979 Cal. App. LEXIS 2020, at *14.

the “legal rate, if any, then prevailing in the state where the award was rendered,” the Rule does not adopt state law to govern the calculation of interest. Rule 10330(h) only looks to state law to set the interest rate. The Hearing Officer therefore rejects Wedbush’s argument that California law governs the interpretation of Rule 10330(h).

The general rule in the United States regarding the payment of post-judgment interest is that “payments are applied first to interest and then to the principal, unless there is a clearly expressed intention [by the parties] to handle allocation in some other way.”¹⁸ In the absence of evidence to the contrary, the Hearing Officer interprets Rule 10330(h) to adopt the general rule rather than the more restrictive rule urged by Wedbush. Accordingly, the Hearing Officer concludes that under Rule 10330(h) partial payments of arbitration awards shall first be applied to the payment of any accrued post-award interest in the absence of an express agreement of the parties to apply the payment in a different manner.

Here, there is no evidence or claim that the parties agreed to apply Wedbush’s first two payments to principal before post-award interest. Accordingly, applying the general rule governing the payment of post-judgment interest, the Hearing Officer will first allocate Wedbush’s partial payments to the payment of accrued interest on the Award, and any balance remaining thereafter to the payment of principal. Application of partial payments in this manner is consistent with the goals of arbitration and Rule 10330(h).

Turning then to the ministerial act of calculating the amount of post-award interest due, the Hearing Officer concludes that Wedbush owed an additional \$16,620.70 after its last

¹⁸ *Allstate Ins. Co. v. Clymer*, 1994 U.S. Dist. LEXIS 11319, at *4 (Aug. 11, 1994) (quoting *Bonjorno v. Kaiser Aluminum & Chemical Corp.*, 865 F.2d 566, 576 (3d Cir. 1989) (alteration in original), *rev’d on other grounds*, 494 U.S. 827 (1990)); *Devex Corp. v. General Motors Corp.*, 749 F.2d 1020, 1025 (3d Cir. 1984).

payment is applied in accordance with this Decision.¹⁹ Post-Award interest continues to accrue at the rate of \$4.55 per day from December 1, 2006, until paid.

III. Order

Pursuant to Article VI, Section 3(b) of NASD By-Laws and Rule 9559(n), it is hereby ordered that Wedbush Morgan Securities' membership shall be suspended effective at the opening of business on March 23, 2007, and that such suspension shall continue until it provides documentary evidence to NASD showing: (1) it has made full payment of the Award, including all post-award interest; or (2) claimants have agreed to settle the Award; or (3) the Award has been discharged by a U.S. Bankruptcy Court.

Proof of payment when made shall be sent to counsel for Enforcement, John S. Han, Esq.

In addition, a total of \$998.15 in costs will be imposed on Wedbush, which includes an administrative fee of \$750 and hearing transcript costs of \$248.15.²⁰

Andrew H. Perkins
Hearing Officer

¹⁹ The balance due is calculated as follows:

Date	Interest	Payment	Balance
May 26, 2006			\$3,801,933.00
June 27, 2006	\$33,332.16	\$1,450,298.00	\$2,384,967.16
November 7, 2006	\$86,904.86	\$2,351,635.00	\$ 120,237.02
November 30, 2006	\$ 757.62	\$ 104,373.94	\$ 16,620.70

²⁰ The Hearing Officer has considered all of the arguments made by the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.

Copies to:

Cindy Chang, Wedbush Morgan Securities, Inc. (*via FedEx, next day delivery, and first-class mail*)

Jerry S. Phillips, Esq. (*via facsimile and first-class mail*)

John S. Han, Esq. (*via electronic and first-class mail*)