

Pacific Exchange, Inc.  
115 Sansome Street  
San Francisco, CA 94104

In The Matter of The Arbitration Between:

Suzanne Rickwal

Claimant

PCX Case # 02-S055

v.

DECISION

Salomon, Smith Barney; Ernest M. Back;  
Gerald R. Maestu; Lee Beattie

Respondents

The undersigned Arbitrators, having read and considered the Claim submitted by Claimant and the Answer of Respondents, and having considered evidence presented at hearings on January 25, 26, 27, March 21, and April 18, in the year 2005, hereby render the following Decision pursuant to Pacific Exchange Rule 12:

#### REPRESENTATION OF PARTIES

Of Claimant: Irwin G. Stein, Richard Sacks (Law Offices of Timothy Canning)

Of Respondents: Julie L. Taylor, Esq., Darrell C. Martin, Esq. (Keesal, Young & Logan)

#### SUMMARY OF FACTS

Claimant's allegations: that she opened an account with Respondent Salomon, Smith Barney ("SSB") with securities worth approximately \$350,000 that she had acquired from a predecessor (twice removed) of US Web as payment for services. (US Web became MarchFirst following a merger but is referred to throughout as US Web). Claimant agreed with Respondent Back to follow a "collar strategy" recommended by him which purportedly would limit her risk in this concentrated position, yet allow her to earn income. (*"A 'collar' consists of buying a put option to fully protect the downside risk in a stock position (below the strike price level) and selling a covered call option to either partially or completely finance the cost of the put."* See Respondents' Exhibit 4) She subsequently lost her entire investment and the funds in her IRA, and was assessed a tax liability by the IRS on the early withdrawal from her IRA.

**Respondents allegations:** that it was Claimant's decision to follow the "collar strategy", that it was followed for approximately one year with good results, that when the price of US Web declined the strategy was discontinued based upon the belief that the price would recover. It failed to recover because of fraud arising out of the merger of US Web with MarchFirst, which resulted in class actions filed against it and the subsequent liquidation of the company.

### **ISSUES PRESENTED**

Did Respondent Back make reasonable efforts to determine Claimant's financial and tax status and investment objectives?

Was the "collar strategy" proposed by Respondent Back suitable for Claimant? Was the collar strategy carried out by him as represented?

Did Respondents Back and Maetsu have de facto control of the Claimant's account?

Did Respondent Back urge Claimant to take the funds out of her IRA account to pay down the margin in her personal account?

If so, did Respondents act in Claimant's best interests, as fiduciaries, in urging her to use her IRA funds as described above and was this recommendation suitable?

Was there adequate supervision of Respondents Back and Maetsu by SSB?

### **RELIEF REQUESTED**

1. Restoration of Claimant's personal accounts, subject to proof, of up to \$300,000.
2. Restoration of Claimant's retirement accounts, subject to proof, of up to \$100,000.
3. Reimbursement for reasonable costs and fees.
4. Punitive and exemplary damages as determined by the panel.
5. Interest on the award from the date of filing (presented on oral argument).

### **FINDINGS AND DECISION**

#### **A. Findings of Fact:**

After considering the argument and evidence of both the Claimant and Respondents in this matter, the undersigned Arbitrators make the following findings:

1. Respondent Back did not make reasonable efforts to determine Claimant's financial status or investment objectives. His understanding of her circumstances was superficial and incorrect in many respects. Claimant was not sophisticated in financial matters and had little understanding of the financial transactions proposed by Respondent Back, but trusted and relied upon his judgment because he was recommended by Claimant's friend, David Rabin, who had been employed in the securities industry. Respondent Back had de facto control over Claimant's account. Claimant was single and in the process of trying to establish a new business. She had a net worth, including the US Web stock and excluding her home, of approximately \$400,000.

2. The "collar strategy" proposed by Respondent Back was represented to Claimant as a way in which she could earn income in her account while maintaining the safety of her concentrated position in US Web. Claimant had no "attachment" to this stock, contrary to Mr. Back's testimony. She would have diversified her holdings, despite the substantial tax effect, if Mr. Back had so recommended.

3. Respondent Back had substantial experience in options and was considered by Respondent Beattie (Branch Manager) to be the most knowledgeable person in the branch in this area. Respondent Back frequently accessed a "Bloomberg Program" which purportedly gave him computer-generated information on the most propitious times and terms to purchase and sell options and puts. Respondent Back relied on this program to effect the option strategy referred to below.

4. Claimant's account statements indicate that for the majority of the time she had the account, and for the entire period of March 2000 to October 2000, when the price of US Web declined from approximately \$50 per share to less than \$4, Respondents failed to purchase any puts to protect Claimant against a price decline. As a result, approximately 90% of Claimant's liquid assets were invested in one speculative, volatile stock with no collar or other protection during this period. In fact, Respondent Back caused Claimant to purchase an additional 2000 shares of US Web in May 2000 as a result of the exercise of a put she had sold, thereby increasing her already concentrated position to more than 10,000 shares. The account statements show that Respondent Back engaged in an options strategy of buying and selling call and put options, but contrary to his representations to Claimant, he did not engage in a "collar strategy". As a result, while this option strategy produced approximately \$172,000 of income for Claimant's account, ( see Respondents' Exhibit 23) the price decline of US Web in combination with Respondent Back's failure to purchase protective puts caused her to eventually lose all of her funds.

5. In October 2000, Respondent Back urged Claimant to make an early transfer of her IRA funds to her personal account to satisfy margin calls, despite knowing that she would incur tax penalties if the funds were not returned to her IRA within 60 days. On October 26, 2000, Claimant's account had a deficit equity of \$34,382. (See Claimant's

Exhibit 8.) *Claimant was under no obligation to make these transfers from her IRA. At Respondent Back's urging, Claimant signed an IRA Distribution Request on October 26, 2000, two days after US Web publicly announced a major earnings shortfall that sent the stock price down to \$4.40 from \$11.81 three days earlier. Also on October 26, nine shareholders suits alleging fraud arising out of the merger were filed against US Web that were later consolidated into a class action. (See Respondents Exhibit 26 and 27 and Claimant's Exhibit 9.)*

Pursuant to the Distribution Request, \$31,743 was transferred on October 26, 2000 and \$20,000 was transferred on October 31, 2000. On November 20, 2000, at Respondent Back's urging and at a time when the price of US Web had dropped to \$3.06, Claimant authorized the transfer of an additional \$26,759 (\$6,759 on November 21 and \$20,000 on November 27) from her IRA to her personal account to satisfy further margin calls. *(supra)* Claimant's IRA funds of \$78,502 were eventually lost, and because Claimant was unable to return the funds to her IRA within 60 days, she incurred substantial penalties to the Internal Revenue Service. *(While Claimant testified about the tax penalties that took her three years to pay, the claim for damages omitted these penalties and there was no other evidence offered to establish the exact amount. Therefore the panel is unable to consider damages with respect to such penalties.)*

6. Respondent Beattie was the branch manager for the office until March 2000, when he retired. There was no evidence presented as to who served as the branch manager after that date and there was no evidence of supervision thereafter by anyone else. Further, there was a disturbing lack of memoranda, notes or any written matter from SSB or the individual Respondents concerning the recommendations made to Claimant, the effect of the precipitous decline in the price of US Web stock or the propriety of transferring the IRA funds to Claimant's personal account in October 2000.

7. Respondent Maestu became involved in Claimant's account in June 2000 at the urging of Respondent Back, who became more engaged in other brokerage matters and felt he couldn't give Claimant the attention she required. Nevertheless, Respondent Back still had de facto control over the account and Respondent Maestu's functions were essentially ministerial.

#### **B. Decision:**

After considering the argument and evidence of both the Claimant and Respondents in this matter, the undersigned Arbitrators make the final determination and decision of the issues presented, as set forth below:

1. With respect to Respondent Beattie, Respondents moved to dismiss him from the case and Claimant had no objection. Accordingly, he is dismissed from this action and the panel recommends that this action be expunged from his CRD.
2. With respect to Respondent Maestu, the panel finds no liability.

3. With respect to Respondent Back, the panel finds that he misrepresented his intentions to Claimant by not implementing the collar strategy he had recommended to her. It is not clear that the collar strategy was suitable for Claimant, but recommending to Claimant that she hold one speculative, volatile stock in her account with no downside protection was clearly unsuitable. Respondent Back's recommendation that Claimant transfer her IRA funds to her personal account was egregiously unsuitable and therefore a breach of the fiduciary duty he owed Claimant. This misconduct resulted in the loss of all Claimant's assets in her personal and IRA accounts. Accordingly, the panel finds him jointly and severally liable for compensatory and punitive damages and other costs and fees as set forth below.

4. With respect to Respondent SSB, the panel finds that SSB failed to adequately supervise Respondent Back. SSB knew or should have known that the US Web stock was a huge percentage of Claimant's net worth, that Claimant had limited investment experience and that her account was being traded in a speculative manner. SSB knew that the IRA funds were being transferred to support the speculative margin account, but did not take adequate steps to assure itself that this was appropriate. The panel cannot overemphasize the extent to which the IRA funds transfer influenced its decision. Accordingly, SSB is jointly and severally liable for compensatory and punitive damages and other costs and fees as set forth below.

**C. Award:**

1. **Monetary damages:** \$251,665.39 plus interest thereon at the rate of 3.5% from the date of filing of the claim to the date of payment on the award.
2. **Punitive damages:** \$50,000 for the conduct of SSB and Respondent Back regarding Claimant's IRA, described in paragraph 5 of the Findings of Fact.
3. **Costs:** Each party shall bear its own.
4. **Attorney fees:** Each party shall bear its own.


**D. Other determinations:**

1. Respondents shall reimburse Claimant's non-refundable filing fee in the amount of \$200.
2. Respondents shall reimburse Claimant's hearing session deposit in the amount of \$750.
3. Respondents are assessed all forum fees in this matter, in the amount of \$8,550.
4. This matter should not be referred to a regulatory organization (SRO or SEC) for disciplinary investigation of rule violations or violation of federal securities laws.

Dated: May 3, 2005   
Dean J. Dietrich, Chair

Dated: 5/4/05   
Peter Daly, Public Arbitrator

Dated: \_\_\_\_\_  
David Greenberg, Industry Arbitrator

Dated: May 3, 2005   
Dean J. Dietrich, Chair

Dated: \_\_\_\_\_  
Peter Daly, Public Arbitrator

Dated: 5-5-05   
David Greenberg, Industry Arbitrator