

NATIONAL ASSOCIATION OF SECURITIES DEALERS

In the Matter of Arbitration Between

Name of Claimant

Linda L. Cass. Individually
and as Executor of the Estate of John L. Cass

vs.

Case # 91-01484

Name of Respondents

Shearson Lehman Hutton
Harvey Wasserman
Donald Ackerman

REPRESENTATION

For Claimant, Linda L. Cass, individually and as Executrix of the Estate of John L. Cass, Earl Cantwell, Esq. from the law firm of Jaeckle, Fleishman and Mugel.

For Respondents, Shearson Lehman Hutton ("Shearson"), Harvey Wasserman ("Wasserman") and Donald Ackerman ("Ackerman"), (collectively "Respondents"), Theodore Kresbach, Esq., in-house counsel and now with the law firm of Kittay Gold & Krebsbach.

CASE INFORMATION

Statement of Claim was filed on May 10, 1991.

Claimant's Submission Agreement was signed on March 7, 1991.

Joint Statement of Answer was filed by Respondents on December 16, 1991.

Shearson's Submission Agreement was signed on April 20, 1993.

Wasserman's Submission Agreement was signed on April 20, 1993.

Ackerman's Submission Agreement was signed on April 20, 1993.

HEARING INFORMATION

Pre-hearing Conference:	March 30, 1993	-	1 session
Hearing Dates/Sessions:	April 20, 1993	-	2 sessions
	April 21, 1993	-	1 session
	July 12, 1993	-	2 sessions
	July 13, 1993	-	2 sessions
	July 20, 1993	-	2 sessions
	July 21, 1993	-	2 sessions
	September 29, 1993	-	2 sessions

Hearing Location: NASD offices located in New York, New York.

CASE SUMMARY

THE PARTIES

The parties to this arbitration proceeding are Claimant Linda L. Cass, individually and as Executrix of the Estate of John L. Cass, and respondents Shearson Lehman Hutton, Inc. ("Shearson"), Harvey Wasserman, a registered representative employed by Shearson as a financial consultant, and Donald Ackerman, the branch manager of the Shearson White Plains office. Donald Ackerman was substituted for Lawrence Solomon by stipulation at the commencement of the hearing. John L. Cass died after the events that gave rise to the claims in this arbitration and before the commencement of this proceeding.

Mr. Cass opened a margin account in his individual name at Shearson in September 1986, account no. 386-23998. At the same time, Mr. and Mrs. Cass opened a joint account, 386-23999. Harvey Wasserman was the financial consultant on both accounts.

THE CLAIMS AND DEFENSES

The claims in this arbitration are set forth in the Statement of Claim and exhibits which is Arbitrator's Exhibit No. 1. In summary, the claims are that there was excessive and unsuitable trading in Mr. Cass's individual account during the period October, 1986 through December, 1987, and in the Cass's joint account during the period December, 1987 through December, 1988. It is Claimant's contention that numerous positions were highly speculative, that

substantial positions were taken in securities in which Shearson made a market, and that there was excessive trading in call options. Claimant alleges that the turnover ratio was extremely high, and that commissions totalled \$430,000 and margin interest \$130,000. Claimant alleges that there was a lack of supervision over Mr. Wasserman's activities, who had become a registered representative in 1986 and who derived approximately 70% of his commission income from the Cass accounts. Claimant alleges violations of Section 10b of the Securities Exchange Act of 1933; common law fraud; breach of contractual and fiduciary obligations; negligent and reckless acts and omissions; lack of supervision by Shearson over Messrs. Wasserman's and Ackerman's activities; violation of the RICO statute; breach of implied covenants of good faith and fair dealing; and violation of the New York General Business Law. The amount demanded is \$1,900,000 under all claims, except for the RICO count, in which Claimant seeks an award of \$2,500,000 plus attorney's fees and costs; and under the common law fraud claim in which Claimant seeks \$500,000 punitive damages.

Respondents have generally denied the allegations in the Statement of Claim and have asserted numerous affirmative defenses, including contributory negligence and wrongdoing; assumption of the risks of trading by Mr. Cass, a sophisticated investor; authorization of, consent to, acquiescence in, and ratification of all transactions; and suitability of investments in the two accounts. Respondents contended in their answer and during the hearing, that Mr. Cass had 15 years experience trading in other accounts including one at Merrill Lynch, and that he had lost over \$1-million in his Merrill Lynch account in 1986 alone, that his trading pattern evidenced the fact that he was an aggressive trader and took substantial leveraged positions in few potential takeover stocks, that he had complete control over his trading, and that the losses were the consequence of the 1987 crash. Respondents also contend that, in December, 1986, Mr. Cass was sent "an option negative consent letter" confirming his net worth and income, and requesting an update or correction of the specified information; the letter also confirmed that Mr. Cass's investment objective was "speculative" and that equity options were suitable to his investment objective, and that he was aware of the risk of trading options. Shearson also sent "activity" letters to Mr. Cass in April and November, 1987 asking him to confirm that the transactions in his account were made with his prior knowledge and consent and in accord with his investment objective; both letters were signed and returned by Mr. Cass.

FACTUAL BACKGROUND

In or about 1986, John L. Cass, a 42 year old self-styled consultant, met Harvey Wasserman, who had just become a registered representative with Shearson. Mr. Wasserman is a former practicing lawyer who made a mid-life career change to stockbroking in 1986. Mr. Cass informed Mr. Wasserman that he had an account at Merrill Lynch and that he had experienced substantial losses in that account. In or about September 1986, Mr. Cass transferred the positions in his Merrill Lynch account to Shearson; the equity in the Merrill Lynch account in September 1986 was \$969,916, the debit balance was \$2,451,949, and the cumulative net loss (calculated from January 1983) was \$277,420. Mr. Cass's trading pattern at Merrill Lynch was

to take large positions in few securities which he believed were takeover candidates. At the time he transferred the account, Mr. Cass was apparently not gainfully employed. Mr. Cass represented to Mr. Wasserman that this was his trading account and that he had substantial other funds. Evidence concerning his lifestyle, equity in the Merrill Lynch account, and cash withdrawals from and cash deposits into the Shearson account substantiates this representation.

Mrs. Cass testified that Mr. Cass had a bachelor of arts degree from the University of Buffalo, with a major in philosophy and accounting; he took the certified public accountancy exam three times, but did not pass. She testified that her husband came from a dysfunctional family. He worked as an accountant for his father's company which she said was sold, and she thought he received more than \$1-million for his interest in the company. The couple were married in 1970, and bought a home in Harrison, New York, with savings and without mortgage financing. She testified that she and her husband lived well, having a country club membership and taking expensive holidays. Neither Mr. nor Mrs. Cass worked. Mrs. Cass characterized her husband as angry, argumentative, loud, a screamer, opinionated, intense, and having a temper and a violent streak. Mrs. Cass testified that the couple had a dog, and that her husband bought clothing and toys for the dog which died in 1986; she said that the dog was given a classy funeral, and that her husband was devastated by the dog's death. She said her husband became more eccentric after the dog's death, his grooming deteriorated, he smoked four packs of cigarettes a day, and was very aloof and argumentative. She stated that Mr. Cass was abusive to people and indifferent to neighbors. Mrs. Cass testified her husband was in the Shearson branch office on the day of the 1987 crash and that he was in shock; she said he was nonetheless enthralled with the activities and hustle and bustle that day. Mrs. Cass testified that her husband became more eccentric after the crash, smoked more, and his diet became worse. She testified that her husband asked his brother for financial help, but none was offered. She claims to have known nothing about the extent of his losses in the accounts. Mr. Cass died in 1989.

After the Shearson account was opened, purchases and sales were made with a view to diversifying the account and minimizing the exposure to risk. Mr. Cass was qualified for options trading, and he began to take substantial positions in long call options, a departure from his prior trading experience. There was testimony that the purpose of taking positions in call options rather than solely in the underlying securities was to enable Mr. Cass to use his capital more productively. The testimony demonstrated that there was a close working relationship between Mr. Cass and Mr. Wasserman, that they had a continuing dialogue about investing and trading, that Mr. Wasserman made many recommendations, but all investment and trading decisions were ultimately made by Mr. Cass.

The closing equity in Mr. Cass's Shearson account in October, 1986, when it was transferred from Merrill Lynch was, as noted above, \$1,161,080; the portfolio had a value of \$3,707,500. The analysis of the Shearson account furnished by Respondents demonstrates that this was a highly leveraged and extremely volatile account. The closing equity declined by \$428,000 from October, 1986, to month-end December, 1986; then increased by \$585,000 at month-end

February, 1987; declined again by \$442,000 at month-end May, 1987; increased again by \$400,000 at month-end August, 1987; and finally declined by more than \$1,000,000 at month-end October, 1987. Purchases ranged from a low of \$216,321 in November, 1986 to a high of \$5,243,188 in August 1987; purchases totaled \$2,026,006 in October, 1987. The cumulative net-out-of-pocket loss increased from \$8,670 in October, 1986, when the account was transferred from Merrill Lynch, to \$1,103,247 in December, 1987, with cumulative out-of-pocket gains in six of the intervening 13 months ranging from \$9,738 to \$224,107. Commissions during the period October, 1986 through December, 1987 totaled \$363,082.

The documentary evidence showed that Mr. Cass made substantial cash withdrawals from, and deposits into, his individual Shearson account from October, 1986 through December, 1988. There was testimony that Mr. Cass was using the cash withdrawals for living expenses. As noted above, Mr. Cass was an accountant by education. Claimant submitted a journal maintained by Mr. Cass which showed, on a monthly basis beginning September, 1982 and ending January, 1989 when Mr. Cass died, receipts and expenditure for personal items, and transactions in his accounts. The monthly ledger sheets indicated that Mr. Cass scrutinized his financial resources, for it showed, at the end of each month, a balance figure. In particular, during the period September, 1986 through December, 1988, Mr. Cass kept a detailed record of the sources and uses of funds, so that he was obviously aware at all times of the extent of his financial resources. These ledger sheets also show expenditures for personal items after the crash without significant diminution from expenditure for similar items before the crash, indicating that there was no change in Mr. Cass's lifestyle. There is no evidence that Respondents had access to, or were aware of this journal.

From October, 1986 to November, 1987, the joint account was inactive, except for cash withdrawals and cash deposits and transfers from Mr. Cass's individual account. In December, 1987, when the individual account was transferred to the joint account, the closing equity was \$328,974, and there were purchases of \$283,509. There were no purchases in the preceding 14 months. At the end of the following month, January, 1988, the equity had declined to \$236,159 and purchases totaled \$1,528,206 during that month. Trading in the joint account followed the same pattern as in the individual account, with the result that the equity declined from \$236,159 at month-end January, 1988 to \$3 in December, 1988. According to respondents' exhibit X, the cumulative net out-of-pocket gain in the joint account, after consolidation at the month-end December, 1986, was \$56,840, and the cumulative net out-of-pocket loss at month-end December, 1988 when the account was closed was \$295,677.

When the individual Shearson account was opened in September, 1986, Mr. Cass was qualified as suitable for option trading: purchase puts and calls and sell covered calls. When the positions in the individual account were transferred to the joint account in December, 1987, Mr. Cass was again qualified for options trading. The 1986 new account application and option suitability form showed estimated household income of \$100,000+, annual taxes of \$50,000, liquid net worth of \$1,000,000+, and total net worth of \$1,500,000+. The investment

objective on the 1986 application was "appreciation with risk." This information was confirmed in the negative consent letter sent to Mr. Cass in December, 1986. In December, 1987, when the individual account was transferred to the joint account, a new account application and option suitability form was filled out, showing the same financial information with the exception of estimated liquid net worth and total net worth which was shown as "1 million" and "1.5 million," respectively. The investment objectives on the 1987 application were "appreciation with safety," "appreciation with risk," "speculative," and "income with safety."

Despite the fact that Respondents knew that Mr. Cass had incurred substantial losses in his Merrill Lynch account and had experienced losses in excess of \$1-million in his individual Shearson account in the 15 preceding months, no meaningful inquiry was made as to his financial resources to continue highly speculative trading and his ability to continue to bear potential risks. It is undisputed that Mr. Wasserman spoke to Mr. Cass after the crash and was assured that he, Mr. Cass, was satisfied with his account and that he was going to try to get all his money back. It is also noteworthy that Mr. Cass made no complaint about his losses during his lifetime, even after the account was closed, and, in fact, signed two activity letters in April and November, 1987. The documentary evidence does show that from September, 1987 through January 1988, Mr. Cass made cash deposits aggregating \$276,303 into both the individual and the joint accounts. These deposits might have lulled Respondents into believing that Mr. Cass had the financial wherewithal to continue the same trading strategy that had resulted in more than \$1-million of losses in his individual Shearson account.

OTHER ISSUES CONSIDERED & DECIDED

The parties have agreed to receive conformed copies of the award while the originals remain on file with the NASD.

Claimant requested and was granted two postponements of two sets of hearings: July 30 and 31, 1992 and April 13 and 14, 1993. Claimant was assessed and paid \$1,000.00 for each postponement.

FINDINGS AND CONCLUSIONS

The arbitrators find and conclude that Respondents are not liable for losses incurred by the Claimant prior to the October, 1987 crash and following the crash through January, 1988. When Mr. Cass opened his account with Shearson, he had substantial net worth as evidenced

by his equity in the transferred Merrill Lynch account. The panel does not believe Respondents had any duty to inquire further into his financial resources at that time. The "essential facts" to establish suitability were provided by the account itself and the information he furnished to Respondents.

Moreover, Mr. Cass's aggressive trading habits, and preference for an extremely risky strategy utilizing high leverage, were well established at Merrill Lynch. The active trading of very large positions on margin in the Shearson account continued an existing pattern, even though the use of options was new. Mr. Cass clearly was doing what he wanted to do. He had a close relationship with Mr. Wasserman and continuous dialogue about his trading. He was fully cognizant of the consequences of his strategy; he tracked his financial resources closely.

Following the October, 1987 crash, however, there was an enormous change in the character of the account. Mr. Cass had incurred huge losses, approximately \$1 million, depleting the bulk of his visible capital. Respondents no longer had per se evidence that aggressive trading of large positions and the use of options and margin debt were appropriate for him. Respondents also were aware that Mr. Cass had incurred losses of similar magnitude in the Merrill Lynch account. They knew his net worth had thus diminished by at least \$2 million over the two-year span.

These circumstances should have raised serious questions of suitability, even though Mr. Cass was willing to affirm that his high-risk investment style was still satisfactory. Yet Respondents made no effort at all to confirm Cass's vague assurances of substantial investment assets outside his Shearson "trading" account--not even when he was requalified for options trading through the joint account in early 1988.

The panel believes it was especially improper for Shearson to allow Mr. Cass to continue his disastrous trading strategy at that point since Shearson holds out its registered representatives to be not merely brokers but "financial consultants". A competent financial consultant never would have permitted Mr. Cass to continue his disastrous trading strategy, in the wake of back-to-back \$1 million losses, without first taking careful inventory of his whole financial situation.

In December, 1987, when the individual account was transferred to the joint account, it is our opinion that, in view of the loss of more than \$1-million in the individual account, and the cumulative loss of some \$2-million in both the Merrill Lynch and Shearson accounts, Respondents should have made a diligent inquiry into Mr. Cass's financial resources and his suitability for continued speculative trading, risking the remnants of his capital. The failure to make such an inquiry is a violation of the suitability rules of the New York Stock Exchange and other self-regulatory organizations. It is our opinion that this inquiry should have taken place at least by month-end January 1988. Significantly, at month-end December, 1987, the closing equity in the Claimant's joint account was only \$328,974, but in the next month, January, 1988, there were purchases of \$1,528,206. At the end of January, the equity had declined by some \$90,000 to \$236,159.

We are of the opinion that the loss of equity from month-end January, 1988 reflects the true measure of recoverable economic loss incurred by the Claimant. At month-end January, 1988, the equity was \$236,159 and was virtually wiped out by month-end December, 1988. We award to the Claimant, as Executrix of the Estate of John L. Cass, the sum of \$236,159 to be paid by Respondent Shearson, plus simple interest at the rate of 6% per annum from February 1, 1988 to the date of payment of this award, or the date of which judgment confirming this award is entered, whichever is the earlier date.

Except as specified above, all claims by Claimant, individually or in her fiduciary capacity, against the Respondents, Shearson Lehman Hutton, Inc., Harvey Wasserman and Donald Ackerman, for damages (compensatory, punitive and treble) and for attorney's fees and costs are denied in their entirety.

FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following forum fees are assessed against Respondent Shearson.


Non-refundable Filing Fee:	\$250.00
Hearing Session Fees:	\$1,000.00 x 15 sessions = \$15,000.00
Pre-Hearing Conference Fees:	\$300.00 x 1 session = \$300.00
Total:	\$15,550.00

1. Claimant previously deposited \$1,250.00 and is entitled to a refund in that amount.
2. Shearson shall satisfy the fees assessed by reimbursing Claimant \$1,250.00 and by remitting the balance \$14,300.00, to the NASD.

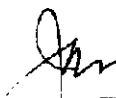
Fees are payable to the National Association of Securities Dealers, Inc.

ARBITRATION PANEL

James Dolan, Esq. - Public Chairperson
Paul T. Green - Public Panelist
Alexander Stewart Barnes - Industry Panelist


James Dolan, Esq.

Executed on
~~Date of Decision:~~

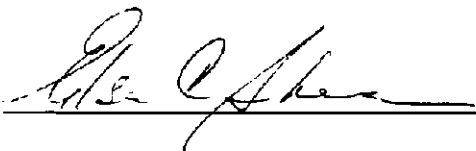
 1995

Date of Decision: January 31, 1994

STATE OF NEW YORK
COUNTY OF NASSAU

S.S.:

On this 18th day of January 1994, before me personally appeared James Dolan, Esq. known to me to be the individual described in and who executed the foregoing instrument and be duly acknowledged to me that he executed the same.



ELSA C. SHEA
NOTARY PUBLIC State of New York
No. 4974346
Qualified in Nassau County
Commission Expires Dec. 15, 1994

ARBITRATION PANEL

James Dolan, Esq.

-

Public Chairperson

Paul T. Green

-

Public Panelist

Alexander Stewart Barnes

-

Industry Panelist

Paul T. Green

Paul T. Green

Date of Decision: January 31, 1994

CONNECTICUT
STATE OF ~~NEW YORK~~
COUNTY OF FAIRFIELD

S.S.:

On this 27 day of January 1994, before me personally appeared Paul T. Green known to me to be the individual described in and who executed the foregoing instrument and be duly acknowledged to me that he executed the same.

William A. Korman

ARBITRATION PANEL

James Dolan, Esq.	-	Public Chairperson
Paul T. Green	-	Public Panelist
Alexander Stewart Barnes	-	Industry Panelist

Alexander Stewart Barnes
Alexander Stewart Barnes

Date of Decision: January 21, 1994

STATE OF NEW YORK
COUNTY OF Westchester

S.S.:

On this 26 day of January 1994, before me personally appeared Alexander Stewart Barnes known to me to be the individual described in and who executed the foregoing instrument and be duly acknowledged to me that he executed the same.

Thaine V. Mifflin