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**Award**  
**NASD Dispute Resolution**

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In the Matter of the Arbitration Between:

Names of the Claimants

Joseph L. DeNicola  
Ramona M. Denicola

Case Number: 02-06211

Name of the Respondent

First Union Brokerage Services, Inc.

Hearing Site: Tampa, Florida

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Nature of the Dispute: Customer vs. Member.

**REPRESENTATION OF PARTIES**

For Joseph L. Denicola ("JLD") and Ramona M. Denicola ("RMD"), collectively referred to herein as "Claimants": S. David Anton, Esq., Law Offices of Harvey Schonbrun, P.A., Tampa, Florida.

For First Union Brokerage Services, Inc. ("FUBS"), hereinafter referred to as "Respondent": Andrew R. Park, Esq., Associate General Counsel, Wachovia Securities, Inc., Richmond, Virginia and Stephen Gillman, Esq., Gallwey, Gillman, Curtis & Vento, P.A., Miami, Florida.

**CASE INFORMATION**

Statement of Claim filed on or about: October 16, 2002.

Claimants signed the Uniform Submission Agreements: October 16, 2002.

Respondent's Motion to Dismiss and Answer to Statement of Claim filed on or about: December 18, 2002.

Respondent signed the Uniform Submission Agreement: December 18, 2002.

Claimants' Brief in Opposition to Respondent's Motion to Dismiss Based on Statutes of Limitation or, in Support of Decision to Consider Statutes of Limitation Issues after Presentation of Evidence filed on or about: March 27, 2003.

Motion for Summary Judgment/Renewed Motion to Dismiss Claim with Prejudice as Barred by the Statutes of Limitation and Motion for Directed Verdict filed by Respondent on or about: January 26, 2004.

Response to Respondent's Motion for Directed Verdict filed by Claimants on or about: February 16, 2004.

Reply to Claimants' Response to Respondent's Motion for Directed Verdict filed by Respondent on or about: March 4, 2004.

**CASE SUMMARY**

Claimants asserted the following causes of action: violations of Rule 10b-5 of the Securities Exchange Act of 1934, Article III of the NASD Rules of Fair Practice, and Fla. Stat. Sections 517.211 and 517.301 of the Florida Securities and Investor Protection Act; common law fraud; breach of fiduciary duty; breach of contract; negligence and gross negligence (respondeat superior); unsuitability; over-concentration; overactive trading;

failure to supervise, omission of facts; and improper use of margin. The causes of action relate to the purchase in Claimants' account of Class B shares of the following mutual funds: Putnam Fund for Growth and Income; Putnam High Yield Advantage Fund; Putnam International Growth Fund; Putnam Vista Fund; Putnam Voyager Fund; and AIM High Yield Fund.

Unless specifically admitted in its Answer, Respondent denied the allegations made in the Statement of Claim and asserted various defenses.

### **RELIEF REQUESTED**

Claimants requested compensatory damages of \$96,307.16, pre-judgment statutory interest of \$13,572.45 on the compensatory damages, margin interest of \$23,602.35, commission and sales disgorgement, costs and fees of this action, reasonable attorney's fees pursuant to Section 517.211(6) Fla. Stat., punitive damages in the sound discretion of the Panel, and such other relief as deemed appropriate by the Panel.

Respondent requested that the Panel dismiss the Statement of Claim and award Respondent its costs, expert witness fees, attorney's fees expended in defense of this proceeding, and any other relief the Panel deemed just.

### **OTHER ISSUES CONSIDERED AND DECIDED**

Respondent filed a motion to dismiss which asserted that Claimants' claims were barred by operation of the statutes of limitation. In their response, Claimants asserted that before the statutes of limitation can be applied, the Panel must first consider evidence as to the accrual of the claim, the date Claimants had reasonable knowledge of their cause of action, and the tolling of the statute, if any. On or about April 23, 2003, the Panel issued an Order which denied, without prejudice, Respondent's motion to dismiss. The Panel further stated in its Order that Respondent could renew this motion at the evidentiary hearings after Claimants' presentation of their case.

Respondent filed a motion for summary judgment/renewed motion to dismiss, which asserted that Claimants' claims were barred by statutes of limitation. Respondent simultaneously filed a motion for directed verdict, which asserted that Claimants failed to establish a prima facie case. In their response, Claimants stated that a prima facie case was made. On or about March 25, 2004, the Panel issued an Order which stated as follows: (1) Respondent's motion for summary judgment based on the statute of limitations was granted solely with respect to the cause of action based on violation of Rule 10b-5 of the Securities and Exchange Act of 1934. The remainder of the motion was denied, without prejudice, with the understanding that these issues would automatically be reconsidered by the Panel at the conclusion of the evidentiary hearings after all evidence was presented; and (2) Respondent's motion for directed verdict was denied.

The parties agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered.

### **AWARD**

After considering the pleadings, the testimony and evidence presented at the hearing, the unanimous decision and findings of the Panel in this matter is as follows:

On or about October 16, 2002, Claimants instituted this arbitration action against Respondent, alleging violations of Article III of the NASD Rules of Fair Practice, Rule 10b-5 of the Securities Exchange Act of 1934, and Chapter 517 of the Florida Statutes, The Securities and Investor Protection Act. An arbitration hearing was commenced on November 10, 11, 12, and 13, 2003, and after completion of Claimants' case, was adjourned to May 17, 2004. Thereafter, the hearing recommenced on May 17, 2004 and was completed on May 18, 2004. During the intervening period subsequent to Claimants' resting their case, Respondent moved for summary judgment based on Statutes of Limitation and Repose, and by separate motion, for a Directed Verdict. The Panel denied Respondent's Motion for a Directed Verdict. The Panel granted Respondents' Motion for Summary Judgment as to that portion of Claimants' action that arose under Rule 10b-5 of the Securities act of 1934. All other aspects of Respondent's Summary Judgment Motion were denied.

The record supports Claimants' contention that they were at all times inexperienced investors. Claimant JLD is 60 years old and Claimant RMD is 62. Neither were high school graduates. During the entire course of their 40 plus year marriage, Claimant RMD devoted her time to family matters and had never worked outside the home. Claimant JLD's salary was barely sufficient to support the family, yet the family made due. They never had any savings, let alone any money to invest until Claimant RMD inherited a portfolio of New Jersey Municipal Bonds from her father. At the time, the bonds were worth approximately \$382,000.00. The bonds were called in 1993.

At that time, Claimants were living in the Camden County, New Jersey/Philadelphia, Pennsylvania area, and sought the advice of First Union Bank regarding reinvestment of the funds. Through First Union, they purchased 382 Fannie Mae 6s 6-25-19 bonds with an aggregate value of \$382,000.00. The bonds produced a monthly income of just over \$1,900.00. [During the hearing, these securities were consistently referred to as Collateralized Mortgage Obligations (hereinafter "CMO" or "CMOs" are used interchangeably for Ginnie Mae, Freddie Mac, Fannie Mae and other similar, quasi-government bonds.)]

In 1994, Claimants moved to Dunedin, Florida, and transferred the Fannie Mae bonds to the local First Union Branch. To this point all of the bonds were in Claimant RMD's name. In 1996, Claimant RMD executed documents that converted her individual ownership of the bonds to joint ownership with Claimant JLD. In February 1996, with the help of their First Union Account Executive, Ms. Paulette Hill, Claimants opened a new joint account at the Florida First Union Bank, funding the account with the \$382,000.00 in Fannie Mae CMOs. Claimants have no complaints about the suitability of this transaction.

Subsequently, in or about October 1996, Claimants, having incurred considerable debt, sought to obtain debt reduction financing from First Union. Because of their unfavorable credit rating, however, this was not possible. First Union suggested using the assets in their brokerage account to pay down their high interest debt, including a 15% second mortgage, and very high credit card interest. At that time, Paulette Hill introduced them to Joseph Bowers ("Bowers"), a broker employed by the bank. Bowers did a client profile, which he testified that he filled out in his own longhand script. Claimants advised Bowers that their primary investment objective was income and capital preservation. Through Bowers, they redeemed the \$382,000.00 in Fannie Mae Bonds. Claimants used approximately \$140,000.00 to pay off their debt, and Bowers purchased for them \$240,000.00 worth of FHLMC 8s 9-15-26 bonds. Bowers testified that sale of securities from the account for the purpose of high interest debt reduction was highly suitable and financially beneficial. Claimants have no

complaints about the suitability of this transaction. Overall, this provided them with an income of approximately \$1,600.00 per month.

According to Claimants, the alleged violations, which form the basis of this arbitration, arose in or about late September 1997, when Claimants' portfolio was restructured. During the interval between October 1996 and September 1997, the Federal Home Loan Mortgage Corp. Bonds were called. Again Claimants went to First Union for help in reinvesting the bonds. Again, Bowers was the broker, and again Bowers prepared a customer profile.

Bowers testified that Claimants expressed their need to maintain a \$1,600.00 monthly income stream. He stated that on the basis of the second profile and the investment objectives provided by Claimants, including the need to maintain the \$1,600.00 monthly income, he restructured the \$240,000.00 realized from the bond call with a portfolio that included a \$60,000.00 CMO, and 5 separate Putnam funds including: Putnam's Fund for Growth and Income (\$30,000.00); High Yield Advantage (\$60,000.00); International Growth (\$30,000.00); Vista (\$30,000.00); and Voyager Funds (\$30,000.00). Bowers testified that he believed the best way to protect Claimants' investments, meet their investment goals, and still provide them with the needed \$1,600.00 monthly income was to diversify. In so doing he chose mutual funds that had a sound history of stability and performance. He said that while the Putnam High Yield Fund was composed of non-investment grade bonds, he felt that any risk was offset by the equal value CMO. Further, he testified that he explained to Claimants all of the risks associated with the funds, and the fact that the bonds in the High Yield Fund paid a higher return only because they were higher risk and that these bonds were referred to as junk bonds. Bowers noted on the new financial profile that he had advised Claimants as to the purchase differences between A and B Securities, and that they elected to take the B option. He testified that Claimants understood this, and directed him to go ahead with the purchase. Thus, he testified that both the diversification and the investments in the restructured portfolio were suitable. Bowers also stated that he explained to Claimants that in order to maintain a consistent \$1,600.00 monthly income payment, there would be a systematic sale of the securities in the account. He testified that he explained to Claimants just how this would work. Claimants do not dispute that the investment of \$60,000.00 in a CMO was suitable. However, Claimants assert that the remainder of the portfolio structure was unsuitable.

At the time Claimants opened their joint account in 1996, they also opened what was referred to as a CAP account. This account was a margin account on which they could draw checks. They could also use it as an ordinary checking account, with the added feature of overdraft protection, because overdrafts would be charged against the account on margin. At the hearing there was no testimony as to any usage of the margin overdraft feature by Claimants prior to October 1997. The margin account worked similar to a stock purchase margin, in that no repayment was necessary until such time as the value of the account fell below the margin. Interest on unpaid overdrafts was, however, charged to the account. The proofs offered at the hearing did not support a contention that the margin account was unsuitable. Indeed, both Bowers and Respondent's expert, Mr. Brucki, testified that the CAP margin account was suitable. Even Mr. Lyman, Claimants' expert, when specifically asked by the Panel, could not state that there was anything unsuitable about the CAP account, and the Panel finds that the CAP account was suitable.

The first, and only time that there was any indication that Claimants were having any trouble understanding the CAP account was when Claimant RMD attempted to balance her October 1997 CAP statement. As testified, Claimant RMD was the one who always balanced the checkbook. She called Bowers and asked for help.

Bowers testified that he came to Claimants' home and helped Claimant RMD balance her checkbook, and at the same time explained to her how the margin account worked. There was no testimony as to whether after Mr. Bower's visit anyone ever called Respondent to seek help or complain about balancing the CAP account statement.

Ten months after the September 1997 portfolio restructure, the \$60,000.00 CMO was called. Bowers was no longer with the bank, and Claimants' new broker, Mr. Cerrulo, invested the \$60,000.00 in the AIM High Yield (Mutual) Fund. This fund was primarily comprised of non-investment grade bonds, for which, according to Mr. Brucki, the market had stabilized. Claimants assert that this purchase was unsuitable, and with it they contended that the entire portfolio became unsuitable.

The testimony revealed that during the entire time period, commencing with the September 1997 restructuring until the account was closed in October 2001, Claimants were overdrawing on their account. Nevertheless, while the principal was not affected until such time as the margin was exceeded, Claimants were assessed interest on the overdraft. The margin interest, however, was considerably less than credit card interest. Ultimately, Claimants' overdrafts exceeded the margin, and were well over \$100,000.00. Respondent called the margin, and Claimants could not meet the call. Securities were liquidated to cover the call. Unfortunately, at the time the securities were sold, the market had fallen. Claimants' over-use of the overdraft feature and the subsequent sale to cover the call resulted in an amount of just under \$9,500.00 in the account at the time it was closed.

The primary thrust of Claimants' testimony at the hearing was that as a result of the unsuitability of the portfolio that Respondent developed, Claimants are entitled to "benefit of the bargain" damages. Claimants presented expert testimony by Mr. Lyman, to the effect that these damages ranged from approximately \$106,000.00 to \$116,000.00, depending on which of Mr. Lyman's three models of suitable portfolios was used. The ultimate issue that the Panel must decide is, therefore, suitability. Since, if the portfolio developed by Respondent for Claimants was suitable, it follows that there are no damages. All parties agreed that suitability is determined as of the date of purchase.

Mr. Lyman testified that it was his opinion that for investors like Claimants, all of the Putnam Funds and the AIM Fund were unsuitable. He based his opinion not on the prior performance history of the funds, nor upon any Beta index rating that existed at the time of the purchase. Rather, to support his opinion, Mr. Lyman, *inter alia*, cited and relied upon selected portions of each of the funds' prospectus', which referenced possible risk, and other portions of each prospectus, which set out permissive, discretionary actions available to managers of the respective funds. Mr. Lyman presented no testimony or other evidence to support the actual occurrence of any of the identified risks, nor did he present anything that would indicate either use or misuse of any of the discretionary authority granted to any of the funds' managers. Mr. Lyman's opinion was based solely on the presence of these statements in each prospectus. None of the evidence received at the hearing, from Mr. Lyman, from any other witness, or from documentary evidence was sufficient to establish or sustain a separate cause of action founded in actual or intentional fraud.

In contrast, Respondent's expert, Mr. Brucki, testified that it was his opinion that all of the securities purchased for Claimants, including all of the Putnam Funds and the AIM High Yield Fund, were suitable. Mr. Brucki described the responsibilities of the broker, inherent in the know your customer rule, that must be addressed in determining whether a particular security was suitable for a given investor. It should be noted that Bowers'

testimony, presented immediately before Mr. Brucki's, supports a finding by the Panel that Bowers did, in fact, conduct a proper client financial profile interview, and properly presented and explained various investment options and risks to Claimants, and the Panel so finds. Thereafter, Mr. Brucki based his opinion that the securities were suitable on the performance history (a three year beta index); the composition of the securities in the funds; and, the quality of management of the various funds.

After consideration of all of the evidence and in particular the testimony as to the actions of the broker at the time of purchase and the expert opinions as to whether or not the purchases of the Putnam and AIM Funds were suitable/unsuitable, the Panel finds that the evidence supports its finding that all of the Putnam and AIM Fund purchases were suitable. In so finding the Panel ascribes greater weight to the testimony of Mr. Brucki, as supported by the testimony of Bowers. The Panel finds that Mr. Lyman's testimony was not sufficient to sustain Claimants' burden of proving unsuitability. Further, although the broker for the AIM Fund, Mr. Cerullo, could not testify because he was deployed on Active Military Duty, Mr. Brucki's explanation of the high stability and low volatility of this fund by reference to its low Beta rating and the nature of the securities in the fund was more than sufficient for the Panel to find suitability. The objectivity of the use of the Beta analysis as a tool to assess past performance outweighs Mr. Lyman's essentially unsupported, subjective, if not speculative, approach to determining suitability.

The Panel, having found that all of the Putnam and AIM Fund purchases were suitable, finds there is, theoretically, no need to proceed any further. The Panel finds no liability on the part of Respondent. Yet, notwithstanding, and in order to complete the record, the Panel also finds as follows:

The Panel finds that the evidence produced at the hearing does not support a finding of a violation of any statute, State or Federal, by Respondent. The Panel further finds that the evidence does not support a finding of a violation of any duty that Respondent owed or might have owed to Claimants, or a violation of any NASD Rule, whether or not actionable by a non-member claimant.

The Panel rejects all three of the Damage Models presented by Mr. Lyman in support of his opinion as to what would constitute damages under a Well Managed Portfolio (Benefit of the Bargain) Theory. The models are inconsistent with the evidence that was presented in this arbitration. Among other things, each of the damage models reflects a once-yearly sale of securities to cover overdrafts. The models do not attempt to address the fact that this was a margin account and that sales of securities occurred as the margin was called, and that the amount of securities that had to be sold was determined by market conditions at the time of sale. The Model also ignores the fact that Claimants had beneficial use of the full account up to the time of the margin call. Here again, the Panel reiterates that there was no evidence to sustain a contention that providing Claimants with a CAP margin account was somehow unsuitable. Thus, if the facts revealed by the evidence in this arbitration (including but not limited to subtraction of margin interest and use of actual sale dates) were applied to any or all of the Models used by Mr. Lyman, the Panel finds that, depending on the securities in the Model, the result would be similar to what was actually experienced by Claimants in the First Union/Wachovia account.

Finally, the Panel finds that the evidence is overwhelming that the loss suffered by Claimants had absolutely nothing to do with the composition of their portfolio. Claimants' losses are a direct result of their inability to control their spending. As a direct result of their overspending, and solely as a result of overspending, they reduced their account from the \$240,000.00 that remained after the first restructuring for debt reduction to approximately \$9,500.00. The Panel further notes that in so doing they had the benefit of a lower margin

interest rate, as compared to a credit card rate, and had the beneficial use of credit based on the full value of the account as it existed up to or between margin calls. The Panel further notes that Claimants had the benefit of the goods and services they received as they spent the money in their account. Thus, the depletion of the account to \$9,500.00 was the natural consequence of Claimants' actions, for which they alone must accept responsibility

Claimants' claims are denied in their entirety.

Any and all claims for relief not specifically addressed herein, including Claimants' claims for relief pursuant to Fla. Stat. Sections 517.211 and 517.301 of the Florida Securities Investor Protection Act and Claimants' request for punitive damages, are denied.

### **FEES**

Pursuant to the NASD Code of Arbitration Procedure (the "Code"), the following fees are assessed:

#### **Filing Fees**

NASD Dispute Resolution will retain or collect the non-refundable filing fees for each claim:

Initial claim filing fee	= \$300.00
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#### **Member Fees**

Member fees are assessed to each member firm that is a party in these proceedings or to the member firm(s) that employed the associated person(s) at the time of the event(s) giving rise to the dispute. Accordingly, FUBS is a party.

Member Surcharge	= \$1,700.00
Pre-hearing Process Fee	= \$ 750.00
Hearing Process Fee	= \$2,750.00
Total Member Fees	= \$5,200.00

#### **Adjournment Fees**

Adjournment fees were not assessed in this matter.

#### **Injunctive Relief Fees**

Injunctive relief fees are assessed to each member or associated person who files for a temporary injunction in court. Parties in these cases are also assessed arbitrator travel expenses and costs when an arbitrator is required to travel outside his or her hearing location and additional arbitrator honoraria for the hearing for permanent injunction. These fees, except the injunctive relief surcharge, are assessed equally against each party unless otherwise directed by the panel.

Injunctive relief fees were not assessed in this matter.

#### **Forum Fees and Assessments**

The Panel has assessed forum fees for each session conducted. A session is any meeting between the parties and the arbitrator(s), including a pre-hearing conference with the arbitrator(s), that lasts four (4) hours or less. Fees associated with these proceedings are:

One (1) Pre-hearing session with the Panel @ \$1,125.00/session = \$ 1,125.00  
Pre-hearing conference: April 23, 2003 1 session

One (1) Pre-hearing session with a single arbitrator @ \$450.00/session = \$ 450.00  
Pre-hearing conference: July 16, 2003

Twelve (12) Hearing sessions @ \$1,125.00/session = \$13,500.00  
Hearing Dates:

November 10, 2003 2 sessions  
November 11, 2003 2 sessions  
November 12, 2003 2 sessions  
November 13, 2003 2 sessions  
May 17, 2004 2 sessions  
May 18, 2004 2 sessions

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Total Forum Fees = \$15,075.00

The Panel has assessed the total forum fees of \$15,075.00 to Respondent.

#### Administrative Costs

Administrative costs are expenses incurred due to a request by a party for special services beyond the normal administrative services. These include, but not limited to, additional copies of arbitrator awards, copies of audio transcripts, retrieval of documents from archives, interpreters, and security.

There were no administrative costs incurred in this matter.

#### Fee Summary

Claimants are jointly and severally liable for:

<u>Initial Filing Fee</u>	= \$ 300.00
<u>Total Fees</u>	= \$ 300.00
<u>Less Payments</u>	= \$ 300.00
Balance Due NASD Dispute Resolution	= \$ 0.00

Respondent is solely liable for:

Member Fees	= \$ 5,200.00
<u>Forum Fees</u>	= \$15,075.00
<u>Total Fees</u>	= \$20,275.00
<u>Less Payments</u>	= \$ 5,200.00
Balance Due NASD Dispute Resolution	= \$15,075.00

All balances are payable to NASD Dispute Resolution and are due upon receipt pursuant to Rule 10330(g) of the Code.



**ARBITRATION PANEL**

Nickolas F. Monteforte, Esq.	-	Public Arbitrator, Presiding Chairperson
Alison Hardage	-	Non-Public Arbitrator
George K. Beardsley	-	Public Arbitrator

**Concurring Arbitrators' Signatures**

/s/	05/21/04
_____ Nickolas F. Monteforte, Esq. Public Arbitrator, Presiding Chairperson	_____ Signature Date
/s/	05/21/04
_____ Alison Hardage Non-Public Arbitrator	_____ Signature Date
/s/	05/21/04
_____ George K. Beardsley Public Arbitrator	_____ Signature Date

05/21/04

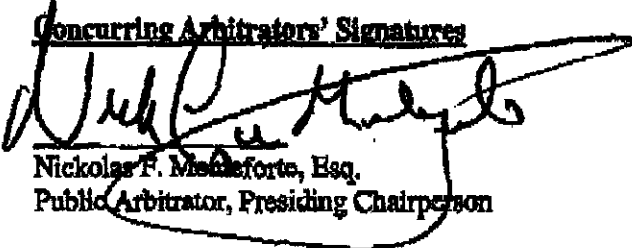
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Date of Service (For NASD Dispute Resolution office use only)

NASD Dispute Resolution  
Arbitration No. 02-06211  
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Nickolas F. Monteforte, Esq.  
Alison Hardage  
George K. Beardsley

Public Arbitrator, Presiding Chairperson  
Non-Public Arbitrator  
Public Arbitrator

Concurring Arbitrators' Signatures

  
Nickolas F. Monteforte, Esq.  
Public Arbitrator, Presiding Chairperson

May 21 2004  
Signature Date

Alison Hardage  
Non-Public Arbitrator

Signature Date

George K. Beardsley  
Public Arbitrator

Signature Date

Date of Service (For NASD Dispute Resolution office use only)

**NASD Dispute Resolution**  
**Arbitration No. 02-06211**  
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Nickolas F. Monteforte, Esq.	-	Public Arbitrator, Presiding Chairperson
Alison Hardage	-	Non-Public Arbitrator
George K. Beardsley	-	Public Arbitrator

**Concurring Arbitrators' Signatures**

Nickolas F. Monteforte, Esq.  
Public Arbitrator, Presiding Chairperson

Signature Date

  
Alison Hardage

5-21-2004  
Signature Date

Non-Public Arbitrator

George K. Beardsley  
Public Arbitrator

Signature Date

Date of Service (For NASD Dispute Resolution office use only)

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NO. 552 P. 10

NASD Dispute Resolution

Arbitration No. 02-06211

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Nickolas F. Monteforte, Esq.

Alison Hardage

George K. Beardsley

Public Arbitrator, Presiding Chairperson

Non-Public Arbitrator

Public Arbitrator

Concurring Arbitrators' Signatures

Nickolas F. Monteforte, Esq.

Public Arbitrator, Presiding Chairperson

Signature Date

Alison Hardage

Non-Public Arbitrator

Signature Date

  
George K. Beardsley

Public Arbitrator

5/21/04  
Signature Date

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