

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

In the Matter of the Arbitration Between

Name of Claimant

Arthur Ashley Williams Foundation

vs.

Case#

91-03060

Name of Respondents and Third Party Claimants

E.F. Hutton & Company, Inc.  
Shearson Lehman Brothers, Inc.  
Robert Sarly

vs.

Third Party Respondent

Clement T. Lambert

REPRESENTATION

For Claimant: Patrick G. Finegan, Jr., Esq.

For Respondent: George Richardson, III, Esq. of Shearson Lehman Brothers, Inc.

CASE INFORMATION

Statement of Claim filed: September 30, 1991.

First Amended Statement of Claim filed: November 15, 1991.

Second Amendment to the Statement of Claim filed: December 18, 1991.

Claimant's Submission Agreement signed on: September 25, 1991.

Joint Statement of Answer and Third Party Claim filed by Respondent, on: January 22, 1992.

Respondent, Shearson Lehman Brothers, Inc.'s Submission Agreement signed on: January 22, 1992.

Respondent, Robert Sarly's, Submission Agreement signed on: January 23, 1992.

Claimant's Answer to Respondent's Third Party Claim filed: January 30, 1992.

HEARING INFORMATION

Hearing Dates/Sessions: July 14, 1992 - 2 Sessions.

July 15, 1992 - 2 Sessions.

July 16, 1992 - 2 Sessions.

Hearing Location: NASD offices located at 260 Franklin Street, Boston, Massachusetts.

#### CASE SUMMARY

In its Statement of Claim, including two Amendments thereto, Claimant makes a claim for losses of \$332,920.00, as of September 30, 1990, due to transactions in six securities. Claimant alleges that the losses were the result of Respondents' failure to properly supervise its broker, Robert M. Sarly ("Sarly"); unsuitability of the investments; self-dealing in securities in which Respondents had a proprietary interest; fraud; breach of disclosure duties; and negligence. Claimant also alleges churning, for which it seeks damages of \$50,000.00; Racketeer Influenced and Corrupt Act (RICO) violations, for which it seeks treble damages of \$998,760.00; punitive damages of \$1,664,600.00; and lost opportunity costs of \$100,000.00; plus cost, fees, counsel fees, and further just and equitable relief. In its closing argument, Claimant also requested \$30,000.00 for counsel fees and recovery of various underwriting discounts and commissions paid to Respondents by Claimants on mutual fund investments and sales.

Respondents deny the allegations of Claimant, allege that Respondents acted properly in every respect and that Claimant, in essence, merely seeks to recover for investments which did not perform as well as desired. Respondents assert affirmative defenses. Finally, Respondents assert a third-party claim, in the amount of any award in favor of Claimant, against Clement T. Lambert ("Lambert"), a Trustee of Claimant, who was authorized by Claimant to make investment decisions, on the ground that Respondents relied on Lambert's decisions.

Claimant, in its answer to Respondents' third-party claim, denies the allegations therein and requests the third-party claim be dismissed.

#### RELIEF REQUESTED

Claimant requested a total award of at least \$3,336,382.00, plus interest, costs, and fees, together with an injunction requiring that Respondent Shearson Lehman Brothers include a notice of any award in this case in the next mass mailing of the mandatory statement of its financial condition pursuant to SEC rules.

Respondents request that the claims of Claimant be dismissed in all respects and that Respondents be awarded costs, including reasonable attorneys fees. Respondents also request that Lambert be held liable for any award against Respondents in favor of Claimant.

Claimant request that Respondents third-party claim be dismissed.

#### DISCUSSION and CONCLUSIONS

1. The Arbitrators reject the securities claims under SEC rules 10b-5 and other fraud claims. There was a long history of correspondence and communications between Sarly, the broker, and Lambert, Claimant's Trustee, about potential Claimant investments, investment objectives, and specific recommendations. Claimant originally complained of losses in six securities. During the course of the hearings, Claimant abandoned its claim as to two of the six securities (Alliance S.T. Multi-Mkt. Trust and the preferred stock), leaving four mutual fund investments as to which it complains - Putnam Divided Income Fund, Putnam Master Income Trust, TCW Convertible Securities fund, and MFS Intermediate Income Trust ("MFSIIT") fund. With respect to the recommendations by Sarly for these mutual fund investments, prospecti were sent to Claimant. Lambert reviewed or had an opportunity to review those prospecti and authorized investment in the four mutual funds at issue. Lambert is a sophisticated CPA and entrepreneur, accustomed to evaluating financial information and advising clients on business decisions, many of which involve risks similar to those involved with mutual fund investments. Sarly's actions, under the circumstances, do not amount to fraud.

2. The investments in question were recommended by Sarly, so suitability is a relevant issue. If the investments were not suitable for Claimant, then a claim may be sustained for the losses and damages suffered, to the extent these can be proven. Based on the evidence regarding the objectives of Claimant in its overall investment strategy, including regular communication and correspondence between Sarly and Lambert, the mutual fund investments, although they performed less well than anticipated, were not unsuitable for Claimant. The mutual funds had features which included high rates of income, relative safety of principal, and bond investments, all of which were consistent with Claimant's investment objectives. Therefore, the Arbitrators do not need to address the question of what, if any, actual losses Claimant suffered on the investments in question.

3. With respect to claimant's trust and negligence theories of recovery, the broker-customer relationship does not normally involve a relationship of special trust such that a fiduciary duty to the customer is created. However, in this case Sarly was Claimant's primary broker for over eight years. Claimant followed him from Merrill Lynch to E.F. Hutton & Co. ("E.F. Hutton"), Inc. to Shearson Lehman Brothers. Claimant relied heavily on his advice, although it did not accept all of his recommendations. Sarly, on a number of occasions in correspondence to Claimant, held himself out as having worked closely, as a team, with Claimant (and in particular Lambert) over many years to realize its objectives, including joint monitoring of investment decisions. Under these circumstances, Claimant reasonably relied on certain selected information provided by Sarly as to the MFSIIT mutual fund investment, even though a complete reading of the prospectus would have shown the information provided by Sarly to be incomplete. The underwriting discount of \$32,625.00 on the \$725,000.00 purchase of 72,500 shares of the MFSIIT mutual fund was not mentioned in Sarly's letter of March 4, 1988. Instead, the letter mentioned only that because the purchase of shares was during an original issue offering period, there would be no commission sales charge or load. Under the circumstances, this statement could reasonably be

expected to mislead Claimant and thus was a breach of Sarly's duty to claimant arising from his special trust relationship as Claimant's broker for many years and a financial consultant on investments. Sarly, as Claimant's broker of longstanding, should have disclosed, in the context of the letter of March 4, 1988, the fact that an underwriting discount would be involved, which was paid out of the funds invested in the mutual fund. Also relevant are NASD policy on fair dealing with customers and E.F. Hutton Branch Office Procedures Manual provisions on original mutual fund investments and switching from one fund to another (Sections 17.01 and 17.04). E.F. Hutton should have obtained a switch letter from Claimant in this case, and therefore, did not comply with its own procedures on the substantial mutual fund investment at stake. In this case, a significant portion of the funds used to make the MFSIIT purchase came from the sale or redemption of \$500,000.00 of MFS Multi-Mkt. Trust mutual fund shares. Therefore, at least a partial switch was involved. Accordingly, the arbitrators find that Claimant should recover damages from Shearson Lehman Brothers and Sarly with respect to the underwriting discount on this mutual fund investment.

However, a portion of the responsibility for the payment of the underwriting discount of \$32,625.00 must rest with Lambert, a sophisticated CPA and entrepreneur acting on behalf of Claimant, who, had he paid proper attention to the prospectus, would have discovered the existence of the underwriting discount, which he could then have questioned. Thus, his reliance on Sarly to present fully all details regarding the cost of the MFSIIT investment was only partially justified, because of the furnishing of the prospectus by Sarly. The arbitrators also take into account in their award the fact that this particular investment was made with funds Claimant desired to invest. Thus, even if Claimant did not have to pay the underwriting discount in this case, it would have had to pay a commission on some other investment of the funds used to purchase MFSIIT.

As to underwriting discounts and/or commissions on all other purchases and/or sales of mutual fund securities as to which Claimant complains, the Arbitrators find that the evidence does not support a conclusion that Sarly breached the duty to Claimant which arose from his special relationship to Claimant, discussed above.

4. The award in this case is made against Sarly and Shearson Lehman Brothers, even though the actions relative to the underwriting discount on MFSIIT occurred at a time Sarly was with E.F. Hutton and the procedures of E.F. Hutton for mutual fund investments were in effect, rather than those of Shearson Lehman Brothers. E.F. Hutton merged with Shearson Lehman Brothers, which latter firm assumed any obligations of E.F. Hutton relative to the claims against E.F. Hutton arising in this case.

**OTHER ISSUES and SUBSTANTIVE MOTIONS CONSIDERED and DECIDED**

The parties have agreed that the Award in this matter may be executed in counterpart copies. The parties have also agreed to receive conformed copies

of the award while the originals remain on file with the N.A.S.D..

During the course of the hearings, Respondents made a Motion for Dismissal and Summary Judgment, as well as an oral Motion for Directed Verdict. Claimant opposed both motions. After argument and deliberation, the Arbitrators denied the Motion for Dismissal and Summary Judgment and granted the Motion of Directed Verdict as to Claimant's churning and RICO claims but denied said latter Motion in all other respects.

#### AWARD

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

1. Respondents Robert M. Sarly and Shearson Lehman Brothers are hereby jointly and severally liable to Arthur Ashley Williams Foundation in the amount of EIGHT THOUSAND ONE HUNDRED AND FIFTY SIX DOLLARS AND TWENTY FIVE CENTS (\$8,156.25).
2. Respondents Robert M. Sarly and Shearson Lehman brothers are further jointly and severally liable to Arthur Ashley Williams Foundation for interest at a rate of twelve percent (12%) per annum, from September 1, 1992 to the date of payment.
3. The third-arty claim against Clement T. Lambert is dismissed.
4. All claims for punitive and treble damages are denied.
5. All claims for attorney's fees are denied.
6. All claims for cost, expenses, or other fees are denied.
7. All claims for injunctive relief are denied.

#### FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following Forum Fees are assessed.

1. Forum fees in the amount of \$6,000.00 for six hearing sessions at \$1000.00 per session are assessed and shall be borne equally by Claimant and Shearson Lehman Brothers, Inc.
2. Claimant is further assessed \$250.00 non-refundable fee for filing the Claim;
3. Respondent Shearson Lehman Brothers, Inc. is further assessed

\$500.00 non-refundable fee for the Third-Party Claim;

4. Claimant deposited \$1,250.00 with the NASD and shall receive a credit for that amount. Therefore, the balance due is \$2,000.000;

5. Respondent Shearson Lehman Brothers, Inc. deposited \$500.00 with the NASD and shall receive a credit for that amount. The balance due is \$3,000.00.

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

Concurring Arbitrator's Signature

David Plimpton, Esq.

Date of Decision: 9/8/92

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Julien F. Begien, Esq.

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Concurring Arbitrator's Signature

Linda A. Gelfand

Date of Decision: \_\_\_\_\_