

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

In the Matter of the Arbitration Between

Name of Claimant

Rebecca S. Red

90-02897

Name of Respondents

Thomas F. White & Co. Inc.;
Stephen H. Gummels

REPRESENTATION

For Claimant: Rebecca S. Red was represented by Andrew R. Harvin, Esq. of Doyle, Reed, Restrepo, Harvin & Robbins, located in Houston, Texas.

For Respondents: Thomas F. White & Co., Inc. and Stephen H. Gummels were represented by Patrick Baldwin, Esq. of Menlo Park, California.

CASE INFORMATION

Statement of Claim filed: October 17, 1990.

Claimant's Submission Agreement signed on: October 15, 1990.

Statement of Answer, Challenge to Jurisdiction and Motion to Dismiss filed by Respondents Thomas F. White & Co., Inc. and Stephen H. Gummels on: December 13, 1990.

Respondent Stephen H. Gummels's Submission Agreement signed on: February 8, 1991.

Response to Claim and Section 15 Motion to Dismiss of Respondent Stephen H. Gummels filed on: December 2, 1990.

First Amended Statement of Claim filed by Claimant Rebecca S. Red on: December 27, 1990.

Second Amended Statement of Claim filed by Claimant Rebecca S. Red on: January 2, 1991.

Response to the January 2, 1991 Amended Statement of Claim and Renewed Motion to Dismiss filed by Respondents Thomas F. White & Co., Inc. and Stephen H. Gunnels on: January 16, 1991.

Claimant's Response to the Challenge to Jurisdiction and Motion to Dismiss filed on: February 28, 1991.

Respondents' Motion for Dismissal with Prejudice filed on: February 5, 1992.
Claimant's Response to Respondents' Motion for Dismissal with Prejudice filed on: February 14, 1992.

Respondents' Supplement to the Motion for Dismissal with Prejudice filed on: February 21, 1992.

Claimant's Response to Respondents' Supplement to the Motion for Dismissal with Prejudice filed on: February 23, 1992.

Respondents' Renewed Motion to Dismiss filed on: June 16, 1992.

Claimant's Response to the Renewed Motion to Dismiss filed on: June 26, 1992.

Respondents' Reply to Claimant's Response to the Renewed Motion to Dismiss filed on: July 1, 1992.

Claimant's Response to Respondents' Reply filed on: July 6, 1992.

Respondent Thomas F. White & Co., Inc. did not file an executed submission agreement, but appeared and testified at the hearing, and as a member of the National Association of Securities Dealers, Inc. is required to submit to arbitration pursuant to Section 12 of the NASD Code of Arbitration Procedure.

HEARING INFORMATION

Pre-Hearing Conference: None Held.

Hearing Dates/Sessions: February 28, 1992 for Two (2) sessions;
May 12, 1992 for Three (3) sessions;
May 13, 1992 for Three (3) sessions;
May 14, 1992 for Three (3) sessions;
July 7, 1992 for Two (2) sessions;
July 8, 1992 for Three (3) sessions.

Hearing Location: Houston, Texas.

CASE SUMMARY

Claimant Rebecca S. Red ("Red") alleged that Respondent Stephen H. Gunnels ("Gunnels"), while employed by or acting as agent for Respondent Thomas F. White & Co., Inc. ("White & Co."), knowingly misrepresented or omitted certain facts regarding investments in oil and gas limited partnerships and their personal qualifications as securities brokers in order to induce Red to purchase the investments. Red specifically alleged that:

1. Commonwealth Enterprises, Inc., sometimes known as Commonwealth Resource Securities, Inc., sometimes known as

Commonwealth Petroleum, Inc. ("Commonwealth"), sold twenty-two oil and gas limited partnerships, two of which were Overland III and Overland IV. As was the custom with these investments, Red paid twenty-five per cent down and borrowed the remaining seventy-five per cent, signing a surety bond with the bank loaning the money;

2. In October of 1984, Gummels telephoned Red soliciting the purchase of units in Overlord III. Gummels represented to Red that Overlord III was a lucrative investment which would allow Red to recoup her entire investment and achieve tax benefits, and that investors in Commonwealth programs, on the average, would "double their money;"

3. In November and December 1984, Gummels solicited Red into purchasing units in Overlord IV, falsely representing that the Overlord III program was a success and that one of the Overlord III wells was already pumping at least 90 barrels per day which would generate sufficient revenues to pay off Red's note obligations;

4. In December of 1985, Red prepaid her investor notes to Commonwealth, wire transferring the money directly to the Commonwealth's account;

5. At the time of purchase, Gummels knew that Red was a school teacher whose annual wages and interest income did not exceed \$35,000.00, was not a wealthy individual, was not a "sophisticated" investor as that term is understood in law, and was not in a high tax bracket requiring the sheltering of what income she had, yet he induced her into the purchase of these unsuitable limited partnerships;

6. Respondents failed to disclose several material facts at the time Red purchased Overland III and IV, including facts regarding the regulatory history of Gummels and Commonwealth, various inconsistencies in the Dealer Agreement between White & Co. and Commonwealth, and pertinent facts relating to the Overlord partnerships themselves;

7. Most, if not all, of the material facts were not known by Red until 1990, and Red would not have purchased the Overlord units had these facts been disclosed;

8. White & Co. failed to exercise a minimal amount of due diligence in regard to the investigation, employment and supervision of Gummels and the background of Commonwealth; and

9. Commonwealth declared bankruptcy in February of 1987 and the partnerships were liquidated and dissolved on or about July 25, 1989. The Insurance Company of North America, the surety of the investor notes, filed suit against Red for non-payment of the notes, even though Red made payment to Commonwealth.

Based upon the above allegations, Red asserted claims for common law fraud; violations of Section 12 of the Securities Exchange Act of 1934, Section 10b

of the Securities and exchange Act of 1934 and Rule 10b-5 thereunder; violation of the Texas Securities Act, Art. 581-33; violation of Section 27.01 of the Tex. Bus. & Comm. Code; and violation of the Deceptive Trade Practices-Consumer Protection Act, Tex. Bus. & Comm. Code, Sections 17.41, et seq., including Section 17.46(b)(2), (3), (5), (7), (12) and (23), and Sections 17.50 and 17.42. In addition, Red alleged that the actions of Respondents amounted to negligence, breach of fiduciary duty and, to the extent that the issues were governed by the laws of New York, breach of the duty of good faith and fair dealing and the New York state securities laws.

Respondent White & Co. and Gunnels Denied the material allegations of Red's Claim, specifically alleging that;

1. Red was a wealthy and experienced investor with a long term personal relationship with Gunnels. Red made written and oral representations of a large net worth of at least mid six figures with additional assets she would not specifically identify, she disclosed ownership of 70,000 shares of Team, Inc. with a trading price of \$20.00 per share and she disclosed, both written and orally, that her investment strategy was aggressive in nature with an interest in sheltering income;
2. Red's purchase of Overlord III and Overlord IV was consistent with her stated investment objective;
3. The Overlord programs were private placement highly leveraged oil and gas drilling partnerships providing significant immediate and long term tax shelter whose track records were exhaustively disclosed in the disclosure documents provided to Red; and
4. Red received extensive disclosure documents containing exhaustive risk factors. In addition, the subscription documents contained further representations by the sponsor and required Red to make representations to the sponsor, including her sophistication, knowledge of restricted illiquid investments, financial ability to make the investment and withstand the loss.

In addition, White & Co. and Gunnels asserted multiple affirmative defenses, including the following:

1. Red's losses, if any, were caused by her own conduct or negligence, or the conduct or negligence of third parties, and not by the actions of the Respondents;
2. Red is barred from bringing this action on the grounds of res judicata;
3. Red is barred from bringing this action on the grounds of the applicable statute of limitations and, the doctrines of estoppel, authorization and ratification;
4. Respondents performed all necessary due diligence consistent with their obligations and similarly fulfilled all necessary supervisory responsibilities consistent with their obligations

under the securities laws and the rules and regulations of the NASD;

5. Red's Statement of Claim fails to state a claim upon which relief can be granted;

6. Red failed to mitigate her damages;

7. Respondents maintained an adequate and reasonable system of supervision and control over their employees;

8. Red knowingly and willingly assumed the risks of the investment in the Overlord programs;

9. The damage sustained by Red, if any, was the result of her own negligence in that she erroneously paid her investor notes to the wrong entity. White had no involvement with respect to such payment and cannot be the proximate cause of any loss incurred by Red; and

10. The Dealer Agreement executed by White and Co. in this matter provides that "the Dealer has not participated in the preparation of the offering memorandum or offering materials for Overlord IV Oil and Gas Limited Partnership and bears no responsibility for any statement made in the offering memorandum."

In a separate Statement of Answer, Gunnels denied the material allegations of the Claim and made several allegations, including the following:

1. Red was a wealthy, sophisticated investor who concentrated her investments activities on tax free bonds and other tax advantaged instruments;

2. The Overlord programs were discussed with Red over three dinner meetings, at which time the private placement memorandum and signature documents were provided to her and Red retained the memorandum for further study. At the meetings, Gunnels told Red that the securities were exempt from registration, involved a high degree of risk and that only an investor who could afford to lose part or all of his investment should consider investing;

3. Red is at fault in paying the wrong party on the investment note and in not receiving a cancelled note back;

4. The claim is not eligible for arbitration under Section 15 of the NASD Code of Arbitration procedure, inasmuch as six years has elapsed from the date of the occurrence giving rise to this arbitration and the filing date;

5. The claim is barred by the applicable statute of limitations; and

6. Red did not deal with her investment as a normally prudent person would and any loss she experienced was due to her own

negligence.

RELIEF REQUESTED

Claimant Red requested entry of an award against Respondents White & Co. and Gunnels in the sum of \$60,000.00 in actual damages plus interest; consequential damages; punitive damages; reasonable attorneys' fees; and such other and further relief as the panel determined was just.

Respondents White & Co. and Gunnels requested that the matter be dismissed on the grounds of lack of jurisdiction by the NASD and/or on the alternative grounds of res judicata; that the Claimant take nothing by way of her Statement of Claim; that the costs of this suit be assessed against Claimant, including attorneys' fees; and for such other and further relief as may be just and proper.

OTHER ISSUES CONSIDERED & DECIDED

The Arbitration Panel finds that Respondent Thomas F. White & Co., Inc. did not file an executed submission agreement, but appeared and gave evidence at the hearing, and as a member firm of the NASD is required to submit to arbitration pursuant to Section 12 of the NASD Code of Arbitration Procedure.

On March 6, 1991, the Director of Arbitration denied Respondent Gunnels' Motion to Dismiss pursuant to Section 15 of the NASD Code of Arbitration Procedure. In addition, on March 6, 1991, Respondents' Motion to Dismiss on the grounds of the absence of jurisdiction was denied by the Director of Arbitration, based upon Section 12(a) of the NASD Code of Arbitration Procedure.

In June of 1991, the parties dismissed, by agreement, named Respondent Michel Millette. This agreement was further stipulated to by the parties on the record at the hearing. Therefore, based upon the agreement of the parties, the panel makes no determination on the issues as to Michel Millette.

On February 25, 1992, after review of the motion and all responses filed through February 23, 1992, the panel determined that Respondents' Motion to Dismiss with Prejudice was denied.

At the hearing on February 28, 1992, Respondents Thomas F. White & Co., Incorporated and Stephen H. Gunnels renewed their Motion to Dismiss. After hearing argument on the issue, the panel determined that the motion would be denied.

At the continuation of the hearing on July 7, 1992, the panel heard argument on Respondents' Renewed Motion to Dismiss filed on June 16, 1992. After review of the arguments, the Motion, and all responses and replies filed therein, the panel determined that the Motion would be taken under advisement and ruling would be reserved until the rendering of the Award. The

Arbitration Panel has determined that the Renewed Motion to Dismiss filed on June 16, 1992 shall be denied.

The parties have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered. In either case, the parties have agreed to receive conformed copies of the Award while the originals remain on file with the NASD.

AWARD

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

1. Respondents' Renewed Motion to Dismiss held under advisement is hereby denied;
2. Respondents Thomas F. White & Co., Inc. and Stephen H. Gummels are jointly and severally liable for and shall pay to Claimant Rebecca S. Red the sum of \$60,000.00 as actual damages plus interest in the amount of \$38,726.00;
3. In addition, Respondents Thomas F. White & Co., Inc. and Stephen H. Gummels are jointly and severally liable for and shall pay to Claimant Rebecca S. Red the sum of \$50,000.00 as punitive damages. In determining to award punitive damages to Claimant, the panel considered the arguments of the parties, as well as the cited case of Ladd v. Knowles, 505 S.W. 2d 662 (1974), and determined that authority existed for an award of punitive damages to Claimant Rebecca S. Red;
4. In addition, Respondents Thomas F. White & Co., Inc. and Stephen H. Gummels are jointly and severally liable for and shall pay to Claimant Rebecca S. Red the sum of \$60,000.00 as attorneys' fees and expert witness fees. In determining to award attorneys' fees and expert witness fees, the panel considered the arguments of the parties, as well as the Texas Securities Act, the Texas Deceptive Trade Practices Act and common law equity, and determined that authority existed for an award of attorneys' fees and expert witness fees to the Claimant Rebecca S. Red;
5. All other costs of arbitration not specifically enumerated herein shall be borne by the party incurring the cost.

FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following Forum Fees are assessed: Sixteen (16) sessions x \$500.00 = \$8,000.00.

The National Association of Securities Dealers, Inc. ("NASD") shall retain the claim filing fee of \$150.00 and refund the hearing session deposit of \$500.00 previously deposited by the Claimant Rebecca S. Red. Respondents Thomas F. White & Co., Inc. and Stephen H. Gummels are jointly and severally liable for and shall pay to the NASD forum fees in the sum of \$8,000.00.

Fees are payable to the National Association of Securities Dealers, Inc.

CONCURRING ARBITRATORS' SIGNATURES

Dated:

Gordon W. Hall, Esq.
Gordon W. Hall, Esq.
Public Arbitrator
Chairperson

October 9, 1992

James P. Hoefling
James P. Hoefling
Public Arbitrator

October 18, 1992

John M. Greer
John M. Greer
Industry Arbitrator

October 8, 1992

Date of Service on Parties: 10-22-92