

NASD DISPUTE RESOLUTION AWARD
NASD DISPUTE RESOLUTION, INC.

CASE:00-04582

Keith A. Covington and Kathleen A. Covington, JTEN, claimants vs. TD Waterhouse Investor Services, Inc., respondent.

ATTORNEYS:

Claimants appeared pro se through Keith A. Covington, El Segundo, CA.

For Respondent appeared John L. Erickson, Jr., Esq. of the firm Jones, Bell, Abbott, Fleming & Fitzgerald LLP, Los Angeles, CA.

DATE FILED: October 16, 2000

CASE SUMMARY: Claimant alleged that respondents improperly sold out their margin account and although the additional funds requested were already posted, the account was negligently liquidated.

ARBITRATOR'S REPORT: See Attached Exhibit A.

Claim Data

Claim: \$20,000.00
Interest: \$.00

Filing Fees: \$425.00

Award Data

Award: \$20,000.00
Interest: @ 10% per annum from
7/24/01 until the date of payment
of the award.
Filing Fees: \$425.00

AWARD: The undersigned arbitrator has decided and determined in full and final resolution of the issues submitted for determination as follows: 1) Respondent is liable and shall pay to the claimant \$20,000.00. 2) Respondent is liable and shall pay to the claimant interest at a rate of 10% per annum from July 24, 2001 until date of payment of the award. 3) All other relief requests are denied. 4) The \$425.00 filing fee previously deposited with NASD Dispute Resolution, Inc. by the claimant, shall be retained by NASD Dispute Resolution, Inc. 5) Respondent is liable and shall pay claimant \$425.00 as reimbursement of the filing fee.

OTHER FEES: Pursuant to Rule 10333 of the Code, respondent has paid to NASD Dispute Resolution, Inc. the \$400.00 Member Surcharge previously invoiced.

OTHER ISSUES: The arbitrator denied claimants' Motion for Default Award.

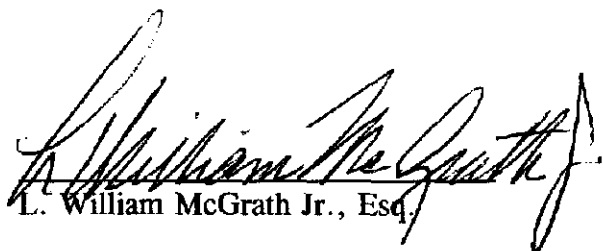
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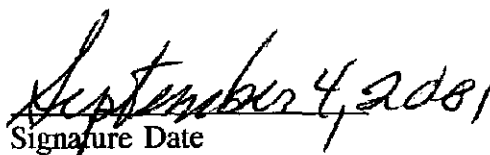
L. William McGrath Jr., Esq.

Sole Public Arbitrator

AFFIRMATION

I, L. William McGrath Jr., Esq., do hereby affirm, upon my oath as arbitrator that I am the individual described herein who executed this instrument, which is my oath and award.


L. William McGrath Jr., Esq.


Signature Date

October 2, 2001
Date of Service (for NASD Office Use Only)

BEFORE THE ARBITRATION BOARD OF THE
NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

In the matter of arbitration between)	NASD Arbitration No. 00-04582
)	
KEITH A. COVINGTON and KATHLEEN A. COVINGTON)	MEMORANDUM OF DECISION
)	
Claimants,)	
)	
v.)	
)	
TD WATERHOUSE INVESTOR SERVICES, INC.)	
)	
<u>Respondent</u>)	

This matter was submitted to arbitration pursuant to a Uniform Submission Agreement filed by Claimants dated October 10, 2000, together with claimants' Statement of Claim. When Respondent failed to file a timely answer to the Statement of Claim, claimants filed a request for a motion for default award. Subsequently, Respondent filed both an Answer to Statement of Claim and Opposition to the Motion For Default Award.

The issue of default is addressed separate from the merits of this controversy. This Arbitrator finds that while respondent's may have been negligent in the manner in which the claim was initially handled, the timeliness in which respondent did respond, combined with the severity of this form of remedy, was sufficient to deny claimants' request.

Turning now to the merits of claimants' claim. The parties both seem to agree that the date of Friday, April 14, 2000, is significant. Respondent states that because at the close of market on April 13, 2000, claimants' margin account has fallen below the required minimum to some 22%. April 14, 2000, is the date apparently when respondent saw fit to prepare an

"Expedited Message Service" to claimants, which stated that an additional \$15,000 would need to be deposited into their account by 3:00 PM, Wednesday, April 19, 2000. Unfortunately, this expedited message was not mailed until Monday, April 17, 2000, and obviously not received until April 18, 2000.

Claimants also acknowledge their awareness of at least a problem on April 14, 2000, when they allege that they repeatedly tried to telephone respondent's office, but could not get through. Not only is this allegation uncontested, but it is supported by claimants' conduct. On Monday, April 17, 2000, claimants voluntarily deposited with respondent the sum of \$20,000 to their account. It should be noted that if claimants had timely received the expedited message, they were a day early and \$5,000 above what respondent had demanded.

In support of their claim, claimants assert that the deposit of \$20,000 should have been sufficient to satisfy the deficiency that existed as of April 14, 2000, and that respondent was unjustified in liquidating the securities it did before the market even opened that day. Claimants also assert that under their "Customer Agreement" they were obligated to make additional deposits only "upon demand" (para. 4). They support this interpretation of this provision in the Customer Agreement by citing the language on the back of respondent's confirmation form, which states:

"Q: What happens if the value of my margin account declines?

A: . . . Generally, if your account's equity dips to below 30%, you will be asked to deposit additional cash or marketable securities or to sell securities."

Claimants also cite a similar provision in respondent's "Truth In Lending" form. The particular language states:

"In connection with margin accounts, if there is a decline in the market value of your securities which are the collateral for your debits, it may be necessary for us to request additional margin. . . ."

Respondents filed extensive opposition to claimant's position. While respondent does not deny the language cited above, it relies on three different documentary sources. In its answer, respondent cites a portion of paragraph 7 of the Customer Agreement. It did not quote the portion underlined:

7. Security for Indebtedness. All securities . . . are subject to a lien in your favor for the discharge of all indebtedness . . . [Waterhouse shall have the right to

sell, assign, and deliver all or any part of the securities or other property in any of [Claimants'] accounts when [Waterhouse] deem[s] necessary for its protection. . . . You shall have all rights of a secured party under the Uniform Commercial Code."

Nowhere in its pleadings, however, does respondent try to explain the apparent ambiguity between paragraphs 4 and 7, or whether as a secured creditor, it must make a demand for payment before exercising its lien rights as a secured creditor under this agreement.

Next, respondent attaches a NASSD website publication "Additional Risks Involved With Trading On Margin" together with a NASD pamphlet entitled "Finding And Choosing A Broker". Respondent adds to these a Securities and Exchange Commission website publication captioned "Tips On Online Investing". As informative and erudite as these documents are, nowhere in the Customer Agreement or any other document cited by respondent are they made a part of the contractual relationship between claimant and respondent.

Finally, respondent appears to concede the futility, or at least ambiguity, of the position it was trying to make under the terms of its own Customer Agreement with claimants. In its Arbitration Brief, Respondent seems to dismiss or set aside this agreement by asserting that Claimants were also bound as of April 14, 2000, by the terms of an agreement which claimants had signed earlier with one of respondent's predecessor. Claimants had opened an account with Kennedy, Cabot & Co., in October 1993. Respondent acquired this account in 1997. Somewhere prior this acquisition, claimants executed an agreement with Gruntal & Co. Claimants do not deny executing this agreement. Respondent subsequently had claimants sign a new customer agreement.

While neither party saw fit to analysis the similarities and differences between the respondent's agreements and the so-called "Gruntal Agreement", respondent focuses on paragraph 9 of the "Gruntal Agreement" to justify its unilateral action. Paragraph 9 states, in part,

" . . . I also acknowledge you are not obligated to request additional margin from me- [sic] my margin falls below any of the foregoing maintenance requirements, and there may be circumstances when you will liquidate securities or other property in my account without notice if my account falls below any of the

maintenance requirements. I will pay on demand any balance owing with respect to my margin account." (emphasis added)

If the so-called "Gruntal Agreement" governed this controversy, respondent would prevail and the claim would be denied. If the so-called "Gruntal Agreement" governed, however, there would have been no reason for respondent to have required claimants to execute a new TD Waterhouse Investor Services, Inc., Customer Agreement. Further, to the extent both agreement could coexist, any discrepancies or ambiguities between the two would have to be resolved against respondent who authored the second agreement.

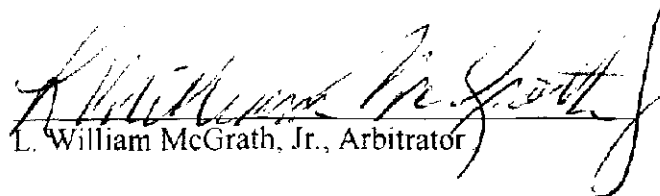
The issue then turns to whether claimants are entitled to any relief and, if so, what should be that relief. Both parties have been sparse in the assistance they could have offered. Claimant's position is more or less two-fold. First, they suggest that their account should have been liquidated on April 10, 2000. This cannot be justified since their margin account was at 35%, which was above the 30% minimum (Resp. Arb. Brief, Exh. 4). Second, they state that they are entitled to the return of their \$20,000 which they would not have deposited on April 17, 2000, if they had known that most of their account had already been liquidated by respondent.

In light of at least the ambiguity of respondent's duty to give notice and make demand before resorting to liquidation, some reconstruction of what was occurring must be attempted even absence any evidence on the point. Resorting to respondent's numbers (Resp. Arb. Brief, Exh. 4), on April 10, 2000, claimants' equity was 35%. On April 13, 2000, if claimants had delivered the \$15,000 which respondent had not requested until April 14, 200, and had not demanded be due until April 19, 2000, claimants' equity would have still been around 35% ($\$70,693 + 15,000 - 55,146 = 30,548 / 85,693 = 35\%$). If on the other hand, on April 17, 2000, when claimants did delivered the \$20,000 which respondent accepted, claimants' account had not been subject to liquidation, claimants equity would have apparently been around 30.5% ($\$59,389 + 20,000 - 55,146 = 24,243 / 79,389 = 30.5\%$). This would have been just above the minimum requirement, but would have been sufficient to avoid the sell-off at least until a new accounting of the changing market could have been made.

It is reasonable to conclude that claimants would not have made the deposit of \$20,000 on April 17, 200, if respondent had disclosed that the liquidation had already occurred. Respondent makes no claim for any loss sustained on claimants' debt. Therefore, claimant is awarded as against respondent the sum of \$20,000. Since a question remains as to whether this

sum became liquidated prior to this decision, interest shall be due only from this date.
Respondent to bear all costs of this proceeding.

Dated: July 24, 2001


L. William McGrath, Jr., Arbitrator