

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

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In the Matter of the Arbitration Between:

Masao Takai, Trustee; Tomiko Takai, Trustee; M. Takai MD Inc. Profit Sharing Plan; M. Takai MD Profit Sharing Sub Plan; Masao Takai MD IRA; Tomiko Takai IRA; Eriko Takai; Masao Takai MD and Tomiko Takai, JTWROS; and Masaki Takai, Claimants v. Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong, Respondents

Case Number: 03-03015

Hearing Site: Honolulu, Hawaii

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Nature of the Dispute: Customers v. Member and Associated Person

**REPRESENTATION OF PARTIES**

For Claimants:

Margery S. Bronster, Esq.  
Rex Y. Fujichaku, Esq.  
Bronster Crabtree & Hoshibata  
Honolulu, Hawaii

For Respondents:

Jeffrey S. Portnoy, Esq.  
Theodore D.C. Young, Esq.  
Cades Schutte  
Honolulu, Hawaii

**CASE INFORMATION**

Statement of Claim filed: April 18, 2003

Claimants Masao Takai, Trustee; Tomiko Takai, Trustee; M. Takai MD Inc. Profit Sharing Plan; M. Takai MD Profit Sharing Sub Plan; Masao Takai MD IRA; Tomiko Takai IRA; and Masao Takai MD and Tomiko Takai, JTWROS's Joint Uniform Submission Agreement signed: May 6, 2003

Claimant Eriko Takai's Uniform Submission Agreement signed: April 3, 2003

Claimant Masaki Takai's Uniform Submission Agreement signed: April 2, 2003

Joint Statement of Answer filed by Respondents: August 25, 2003

Joint First Amended Statement of Answer filed by Respondents: March 17, 2004

Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc.'s Uniform Submission Agreement signed: July 16, 2003

Respondent Frederick C. Wong's Uniform Submission Agreement signed: February 23, 2004

### **CASE SUMMARY**

Claimants alleged misrepresentations, omissions and other deceptive or fraudulent acts in violation of the Federal Securities Laws and Hawaii Uniform Securities Act, unsuitability, churning, unauthorized trading, mismarking of order tickets, excessive commissions, mark-ups, mark-downs and spreads, breach of fiduciary duty, negligence/gross negligence, fraud, breach of contract, *respondeat superior*, controlling person liability, failure to supervise, aiding and abetting liability, agency liability, unjust enrichment, intentional interference with prospective contractual relations, and intentional infliction of emotional distress. Claimants' allegations involved the purchase and/or sale of unspecified securities.

Unless specifically admitted in their Answers, Respondents denied the allegations made in the Statement of Claim and asserted affirmative defenses.

### **RELIEF REQUESTED**

Claimants requested compensatory damages in the amount of \$6,000,000.00, comparative or lost opportunity damages, punitive damages in an amount of three times their actual damages, pre-judgment and post-judgment statutory interest at the rate of 10% per annum, tax offset, and arbitration costs, including attorneys' fees.

Respondents requested dismissal of the Claimants' Statement of Claim in its entirety, and costs, including attorney's fees.

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

During the February 17, 2004 telephonic pre-hearing conference, oral arguments were heard on Claimants' Motion to Compel or, in the Alternative, Motion to Bar Respondents from Presenting Facts and Defenses Not Included in their Answer and Respondents' Memorandum in Opposition to the Motion. The Parties stipulated to Respondents filing an Amended Statement of Answer no later than March 17, 2004. The motion was dismissed upon Respondents filing the Supplemental Amended Answer.

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

## **FINDINGS AND CONCLUSIONS**

### **Liability**

#### **General Findings**

1. Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong are liable to Claimants for breach of fiduciary duties, negligence, unsuitable recommendations, failure to supervise, respondeat superior.
2. The specific facts and circumstances of this case give rise to both the nature and scope of Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong's fiduciary duties. The Panel, in determining a fiduciary duty and its breach, did so in light of these specific facts and circumstances.
3. Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong failed to use reasonable care and diligence in handling the investment accounts and affairs of Claimants.
4. Respondent Frederick C. Wong made unsuitable recommendations.
5. Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. did not exercise ordinary or sufficient care and failed to supervise Respondent Frederick C. Wong and the trading activity in Claimants' accounts. Further, a heightened level of supervision was warranted under the facts and circumstances of this case.

#### **Respondent Frederick C. Wong: Breach of Fiduciary Duties/Negligence/Suitability**

1. Respondent Frederick C. Wong did not possess a reasonable nor sufficient level of expertise in the securities and trading strategies which characterized Claimants' accounts.
2. Respondent Frederick C. Wong recommended and implemented a "naked put" option strategy which was ill-advised and unsuitable given the then current market conditions, relative sophistication and understanding of Claimants, the investment goals of Claimants and the other trading activity in Claimants' accounts. Further, Respondent Frederick C. Wong negligently misrepresented the risks and rewards of the strategy, the margin requirements and the consequences and status of the strategy throughout the period of its implementation.

3. Respondent Frederick C. Wong failed to reasonably consider or analyze the over-all portfolio risks of Claimants' accounts and the impact of his stock and option trading recommendations on these risk levels. This failure resulted in excess margin, concentration in volatile stocks and high levels of leveraged market risk, which, as the market turned sharply downwards, exacerbated Claimants' losses. Further, Respondent Frederick C. Wong failed to timely recommend or implement reasonable courses of actions to mitigate such risks by way of hedging, stop-loss or otherwise simply refrain from making any trading recommendations which unduly increased such risks.

Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc.: Breach of Fiduciary Duties/Failure to Supervise/Negligence

1. Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. failed to make ordinary, reasonable and sufficient inquiries into the transactions occurring in Claimants accounts and take appropriate actions given the trading patterns, order size, type and volume of the stock and options transactions in Claimants' accounts.
2. Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. failed to take reasonable and sufficient care to insure that Respondent Frederick C. Wong (successor financial consultant assigned to Claimants' accounts) had the specific training, knowledge, experience and skill required to properly advise Claimants, given Claimants' relative sophistication, investment and trading history, and the different types and investment objectives of Claimants' accounts.

**Damages**

The Panel rejects Claimants' "well managed portfolio" theory of damages as inapplicable to the facts and circumstances of this case. For purposes of determining Claimants' damages, the Panel considered a confluence of factors:

1. Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong breach of fiduciary duties, negligence and unsuitable recommendations.
2. General market conditions during the subject time period.
3. Relevant actions (inactions) of Claimants.

### **AWARD**

After considering the pleadings, testimony, evidence presented at the hearing, and the post-hearing submissions, the Panel decided in full and final resolution of the issues submitted for determination as follows:

- 1) The Panel awards \$1,600,000.00 for compensatory damages to Claimants plus interest to begin December 1, 2002 until the Award is paid in full.
- 2) Fifty percent of the total Award is jointly and severally assessed against Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong and the other fifty percent of the total Award is assessed against Merrill Lynch, Pierce, Fenner & Smith, Inc.
- 3) Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong are jointly and severally liable to and shall pay Claimants \$800,000.00 plus simple interest at the rate of 4% per annum from December 1, 2002 until the Award is paid in full.
- 4) Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. is liable to and shall pay Claimants \$800,000.00 plus simple interest at the rate of 4% per annum from December 1, 2002 until the Award is paid in full.
- 5) Claimants' request for punitive damages is denied.
- 6) The parties shall bear their respective costs, including attorney's fees.
- 7) All other relief requested and not expressly granted is denied.

### **FEES**

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

#### **Filing Fees**

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

Initial claim filing fee	= \$ 600.00
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### **Member Fees**

Member fees are assessed to each member firm that is either a party in the matter or an employer of a respondent associated person at the time of the events that gave rise to the dispute, claim, or controversy. Accordingly, the member firm Merrill Lynch, Pierce, Fenner & Smith, Inc. is a party and the following fees are assessed:

Member Surcharge	= \$ 3,750.00
Pre-Hearing Process Fee	= \$ 750.00
Hearing Process Fee	= \$ 5,500.00
<b>Total Member Fees</b>	<b>= \$10,000.00</b>

### **Forum Fees and Assessments**

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

Four (4) Pre-hearing conference sessions with the Panel @ \$1,200.00/session = \$ 4,800.00

Pre-hearing conferences:	January 15, 2004	1 session
	February 17, 2004	1 session
	September 10, 2004	1 session
	November 11, 2004	1 session

Twenty-seven (27) Hearing sessions @ \$1,200.00/session = \$32,400.00

Hearings:	November 15, 2004	2 sessions
	November 16, 2004	2 sessions
	November 17, 2004	2 sessions
	November 18, 2004	2 sessions
	November 19, 2004	2 sessions
	November 22, 2004	2 sessions
	November 23, 2004	2 sessions
	November 24, 2004	2 sessions
	November 26, 2004	2 sessions
	January 10, 2005	2 sessions
	January 11, 2005	2 sessions
	January 12, 2005	1 session
	January 15, 2005	2 sessions
	February 17, 2005	2 sessions

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<b>Total Forum Fees</b>	<b>= \$37,200.00</b>
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1. The Panel assessed \$9,300.00 of the forum fees jointly and severally to Claimants.
2. The Panel assessed \$27,900.00 of the forum fees jointly and severally to Respondents.

**Fee Summary**

1. Claimants are charged jointly and severally with the following fees and costs:

Initial Filing Fee	= \$ 600.00
Forum Fees	= \$ 9,300.00
Total Fees	= \$ 9,900.00
Less payments	= \$(1,800.00)
<b>Balance Due NASD Dispute Resolution</b>	<b>= \$ 8,100.00</b>

2. Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. is charged with the following fees and costs:

Member Fees	= \$10,000.00
Less payments	=\$(10,000.00)
<b>Balance Due NASD Dispute Resolution</b>	<b>= \$ 0.00</b>

3. Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. and Frederick C. Wong are charged jointly and severally with the following fees and costs:

Forum Fees	= \$ 27,900.00
Less payments by Merrill Lynch, Pierce, Fenner & Smith, Inc.	= \$( 5,500.00)
<b>Balance Due NASD Dispute Resolution</b>	<b>= \$ 22,400.00</b>

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

ARBITRATION PANEL

Carol M. Egan	-	Public Arbitrator, Presiding Chair
David K. Marquardson	-	Public Arbitrator
Sherlin Y. Lee	-	Non-Public Arbitrator

Concurring Arbitrators' Signatures:

Carol M. Egan  
Carol M. Egan  
Chair, Public Arbitrator

April 29, 2005  
Signature Date

David K. Marquardson  
David K. Marquardson  
Public Arbitrator

Signature Date

Sherlin Y. Lee  
Non-Public Arbitrator

Signature Date

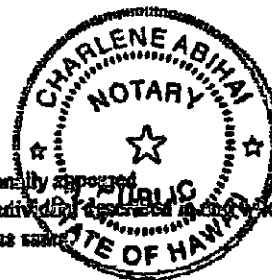
State of Hawaii

City and County of Honolulu

On this 29th day of April, 2005, before me personally appeared  
CAROL M. EGAN to me known and known before me to be the individual who executed  
the foregoing instrument and he/she duly acknowledged that he/she executed the same.

Charlene Abihai  
Notary Public, State of Hawaii  
My commission expires: Sept 9, 2005

CHARLENE ABIHAI



May 10, 2005  
Date of Service



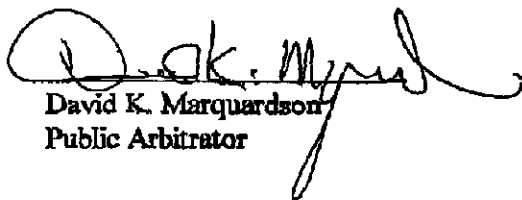
**ARBITRATION PANEL**

Carol M. Egan	-	Public Arbitrator, Presiding Chair
David K. Marquardson	-	Public Arbitrator
Sherlin Y. Lee	-	Non-Public Arbitrator

**Concurring Arbitrators' Signatures**

Carol M. Egan  
Chair, Public Arbitrator

Signature Date

  
David K. Marquardson  
Public Arbitrator

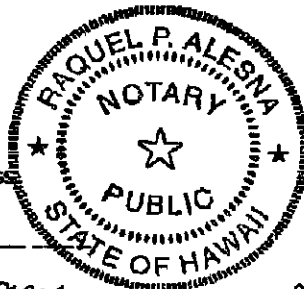
5-9-05  
Signature Date

Sherlin Y. Lee  
Non-Public Arbitrator

Signature Date

State of Hawaii

City and County of Honolulu



On this 9 day of May, 2005, before me personally appeared David K. Marquardson to me known and known before me to be the individual described in and who executed the foregoing instrument and he/she duly acknowledged that he/she executed the same.

  
Notary Public, State of Hawaii

My commission expires: Nov 9, 2010

RAQUEL P. ALESNA

May 10, 2005  
Date of Service

**ARBITRATION PANEL**

Carol M. Egan	-	Public Arbitrator, Presiding Chair
David K. Marquardson	-	Public Arbitrator
Sherlin Y. Lee	-	Non-Public Arbitrator

**Concurring Arbitrators' Signatures**

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Carol M. Egan  
Chair, Public Arbitrator

\_\_\_\_\_  
Signature Date

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David K. Marquardson  
Public Arbitrator

\_\_\_\_\_  
Signature Date

Sherlin Lee  
Sherlin Y. Lee  
Non-Public Arbitrator

4/29/05  
Signature Date

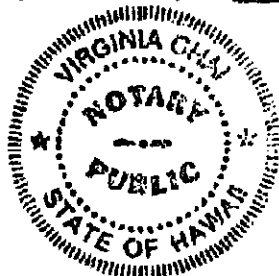
State of Hawaii

City and County of Honolulu

On this 29<sup>th</sup> day of April, 2005, before me personally appeared  
Sherlin Lee to me known and known before me to be the individual described in and who executed  
the foregoing instrument and he/she duly acknowledged that he/she executed the same.

Virginia Okin  
Notary Public, State of Hawaii

My commission expires: 4/30/07



May 10, 2005  
Date of Service