

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

In the Matter of the Arbitration Between

Name of Claimant

Martin A. Bell

91-02189

Name of Respondents

Prudential-Bache Securities Inc., now
known as Prudential Securities Incorporated;
Bear, Stearns & Co., Inc.;
Michael H. Novick;
Peter D. Matthews

REPRESENTATION

For Claimant: Martin A. Bell was represented by Tarell A. Friedley, Esq. of the Ahlberg Law Firm, Ltd., located in Apple Valley, Minnesota.

For Respondents: Bear, Stearns & Co., Inc. was represented by Mark S. Reed, Esq. of Drake & Rogosheske, P.A., located in Minneapolis, Minnesota.

Prudential-Bache Securities Inc., now known as Prudential Securities Incorporated, was represented by William L. Greene, Esq. of Leonard, Street and Deinard, P.A., located in Minneapolis, Minnesota.

Peter D. Matthews appeared pro se.

Michael H. Novick did not appear at the hearing.

CASE INFORMATION

Statement of Claim filed: July 17, 1991.

Claimant's Submission Agreement signed on: July 12, 1991.

Statement of Answer and Cross-Claim against Peter D. Matthews and Michael H. Novick filed by Respondent/Cross-Claimant/Cross-Respondent Bear, Stearns & Co., Inc. on: October 15, 1991.
Respondent/Cross-Claimant/Cross-Respondent Bear, Stearns & Co., Inc.'s Submission Agreement signed on: October 11, 1991 by Mark E. Lehman, Senior Managing Director, Bear, Stearns & Company.

Statement of Answer and Cross-Claim against Peter D. Matthews and Michael H. Novick filed by Respondent/Cross-Claimant/Cross-Respondent Prudential Securities Incorporated on: November 4, 1991.

Respondent/Cross-Claimant/Cross-Respondent Prudential Securities Incorporated's Submission Agreement signed on: October 9, 1991 by Kevin B. Frawley, Vice President, Associate General Counsel, Prudential Securities Incorporated.

Statement of Answer and Cross-Claim against Michael H. Novick filed by Respondent/Cross-Claimant/Cross-Respondent Peter D. Matthews on: January 27, 1992.

Respondent/Cross-Claimant/Cross-Respondent Peter D. Matthews' Submission Agreement signed on: January 23, 1992.

Reply to Cross-Claim by Bear, Stearns & Co., Inc. and Cross-Claim against Bear, Stearns & Co., Inc. filed by Respondent/Cross-Claimant/Cross-Respondent Peter D. Matthews on: January 27, 1992

Reply to Cross-Claim by Prudential Securities Incorporated and Cross-Claim against Prudential Securities Incorporated filed by Respondent/Cross-Claimant/Cross-Respondent Peter D. Matthews on: January 27, 1992

Response to the Cross-Claim by Peter D. Matthews filed by Respondent/Cross-Claimant/Cross-Respondent Prudential Securities Incorporated on: February 13, 1992.

Respondent/Cross-Respondent Michael H. Novick did not file an executed Submission Agreement, but is required to submit to arbitration pursuant to Section 12 of the NASD Code of Arbitration Procedure.

This matter was ordered to arbitration by Judge Harry H. MacLaughlin of the United States District Court, District of Minnesota, Fourth Division, said Order being entered on August 1, 1990 in Case No. 4-90-334.

HEARING INFORMATION

Pre-Hearing Conference: None Held

Hearing Dates/Sessions: April 21, 1992 for two (2) sessions
April 22, 1992 for two (2) sessions
May 5, 1992 for two (2) sessions

Hearing Location: Minneapolis, Minnesota

CASE SUMMARY

Claimant Martin A. Bell ("Bell") alleged that from mid-April 1987 to April 19, 1990, Respondents Bear, Stearns & Co., Inc. ("Bear

Stearns"), Prudential Securities Incorporated ("Prudential"), Peter D. Matthews ("Matthews") and Michael H. Novick ("Novick") engaged in unauthorized trading in Bell's brokerage account and that the Respondents' actions became wholly inconsistent with Bell's investment objectives and instructions conveyed during personal conversations, by telephone and in writing. In addition, Bell was led to believe that securities were managed in accounts with M.H. Novick & Co., Inc., as well as with Bear Stearns and Prudential.

Bell made the following specific allegations:

1. On April 17, 1990, Bell emphatically instructed Matthews to immediately liquidate his holdings of 300 Call OEX Options which Novick had not sold despite specific instructions. The options were not sold until the afternoon of April 18th, despite Matthews' guarantee and Bell's continued instruction to sell, resulting in a loss of at least \$40,000.00;
2. During March of 1990, Novick's unauthorized trading activity in Call OEX Options was so frequent Bell could not determine his financial status and a monthly statement was not provided until April 17, 1990;
3. Bear Stearns and Prudential allowed opening of an option trading account and allowed option trades even before Bell authorized that activity;
4. In late 1989 and early 1990, Bell's efforts to reconcile his account were met with resistance and obfuscation by Novick, who presented a multiplicity of excuses for failing to honor Bell's requests for information and action; and
5. Bear Stearns and Prudential negligently extended margin credit to Bell's account, allowing Novick to borrow funds from Bear Stearns and Prudential through Bell's margin account without his knowledge or consent and frequently over Bell's direct objection to the trades.

Based upon the above allegations, Bell asserted that Novick had defrauded him through various misrepresentations and through numerous unauthorized transactions; Prudential and Bear Stearns had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)5 promulgated thereunder; Matthews was negligent for ignoring Bell's instructions to sell the OEX options; and Prudential, Bear Stearns and Matthews violated Minnesota Statutes Chapter 80A by negligently failing to control the activities of Novick. In addition, Bell alleged that the

activities of Novick, Matthews, Prudential and Bear Stearns constituted a pattern of racketeering activity in violation of 18 USC 1962.

Respondent/Cross-Claimant/Cross-Respondent Bear Stearns denied liability to Bell for the damages sought in the Statement of Claim, alleging that:

1. Bell maintained the account at M.H. Novick & Co., Inc. from approximately August 16, 1977, with Bear Stearns acting solely as the clearing broker on a fully disclosed basis from the account's opening until January 31, 1990;

2. Bear Stearns entered into a Securities Clearance Services Agreement with M.H. Novick & Co., Inc. on October 20, 1982 which remained in effect until Novick & Co. retained Prudential as its clearing broker on February 1, 1990 and which set forth the following functions between Bear Stearns as clearing broker and Novick & Co. as introducing broker:

- a. Novick & Co. was responsible for assuring that margin transactions complied with Regulation T promulgated by the Board of Governors of the Federal Reserve System;

- b. Novick & Co. was solely responsible for the supervision of its customer accounts; and

- c. Bear Stearns was delegated the limited ministerial functions of assuring compliance with payment and delivery requirements, providing safekeeping services and maintaining adequate books and records of Novick & Co.'s accounts;

3. Bell was notified in writing of the respective functions and responsibilities of Bear Stearns and Novick & Co. as required by Rule 382 promulgated by the New York Stock Exchange, Inc.;

4. Bell entered into a Customer Agreement confirming that Bear Stearns was to accept orders and instructions concerning the Bell Account from Novick & Co. and containing Bell's agreement that Bear Stearns would not be liable for the acts of Novick & Co. or its officers, employees and agents;

5. Bear Stearns fulfilled its responsibilities as clearing broker with respect to the Bell account;

6. The Statement of Claim contains no allegations concerning Bear Stearns' conduct in connection with the specific transactions complained of or upon which liability is sought to be imposed;

7. Bear Stearns did not participate in or knowingly and substantially assist the alleged fraudulent activities; and

8. Bear Stearns is not liable for the losses resulting from Bell's determination to permit continued trading after learning of Novick's alleged fraudulent conduct.

In addition, Bear Stearns asserted multiple affirmative defenses including, but not limited to, the following:

1. The Statement of Claim fails to state a claim against Bear Stearns upon which relief can be granted;

2. Bear Stearns is not liable to Bell because at all times it acted in accordance with federal and state laws and the rules and regulations of the self-regulatory organizations of which it is a member;

3. Any loss or damage to Bell was caused by his own acts, omissions, negligence or liability producing conduct or by the acts, omissions, negligence or liability producing conduct of entities outside the control of Bear Stearns;

4. The Statement of Claim fails to state a claim against Bear Stearns for violation of Section 10(b) of the Exchange Act or Rule 10b-5 promulgated thereunder because it fails allege the essential elements of such a claim; and

5. The Statement of Claim is barred by the doctrines of laches, assumption of risk, waiver and the applicable statute of Limitations.

Bear Stearns further asserted a cross-claim for indemnification against Novick and Matthews, alleging that any award of damages to which Bell might be entitled resulted from the conduct of Novick & Co. and its officers, directors and employees.

Respondent/Cross-Claimant/Cross-Respondent Prudential denied the material allegations of the Statement of Claim, alleging that:

1. On or about January 31, 1990, prior to becoming the clearing broker, Prudential sent a letter to Bell

entitled "Correspondent Allocation of Responsibility Letter" which clearly explained that Prudential would not be Bell's broker and that Novick & Co. was "exclusively responsible" for performing the responsibilities of an introducing broker;

2. Prudential performed only those limited operational duties associated with clearing trades and the execution of options trades transmitted by Novick;

3. Prudential cannot be held liable for Novick's alleged misconduct solely because Prudential was Novick's clearing agent; and

4. The Statement of Claim fails to identify any damages attributable to Prudential's conduct because most, if not all of the damages alleged do not relate to the 2-3 month period during which Prudential cleared Bell's trades in his Novick account.

Prudential asserted the following affirmative defenses:

1. The Statement of Claim failed to state a claim upon which relief could be granted;

2. The Statement of Claim was barred on the grounds of estoppel, waiver and/or ratification;

3. The Statement of Claim was barred on the grounds that Bell's alleged losses were caused by persons or entities outside Prudential's control;

4. The Statement of Claim was barred on the grounds that Bell's alleged losses were caused by intervening events over which Prudential did not have control; and

5. The Statement of Claim was barred, in whole or in part, on the grounds that Bell caused or contributed to the alleged injury through his own negligence.

Prudential filed a Cross-Claim alleging that should liability be assessed against it, Prudential would have a right of indemnity against Novick and Matthews as they were the primary violators of Bell's rights.

Respondent/Cross-Claimant/Cross-Respondent Matthews denied the material allegations of the Statement of Claim, alleging that the 300 Call OEX options could not be liquidated immediately on April 17, 1990 because his conversation with Bell occurred after business hours and that he followed the instructions on April 18, 1990 in accordance with market conditions. Furthermore, Matthews

alleged that he never received any complaints of unauthorized transactions prior to April 17, 1990, he was unaware of any violation of Regulation T of the Federal Reserve System, Bell was approved for option trading by Matthews after review of all necessary information and any option trading by Bell was in accordance with the Bear Stearns' Option Approval Form and applicable rules and regulations.

Matthews asserted the affirmative defenses of failure to state a claim, waiver, estoppel, assumption of risk, contributory negligence and failure to mitigate damages. In addition, the following affirmative defenses were asserted:

1. The transactions which Bell alleges form a basis for his claims were authorized by Bell, a sophisticated investor for whom said transactions were suitable;
2. Bell's alleged losses were caused by his own actions or inactions, or by the actions or inactions of third parties over whom Matthews had no responsibility;
3. If there were any unauthorized transactions, Bell ratified said transactions by virtue of his actions;
4. Matthews' license was not transferred to Novick & Co. until approximately July 1, 1989, he did not have responsibility for the activities of Novick and the alleged wrongdoing of Novick was outside the scope of Novick's employment;
5. The claims against Matthews are barred by the applicable statute of limitations; and
6. A Promissory Note executed by Novick and dated September 20, 1989 constituted a release and/or satisfaction for any and all acts or omissions alleged before that date.

Matthews asserted a Cross-Claim against Novick alleging that should the Arbitration Panel rule that Matthews was in any way liable to Bell, then Matthews had a right to contribution and indemnity against Novick as the primary violator of Bell's rights. As to the Cross-Claims filed by Prudential and Bear Stearns, Matthews denied that any liability had been caused by any of his acts or omissions, therefore, Prudential and Bear Stearns were not entitled to indemnity from Matthews. Matthews asserted Cross-Claims against Bear Stearns and Prudential, seeking contribution and indemnity for any liability of Matthews which was caused by the acts or omissions of Bear Stearns and Prudential.

Prudential responded to Matthews' Cross-Claim by denying that it engaged in any wrongdoing and that Matthews was not entitled to any indemnity or contribution from Prudential. In addition, Prudential asserted as affirmative defenses that:

1. The Cross-Claim did not state a claim upon which relief could be granted;
2. The Cross-Claim was barred by the doctrine of unclean hands; and
3. The Cross-Claim was barred on the grounds that it was untimely.

RELIEF REQUESTED

Claimant Bell requested entry of an award against all Respondents, jointly and severally, for the sum of \$392,137.09 in compensatory damages; interest on this amount; treble damages pursuant to 18 USC 1964(c); costs and attorneys' fees.

Respondent/Cross-Claimant/Cross-Respondent Bear Stearns requested that all claims asserted against it by the Statement of Claim be dismissed and denied in their entirety and that it be awarded reasonable attorneys' fees incurred in defending this arbitration. In addition, Bear Stearns requested that the panel enter an award ordering Novick and Matthews to indemnify and hold Bear Stearns harmless from any and all potential damages to this proceeding.

Respondent/Cross-Claimant/Cross-Respondent Prudential requested that the panel deny all claims asserted against Prudential and dismiss those claims with prejudice; award to Prudential its reasonable costs and disbursements herein; and granting such other relief as the Panel may deem appropriate. In addition, in the event that Prudential was found liable, Prudential requested an order that Novick and Matthews are liable for any damages which were assessed against Prudential; its reasonable costs and disbursements; and such other relief as the Panel would deem appropriate.

Respondent/Cross-Claimant/Cross-Respondent Matthews requested that the panel dismiss all claims asserted against him with prejudice; award him his reasonable costs and disbursements; an order that Novick is liable for any damages assessed against Matthews; and for such other relief as the arbitration panel may deem appropriate. In addition, Matthews sought contribution and indemnity against Prudential and Bear Stearns for any liability of Matthews which was caused by their acts or omissions.

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 originals remain on file with the NASD.

Respondent/Cross-Respondent Michael H. Novick failed to appear at hearing. Upon review of the file and after hearing argument from the parties present, the panel determined that Novick had not been properly served with the Statement of Claim and notice of the hearing. Pursuant to Section 16 of the Code of Arbitration Procedure, the panel dismissed without prejudice all claims and cross-claims against Respondent/Cross-Respondent Michael H. Novick.

Claimant Bell presented a Motion to Postpone the hearing in order to pursue service of Novick. After hearing argument from the parties, the panel determined that the motion would be denied.

AWARD

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

1. The Statement of Claim is hereby dismissed with prejudice and denied in its entirety;
2. All Cross-Claims filed by Respondents/Cross-Claimants/Cross-Respondents Bear, Stearns & Co., Inc., Prudential Securities Incorporated and Peter D. Matthews are hereby dismissed and denied in their entirety;
3. Claimant Martin A. Bell is liable for and shall pay to Respondent/Cross-Claimant/Cross-Respondent Bear, Stearns & Co., Inc. the sum of \$1,500.00 as reimbursement of the claim filing fee and hearing session deposit previously deposited by Bear, Stearns & Co., Inc. In addition, Claimant Martin A. Bell is liable for and shall pay to Respondent/Cross-Claimant/Cross-Respondent Prudential Securities Incorporated the sum of \$1,500.00 as reimbursement of the claim filing fee and hearing session deposit previously deposited by Prudential Securities Incorporated;
4. The parties shall each bear their remaining costs

of arbitration, including attorneys' fees, except for those specifically enumerated herein.

FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following total Forum Fees are assessed: Six (6) sessions x \$1,000.00 per session = \$6,000.00.

The National Association of Securities Dealers, Inc. (NASD) shall retain the claim filing fee of \$250.00 and the hearing session deposit of \$1,000.00 previously deposited by the Claimant Martin A. Bell. The NASD shall retain the claim filing fee of \$500.00 and the hearing session deposit of \$1,000.00 previously deposited by Respondent/Cross-Claimant/Cross-Respondent Bear, Stearns & Co., Inc. In addition, the NASD shall retain the claim filing fee of \$500.00 and the hearing session deposit of \$1,000.00 previously deposited by Respondent/Cross-Claimant/Cross-Respondent Prudential Securities Incorporated.

Claimant Martin A. Bell is liable for and shall pay to the NASD additional forum fees in the sum of \$3,000.00. Respondent/Cross-Claimant/Cross-Respondent Peter D. Matthews is liable for and shall pay to the NASD the claim filing fee owed in the sum of \$500.00.

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

CONCURRING ARBITRATORS' SIGNATURES

Dated:

D. Randall Blohm
D. Randall Blohm, Esq.
Public Arbitrator
Chairperson

July 16, 1992

Angela R. Banga
Angela R. Banga, Esq.
Public Arbitrator

July 6, 1992

Emily B. Boote
Emily B. Boote
Industry Arbitrator

July 9, 1992

Date of Service on Parties:

July 21, 1992