

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

National Association of
Securities Dealers, Inc.
NASD Financial Center
33 Whitehall Street
New York, N.Y. 10004
FAX (212) 858-4389

In the Matter of the Arbitration BetweenName of Claimant

Harold Berkowitz

91-00008

Name of Respondents

Janney Montgomery Scott Inc.
Earl Marks

REPRESENTATION

For Claimant Harold Berkowitz ("Claimant"): Justin T. Loughry, of Tomar, Simonoff et al.

For Respondents Janney Montgomery Scott, Inc. ("Janney") and Earl Marks ("Marks"): Richard S. Israel, of Archer & Greiner, P.C.

CASE INFORMATION

Statement of Claim filed: January 2, 1991.

Claimant's Submission Agreement signed on: November 19, 1990.

Joint Statement of Answer filed by Respondents on: May 30, 1991.

Respondent Janney's Submission Agreement signed on: February 4, 1991.

Respondent Mark's Submission Agreement signed on: February 19, 1991.

HEARING INFORMATION

Hearing Dates/Sessions: March 31, 1992/2 sessions
August 7, 1992/2 sessions

Hearing Location: NASD, Inc./Philadelphia, PA.

CASE SUMMARY

Claimant alleged that on February 4, 1985 he signed an authorization to roll over his IRA account into a custodial account to be managed by Janney. Claimant alleged he never received a disclosure statement or a letter of confirmation from Janney maintained he received. Claimant alleged he received periodic statements for each account but did not know of transactions until he received the statements and that control of the accounts was in Marks' hands. Claimant alleged he opened accounts

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with Janney in 1985 and stated his funds were to be invested in high quality, low risk securities. Claimant alleged on or about February 1987, Respondents invested approximately \$5,000.00 of his capital in Southmark Corporation ("Southmark") Senior Notes which he alleged were speculative, "junk bonds". Claimant alleged Respondents made a second purchase of Southmark in September 1987 and in or about April 1985, a purchase in Interfirst Corporation ("Interfirst") which he alleged were high risk "junk bonds". Claimant alleged Respondents represented these transactions complied with his stated investment objectives; recommended unsuitable investments; and failed to disclose and/or misrepresented material facts concerning the risk status of the securities.

Respondents alleged in 1985 Claimant opened a self-directed IRA account and a joint person account with his wife, neither of which was to be discretionary. Respondents maintained the disclosure statement would have been delivered to Claimant with other documents but would not be signed. Respondents stated they did not manage Claimant's account; they purchased and sold securities for his account in accordance with his objectives and with his consent and approval (including the Southmark and Interfirst investments); confirmations of all transactions were forwarded to Claimant; and that Claimant advised Marks he wanted a portion of his account to be invested in higher earning securities which Marks explained carried a higher risk. Respondents maintained the investments were suitable for Claimant according to his stated investment objectives; and that they truthfully conveyed to Claimant their knowledge of the investment quality and degree of risk of all securities purchased or sold for him.

RELIEF REQUESTED

Claimant requested: compensatory damages in the amount of \$44,324.80, plus interest from November 19, 1990 at the rate of eight (8%) percent per annum in the amount of \$6,794.10; costs; and attorneys' fees.

Respondents requested: the claim be dismissed in its entirety; attorneys' fees; and costs.

OTHER ISSUES CONSIDERED & DECIDED

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 original remains on file with the NASD.

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DECISION

After considering the pleadings, the testimony and the evidence presented at the hearing, the undersigned arbitrator has decided in full and final resolution of the issues submitted for determination as follows:

- 1- Respondents Janney Montgomery Scott, Inc. and Earl Marks are hereby liable, jointly and severally, and shall pay to Claimant the sum of \$40,987.45;
- 2- All other claims are dismissed;
- 3- Each party shall bear its own expenses, including attorneys' fees.

FORUM FEES

Pursuant to Section 41c of the Code of Arbitration Procedure, the NAAD shall retain the \$100.00 non-refundable filing fee and the following Forum Fees are assessed.

4 sessions X \$300.00 = \$1,200.00 minus hearing session deposit of \$300.00 = net \$900.00 due.

Forum fees Assessed Against:

- 1- Respondents, jointly and severally, in the amount of \$900.00. Respondents shall also reimburse Claimant, jointly and severally, the amount of \$300.00 which represents the hearing session deposit.

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

Arbitrator Signature

Michael D. Gottsch
Michael D. Gottsch/Public Arbitrator

Date of Decision: October 19, 1992

REPORT OF ARBITRATOR

The testimony as to the Claimant's account relationship with Respondent is consistent: with the exception of a single stock transaction, claimant always relied on Respondent's recommendations. On the surface of this dispute there appears to be conflicting testimony as to the claimant's stated investment objective. It is significant to note that the funds which claimant invested with respondents came from two sources: the RCA pension plan and CDs which claimant held at S&Ls. Respondent broker knew the source of these funds and also knew that the funds were intended to provide for claimant's retirement.

Respondent broker testified that claimant was seeking higher returns than he was obtaining from CDs at his local S&L and that he desired a flow of income to commence several years hence. Claimant testified that he was seeking preservation of capital. These objectives are not mutually exclusive nor are they necessarily inconsistent. Indeed, the statements of claimant's accounts demonstrate that, by and large, the accounts were conducted so as to achieve satisfactory returns from safe investments. While claimant undoubtedly desired better returns than he was getting, the evidence establishes that he did not express any willingness to take the risk necessary to achieve the returns obtainable only from lower than investment-grade securities.

Claimant's purchases of the Interfirst and Southmark securities are the transactions at issue. The evidence establishes that when the respondent broker recommended the Interfirst security, he either did know or should have known that the investment grade rating of such security was in question. He made certain inquiries of Interfirst's "investor relations" or similar department and accepted at face value the company's representations that its financial condition was sufficiently strong. In recommending Interfirst securities to claimant, Respondent broker informed claimant of the rating of such security. However, he failed to inform claimant of information casting doubt upon such rating and thus upon the suitability of such security for claimant's account. The information was indeed material. Respondent himself testified that such information (which was reported in a Wall Street Journal article on April 5, 1985) would have prompted him to call the company.

Approximately one month after claimant's purchase on April 22, 1985, the rating on the Interfirst securities was in fact downgraded. Furthermore, subsequent to claimant's purchase, additional negative information bearing on the safety of claimant's Interfirst securities was reported periodically. Respondent testified that he had been monitoring the situation and that he was aware of such information. However, respondent did not communicate with claimant about Interfirst until after the value of claimant's securities had dropped substantially in 1988. Respondent should

have conveyed negative developments to claimant as he became aware of them so that claimant could have considered whether to continue holding the Interfirst securities.

A more difficult situation is presented by claimant's purchases of Southmark securities in 1987. Respondent testified that claimant insisted upon higher yields and that respondent recommended below investment grade Southmark securities. Respondent testified that he disclosed to claimant the BB+ rating of such securities and that at his initial meeting with claimant in 1985 he had apprised claimant that BB+ was a below investment grade rating. Respondent also testified that he represented the Southmark bonds as below investment grade and that because of their low investment quality he offered claimant a high rate of return.

Respondent stated that he, i.e. respondent, was comfortable with clients accepting the risk over a short period of time. Unless respondent exercised discretion in executing transactions for claimant's account -- something respondent denies having done -- respondent's comfort with a higher level of risk cannot be imputed to claimant. On direct examination respondent testified that when he recommended the Southmark bonds to claimant, claimant asked respondent what he thought. Respondent responded that if he thought there was really a problem with them, he wouldn't recommend them. This evidence establishes that respondent initiated the Southmark idea and advised claimant to accept the

additional risk, knowing that claimant virtually always relied on respondent's advice. The recommendation was not consistent with respondent's investment objectives.