

PACIFIC EXCHANGE, INC.

115 Sansome Street
San Francisco, CA 94104

In the Matter of the Arbitration Between)	PCX Case No. 03-L012
PHYLLIS LAJALA,)
)
Claimant,)
-and-)
)
MORGAN STANLEY,)
)
Respondent.)

The undersigned Arbitrators, having read and considered the claims submitted by claimant Phyllis Lajala on or about April 15, 2003, and the Answer of respondent Morgan Stanley, hereby render the following decision pursuant to Rule 12 of the Rules of the Board of Governors of the Pacific Exchange:

REPRESENTATION OF PARTIES

Of Claimant: Michael E. Friedman

Of Respondent: Michael A. Thurman

Christina Z. Foster

SUMMARY OF FACTS

Claimant is a retired elementary school teacher who opened securities accounts with Dean Witter, now Morgan Stanley, in 1993. There were three accounts: (1) Account No. 256-033853 (the "Trust Account"); (2) Account No. 256-033855 (the "IRA Account"); and (3) Account No. 256-042614 (the "Joint Account") (collectively, the "Accounts").

Claimant alleges that Morgan Stanley and her broker at the firm, Henry DeFord,¹ recommended unsuitable investments for the Accounts, including high risk technology mutual funds and stocks including Intel Corporation. She further contends that DeFord also recommended that she invest in "B shares," which were back-end loaded with higher fees and that Morgan Stanley failed to supervise DeFord in his activities as her personal account manager. During 2002, DeFord became ill and, claimant contends, was unable to monitor her Accounts. When claimant learned of DeFord's illness, she consulted with another broker at Morgan Stanley, Steve Spencer, who she claims "expressed shock at the speculative investments" and moved to reduce her exposure in high-risk investments.

¹ Although originally named as a respondent, DeFord, who died in January 2003, was dismissed after the proceeding commenced. The arbitrators assume that DeFord acted at all times as Morgan Stanley's agent.

Morgan Stanley, for its part, contends that at all times claimant's Accounts were handled in accordance with her stated investment objectives of "capital appreciation" and "income." Respondent further contends that the accounts were profitable over their life with Morgan Stanley and only declined after the bursting of the "Internet bubble" in March 2000. Respondent further contends that DeFord was a diligent investment professional who had a record free of any customer complaints or regulatory inquiries. Overall, Morgan Stanley contends, claimant realized an overall profit of more than \$17,000 in the three Accounts.

ISSUES PRESENTED

The issues are those presented by claimant's Statement of Claim and respondent's Answer. There was no counterclaim. Those issues are as follows:

- whether DeFord recommended investments to claimant that were not consistent with her stated investment objectives, age, economic status, and risk tolerance.
- whether DeFord violated a fiduciary duty to claimant by failing to advise proper diversification of her Accounts so that her

portfolio did not hold excessive amounts of high tech/aggressive growth stocks.

- whether DeFord improperly abandoned claimant's Accounts when he became ill in 2002.

RELIEF REQUESTED

Claimant seeks to recover \$90,151 in compensatory damages, simple interest of 10 percent per annum, attorneys' fees equal to one-third of any award, and punitive damages.

FINDINGS AND DECISION

A. Findings of Fact.

After considering the argument and evidence of both the claimant and respondent in this matter, the undersigned arbitrators make the following findings:

1. Claimant is a retired elementary school teacher who first opened accounts with Dean Witter, which is now Morgan Stanley, in 1993. Claimant and her husband, Robert Lajala, met DeFord at an investment seminar, and opened the Accounts thereafter.

2. At the time she opened the Trust Account, the enrollment form indicates that claimant informed DeFord that her investment objectives for that account were capital appreciation and income, in that order (RX 3).²ⁱ At the time claimant and her husband opened the Joint Account in 1995, they informed DeFord that their investment objective was capital appreciation (RX 15). Although no enrollment form was offered for the IRA Account, the Morgan Stanley Daily Trade Activity Reports (RX 24-002) show the investment objectives for that account to be "income" and "aggressive income." Claimant testified that her objectives were to "save money, and make more money," which is consistent with the records. There was no evidence that claimant ever informed DeFord or anyone else at Morgan Stanley of any change in her investment objectives.

3. At the time she opened her first Dean Witter account, claimant was 62 years old, and had been retired for three years from her teaching career. Her assets included a home, a small securities account with Kemper, and a few other assets. She received income from Social Security and the California Teachers Retirement Plan. Claimant testified that she did not rely regularly on the Morgan Stanley accounts for her living expenses, but did withdraw funds

²ⁱ Respondent's Exhibits are cited as "RX ____," while those of claimant are cited as "CX ____."

“once in awhile” to meet specific expenses, primarily relating to medical treatment. Claimant’s husband also receives Social Security and payments from the Hawaii Teachers Pension Fund.

4. Neither claimant nor her husband are sophisticated investors. Nevertheless, both were aware that stocks could decline as well as appreciate and that there are risks inherent in investing. Both had investment accounts prior to those at Morgan Stanley. Both regularly read the newspapers, and claimant’s husband in particular, beginning in approximately 1988, looked at the Morningstar ratings of mutual funds in the Sunday newspaper. In addition, claimant and her husband received and reviewed the monthly account statements and discussed them, after which claimant’s husband would place them in a file.

5. Claimant has no complaint regarding the handling of her Accounts prior to early 2000. As of December 31, 1999, the Trust Account showed a profit of \$31,334.25 (RX 60-002), the IRA Account a profit of \$43,610.87 (RX 61-002), and the Joint Account a profit of \$15,989.01 (RX 62-002). On that date, the Standard & Poors 500 Index closed at 1469.25 (RX 64). At the end of the damage period, December 31, 2002, the S&P closed at 879.82 (id.). Claimant’s Accounts reflected the market’s decline: at December 31, 2002, the Trust Account showed a profit of \$12,807.97 (RX 60-003); the IRA Account

a loss of \$4,148.13 (RX 61-002); and the Joint Account a profit of \$10,143.17 (RX 62-003).

6. According to Morgan Stanley's telephone records, from January 2000 and December 2002, there were at least 77 telephone calls between claimant and her husband, on the one hand, and Morgan Stanley on the other (RX 27). Both claimant and her husband testified that he would typically listen in to phone calls she placed to DeFord to discuss the Accounts. The majority of the 77 telephone calls were placed by claimant, not by DeFord. In contrast to these records, claimant testified that she telephoned DeFord "once in awhile," and estimated that she did so "four times a year."

7. This was not a discretionary account. Claimant does not assert that any of the trades in the account were made without her authorization, but only that she followed DeFord's advice with regard to the trades. However, claimant and her husband also testified that, after discussing a proposed trade with DeFord, they would hang up, discuss it among themselves, and then call him back with the decision. Claimant was unclear on whether she had ever told DeFord that she did not want to carry out a transaction he had recommended.

8. As the market declined, claimant testified that she expressed anxiety to DeFord, who repeatedly told her to "just hang in there." Given the

length of some of the telephone conversations,³ it is apparent that DeFord was saying more than "just hang in there." As noted, claimant and her husband reviewed the monthly statements and were aware of the declines in value. At any time they could have directed DeFord to make changes.

9. Claimant made a particular issue of a purchase of 135 shares of Intel Corporation on August 22, 2000. Claimant had previously owned Intel and had done well on it. Claimant contended that DeFord had recommended that she sell her investment in Franklin Age High Income A Fund and purchase the Intel shares instead. RX 8-014 and 015 confirm that these transactions took place on that date. The confirmations also reflect that DeFord recorded both transactions as "unsolicited."⁴ The telephone records show that claimant called DeFord on August 21, 2000, at 4:02 p.m. and spoke to him for seven minutes, and called him back at 4:10 p.m. and talked to him for another 9.8 minutes. Thus, DeFord and claimant appear to have spent nearly 17 minutes discussing these transactions the day before they were carried out.

10. In June 2002, DeFord was diagnosed with cancer of the brain. In light of his age, he had already begun slowing down, and had caused

³ During the two years of the damage period, prior to DeFord's departure, there were 16 calls of more than 20 minutes.

⁴ The confirmations reflect that DeFord at least made an effort to distinguish "solicited" trades from "unsolicited" ones. He used both designations in describing the trading in the Accounts.

Spencer to be listed along with himself as the "Financial Advisor" on claimant's account statements in May 2002. DeFord had also begun working at home part of the time. There is no evidence to show that DeFord failed to monitor claimant's Accounts during this period.

11. On August 2, 2002, claimant telephoned the Morgan Stanley office and was informed by someone of DeFord's illness and that he had not been in the office for some time. Instead, claimant spoke to Spencer. Although claimant testified that Spencer expressed "shock" at the "risky" nature of her portfolio and "immediately" moved her into less aggressive investments, in fact more than a one and one-half months passed before there were any transactions in any of the three Accounts.

12. Spencer testified that the transactions were made only after he had a face-to-face meeting with claimant and her husband, a meeting that claimant did not recall. Both Spencer's Daytimer (RX 23) and claimant's own chronological schedule of securities transactions, reflect that the transactions did not take place until September 23, 2002. For his part, Spencer testified that he told claimant that selling out her positions would result in her "taking losses in a market that would come back." He denied expressing any "shock" over the nature of the portfolio and testified that the portfolio, as it existed when he first looked at it, was consistent with the stated investment objectives.

13. Claimant ultimately closed her Morgan Stanley accounts.

Up until the time she did so, she made no complaints to any Morgan Stanley personnel regarding the investment portfolio or DeFord's advice.

B. Decision.

After considering the argument and evidence of both claimant and respondent in this matter, the undersigned arbitrators make the final determination and decision of the issues present, as set forth below:

1. Claimant's view of the suitability of the investments in the Accounts appears to depend on whether they were rising or falling. In light of the investment objectives given to DeFord at the outset, which never changed, the investments in the Accounts were not unsuitable. Claimant did not rely on the investments for her regular living expenses and wanted them to grow. The mutual funds and stocks in the Accounts, whether or not recommended by DeFord, were appropriate.

2. DeFord violated no fiduciary duty owed to claimant. These Accounts were not discretionary, but even assuming a fiduciary duty arose, the investments were not "speculative," nor was there excessive trading. Rather, claimant's losses were similar to those experienced by the market in general. The fact that, in hindsight, claimant can point to investments that would have turned

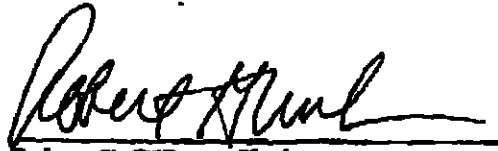
out better does not mean that DeFord acted improperly in his role as claimant's financial advisor.

3. DeFord did not abandon claimant's Accounts when he became ill.

C. Award

Based upon the foregoing, the undersigned arbitrators determined that claimant shall take nothing by her claims herein, that the parties shall bear their own costs of arbitration, and that the forum and hearing fees are to be split evenly.

Dated: April 11, 2005


Robert G. Wilson, Chairman

Louis Eglash, Panel Member


Jan Boström, Panel Member

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