

Award
NASD Dispute Resolution

In the Matter of the Arbitration Between:

Harry S. McCarthy, Jr., Claimant v. Vanguard Marketing Corporation, Respondent

Case Number: 04-01462

Hearing Site: Seattle, Washington

Nature of the Dispute: Customer v. Member

REPRESENTATION OF PARTIES

For Claimant:

Carl J. Carlson, Esq.
Carlson & Dennett, P.S.
Seattle, Washington

For Respondent:

Brian T. Donadio, Esq.
Vanguard Group, Inc.
Malverne, Pennsylvania

CASE INFORMATION

Statement of Claim filed: March 1, 2004

Claimant's Uniform Submission Agreement signed: February 27, 2004

Statement of Answer filed by Respondent Vanguard Marketing Corporation: June 2, 2004

Respondent Vanguard Marketing Corporation's Uniform Submission Agreement signed: June 1, 2004

CASE SUMMARY

Claimant alleged untimely notification by Respondent of redemption of preferred shares of Freeport-McMoRan Copper & Gold Inc. by Freeport-McMoRan Copper & Gold Inc. Claimant's shares of this security were held in his IRA account.

Respondent denied the allegations of wrongdoing set forth in Claimant's Statement of Claim and asserted various affirmative defenses.

RELIEF REQUESTED

Claimant requested \$33,615.10 in compensatory damages and costs, including attorney's fees. Respondent requested dismissal of Claimant's Statement of Claim in its entirety and costs.

OTHER ISSUES CONSIDERED AND DECIDED

On October 28, 2004, Claimant Harry S. McCarthy, Jr. made a motion to amend his claim to include a request for attorney's fees. On October 28, 2004, arbitrator Thomas Y. Higashi granted Claimant's motion.

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

Issue. This arbitration is over whether Respondent timely forwarded a stock redemption and conversion offer it received for Claimant's stock it held in street name.

Findings. Claimant owned 3,000 shares of the Company's (Freeport-McMoRan Copper & Gold Inc.) Convertible preferred stock prior to December 19, 2003. The stock was held in street name by Respondent as custodian for Claimant's IRA.

On December 4, 2003 the Company gave 15 days notice that it was redeeming its preferred stock on December 19, 2003. The redemption price was \$25.00 per share plus unpaid dividends. The preferred stockholders were also allowed to convert their shares to common at one share of preferred for 0.835 shares of common. Between December 4, 2003 and December 18, 2003 the common traded at a high of \$46.74 and a low of \$42.39 per share. As long as the common traded at above \$30.22 per share, without taking into account commissions, a conversion and liquidation to cash would yield more than redemption. The closing quote for the Company's common, was \$43.52 on December 18, 2003.

When Respondent had full and formal notification of the details of the offering it moved on its internal SEC Rule 2260 compliance procedures. By the mailing date to some 52 equitable owners of the Company stocks, it was known that receipt of this mailing would happen with much less than ten days remaining to the expiration date, December 19, 2003. The mailing went out by first class mail, during the heavy Christmas mail season. The transmittal informed the addressee of the offer and gave instructions to contact Respondent regarding the stockholder's election no later than December 16, 2003. Any later contact would be handled only on a "best efforts basis."

The notice of the offer arrived at Claimant's residence on the afternoon of December 17, 2003. Claimant was out of town and the letter was not opened.

A telephone call was planned by Respondent's Special Transactions Unit to Claimant. A daily tracking was set up for his account by Respondent. Because of a heavy workload, out calls were prioritized. The out call to Claimant's residence was placed on December 18, 2003, with less than five hours remaining to the end of business day Eastern Time. Respondent's agent talked to Claimant's wife who advised that Claimant was out of town and would probably not be back until perhaps Christmas. A message was left "[i]f he does call" . . . "its regarding a security in his account." No inquiry was made whether Claimant could be reached by telephone or other mode of communication at some other location in the next few hours. Claimant was on the ground in Florida that afternoon and could have been reached by his wife or Respondent with instructions.

When a notice of voluntary action is received on behalf of a beneficial stockholder, by Respondent, a tracking system is set up, the notice is batched and mailed to the customer along with an in-house checklist informing the stockholder of options and instructions. If the mailing date is less than ten days from expiration date and in the case of a "voluntary action" where the stockholder is given a choice, such as in this case, Respondent's Manual calls for direct telephone calls along with daily tracking of contact results relating to each stockholder. In its web site, Respondent informed stockholders who deposited stock in street name that it was the customer's responsibility to respond to Respondent's deadline when [Rule 2260 type] notices were forwarded.

Discussion. SEC Rule 2260 places an inherent duty on the broker dealer to forward promptly to the beneficial owner, certain information it receives concerning a security, that it has received from an issuer.

I do not view the mail delivery by Respondent on December 17, 2003 as timely notice. I view the representations in the web site and the text of the transmission, as an undertaking to deliver the written notice at least before the response deadline specified by Respondent, in this case December 16, 2003. Not only did it arrive late, it was in fact not opened and did not create actual notice.

I view Respondent's Compliance Manual provisions in evidence, as its strategic plan for compliance when a Rule 2260 information, especially voluntary notice, requiring a choice by the stockholder, is received from an issuer of securities. The Manual adopted back-to-back strategies for providing actual notice and insuring that no customer is left behind in the process.

As a fail-safe the Manual says make a direct telephone call to a customer, if a voluntary distribution is involved [which this offer was] and also when the mailing is less than 10 days from the expiration date of the offer [which also was the case].

Unfortunately for all, the Special Transactions Unit responsible for Rule 2260 compliance was flooded with a heavy workload between the 10th and 19th of December 2003. It called in additional assistance and was operating with overtime workloads. Workloads were "prioritized" and some work got done before other work. While prioritization is a useful management tool, it

also involves taking calculated risks. In this case the calculated risk was that as the time to expiration of the redemption and conversion offering was shortened there was a corresponding buildup of risk that a glitch could cause a customer to miss the personal telephone call. The ten days that existed to make the personal telephone call was not at Respondent's leisure. Rule 2260 still required prompt action.

When Respondent's representative called on the afternoon of December 18, 2003, there were less than five hours left to comply with Rule 2260. Part of the calculated risk was that Claimant could be out of town or otherwise not available at the time of the call. In fact he was out of town. Communication was not achieved. In my opinion the telephone strategy is a lot more than just a drill. The risk of loss did not default to Claimant because he happened to be gone when Respondent chose to call or because Respondent had used "best efforts."

Respondent's "inherent duty" under Rule 2260 still had some four plus hours to go before the 5 PM Eastern Time expiration on December 18, 2003. I reread the text of the telephone call with Claimant's wife. There was no intimation that communication with Claimant was impossible. More aggressive action was necessary to carry out Respondent's duty to communicate. At the very least the caller should have asked whether there was a way Respondent could contact Claimant in the next few hours before 5 PM Eastern Time that created a little more sense of urgency. Unfortunately the time lapsed on Respondent.

Conclusion. I conclude that Respondent failed to meet SEC rule 2260 and its promises.

Loss and Date of Loss. Lastly, in my opinion Claimant's loss occurred at 5 PM ET, December 18, 2003 when all opportunity to make a choice was lost. The closing quotation for the Company's common stock, was \$43.52. The loss is the difference between the closing price for what Claimant could have received for his stock (\$108,600.00), less the amount received (\$75,684.00), which is \$32,684.00.

- 1) Respondent Vanguard Marketing Corporation is liable to and shall pay Claimant Harry S. McCarthy, Jr. the sum of \$32,684.00 in compensatory damages.
- 2) Respondent Vanguard Marketing Corporation is liable to and shall pay Claimant Harry S. McCarthy, Jr. the sum of \$545.57 as reimbursement for costs.
- 3) Respondent Vanguard Marketing Corporation is liable to and shall pay Claimant Harry S. McCarthy, Jr. the sum of \$19,000.00 in attorney's fees, pursuant to the Federal Arbitration Act 9 USCA Sec 1-14 and NASD Code of Arbitration Procedure Rule 10330(e).
- 4) Respondent Vanguard Marketing Corporation is liable to and shall pay Claimant interest in the amount of 8% per annum on \$32,684.00 from December 19, 2003 until the date of service of this Award.

- 5) Respondent Vanguard Marketing Corporation is liable to and shall pay Claimant \$175.00 as reimbursement for Claimant's NASD arbitration filing fee.
- 6) All other relief requested and not expressly granted is denied.

FEES

Pursuant to the 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	= \$ 175.00
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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 Vanguard Marketing Corporation is a party, and the following fees are assessed:

Member Surcharge	= \$ 875.00
Pre-Hearing Process Fee	= \$ 750.00
Hearing Process Fee	= \$1,000.00
Total Member Fees	= \$2,625.00

Forum Fees and Assessments

The Panel assessed a forum fee for each pre-hearing conference or hearing session conducted. A pre-hearing conference and hearing session is any meeting between the parties and the Chair or the parties and the Panel. The following fees are assessed:

Two (2) pre-hearing conference sessions with a single arbitrator @ \$450.00/session = \$ 900.00

Pre-hearing conferences:	August 4, 2004	1 session
	October 5, 2004	1 session

Three (3) hearing sessions @ \$450.00/session =
\$1,350.00

Hearing:	October 28, 2004	2 sessions
	November 5, 2004	1 session

Total Forum Fees	= \$2,250.00
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The Panel assessed \$2,250.00 of the forum fees to Respondent Vanguard Marketing Corporation.

Fee Summary

1. Claimant Harry S. McCarthy, Jr. is charged with the following fees and costs:

Initial Filing Fee	= \$ 175.00
<u>Less payments</u>	<u>= \$(625.00)</u>
Refund Due Claimant	= \$(450.00)

2. Respondent Vanguard Marketing Corporation is charged with the following fees and costs:

Member Fees	= \$2,625.00
<u>Forum Fees</u>	<u>= \$2,250.00</u>
Total Fees	= \$4,875.00
<u>Less payments</u>	<u>= \$(2,625.00)</u>
Balance Due NASD Dispute Resolution	= \$2,250.00

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.

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ARBITRATOR

Thomas Y. Higashi, Esq.

Public Arbitrator

Thomas Y. Higashi
Thomas Y. Higashi, Esq.
Public Arbitrator

November 23, 2004
Signature Date

11/23/04
Date of Service