

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

---

In the Matter of the Arbitration Between

Name of Claimants

Johnston Lemon & Co.

Award  
#92-00218

vs.

Names of Respondents

William Smith  
and  
Paula Michaels

Names of Third Party Respondents

Robert Boorman  
James H. Lemon, Jr.  
Patrick Ryan  
Donald E. Clem  
Morgan Stanley & Co., Inc.  
Louis Ricciardelli  
Terry Nolan

---

**REPRESENTATION**

For Claimant Johnson, Lemon & Co., Inc. ("Johnston Lemon"): Douglas Spaulding, Esq. and Kathleen McGuan, Esq. of the law firm of Reed, Smith, Shaw & McClay in Washington, D.C.

Respondent William Smith ("Smith") appeared pro se.

Respondent Paula Michaels ("Michaels"): Gilbert Boyce, Esq. of the law firm of Kutak Rock in Washington, D.C.

Third Party Respondent Robert Boorman ("Boorman") appeared pro se.

For Third Party Respondents Morgan Stanley & Co. Inc. ("Morgan Stanley"), Louis Ricciardelli ("Ricciardelli") and Jerry Nolan ("Nolan"): I. Scott Bieler Esq.

of the law firm of Brown & Wood in New York, New York.

For Third Party Respondents James H. Lemon, Jr. ("Lemon"), Patrick Ryan ("Ryan") and Donald E. Clem ("Clem"): Douglas Spaulding, Esq. and Kathleen McGuan, Esq. of the law firm of Reed, Smith, Shaw & McClay in Washington, D.C.

### **CASE INFORMATION**

The original claim was filed by public customers on January 17, 1992.  
On January 6, 1993 the original public customer claimants settled their claim with Respondents Johnston Lemon and Smith.

After the original Respondents settled with the public customer claimants, Johnston Lemon's Cross Claim for Indemnity or Contribution against Bill Smith and Paula Michaels remained as arbitrable claims. Michaels and Smiths' counterclaims and third party claims also remained arbitrable. Once the original Respondents had settled with the public customer claimants, Johnston Lemon was treated as the Claimant and Smith and Michaels were treated as Respondents as well as Counter Claimants and Third Party Claimants. The pleadings mentioned below reflect the filings by the above captioned parties including original Respondents Johnston Lemon and Smiths' answers to the original public customer claimants.

Johnston Lemon's Submission Agreement signed on: March 23, 1992  
Johnston Lemon's Cross Claim for contribution against Smith was filed: March 25, 1992  
Johnston Lemon's Third-Party Claim for Indemnity or Contribution against Paula Michaels was filed: March 25, 1992  
Johnston Lemon and Lemons' Joint Response and Motion to Dismiss Cross Claim Asserted by Smith filed: June 12, 1992  
Johnston Lemon, Lemon, Ryan and Clems' Joint Response and Motion to Dismiss Counterclaims Asserted by Michaels filed: June 12, 1992

Smith's Submission Agreement signed on: March 23, 1992  
Statement of Answer filed in response to the public customer claimants claim by Respondent Smith on: March 24, 1992  
Smith's Answer to Johnston Lemon's Cross Claim for Indemnity or Contribution filed: May 7, 1992  
Smith's Amended Answer to Johnston Lemon's Cross Claim for Indemnity or Contribution and Smith's Cross Claim against Johnston Lemon and Lemon (Smith captioned his pleading against Lemon as a Cross Claim when it was a Third Party

Johnston Lemon Award  
Case No. 92-00218  
Page 3

Claim) filed on: May 26, 1992

Smith's Third Party Claim for Indemnity, Expenses and Damages against Morgan Stanley, Ricciardelli and Nolan filed on: May 26, 1992

Smith's Response to Johnston Lemon's Motion to Dismiss filed on: August 19, 1992

Smith's Response to Morgan Stanley, Ricciardelli and Nolans' Motion to Dismiss or Sever Third Party Claims Asserted by Smith filed on: August 19, 1992

Michaels' Statement of Answer to Johnston Lemon and Counterclaims Against Johnston Lemon and Third Party claims against Lemon, Ryan, Clem and Boorman filed on: May 19, 1992

Michaels' Opposition to Johnston Lemon's Motion to Dismiss Counterclaims filed on: July 10, 1992

Third Party Respondent Boorman's Answer to Michaels' Third-Party Claim filed on: June 4, 1992

Statement of Answer by Third Party Respondent Morgan Stanley & Co. Inc., Louis Ricciardelli and Jerry Nolan to Smith's Third-Party Claim filed on: July 17, 1992

### **HEARING INFORMATION**

<b>Hearing Dates:</b>	October 12, 1993 - Two Sessions
	October 13, 1993 - Two Sessions
	February 15, 1994 - Two Sessions
	February 16, 1994 - One Sessions
	February 17, 1994 - Two Session
	February 22, 1994 - Two Sessions
	February 23, 1994 - Three Sessions
	March 1, 1994 - Two Sessions
	March 2, 1994 - Two Sessions
	March 3, 1994 - Two Sessions
	March 4, 1994 - Two Sessions
	April 27, 1994 - Two Sessions
	April 28, 1994 - Two Sessions
	April 29, 1994 - Two Sessions

**Hearing Locations:**

The Carlton Hotel - Washington, D.C.  
The Grand Hotel - Washington, D.C.

Kutak Rock - Washington, D.C.  
Reed, Smith, Shaw & McClay - Washington, D.C.

### **CASE SUMMARY**

The original public customer claimants alleged, among other things, that Johnston Lemon and Smith committed breaches of fiduciary duty. Additionally the public customer claimants alleged that Johnston Lemon and Smith committed fraud under common law and under the District of Columbia Code. The public customer claimants also alleged fraud under certain federal securities laws and under the racketeering provisions of the so-called RICO law all in connection with the offer and sale of securities of Delta Capital Management Limited Partnership ("Delta Capital").

Johnston Lemon and Smith denied all allegations asserted by the public customer claimants.

In response to the original claim filed by the public customers, Smith and Johnston Lemon asserted cross claims against each other for contribution. In addition, Smith asserted cross claims against Johnston Lemon and a third party claim against its chairman, Lemon for, among other things, defamation, intentional infliction of emotional duress and tortious interference with business relationships.

Johnston Lemon and Lemon categorically denied all allegations asserted by Smith and requested immediate dismissal of Smith's claims against them. Johnston Lemon alleged, among other things, that public customer claimants were induced to purchase Delta Capital Management L.P. ("Delta Capital") by material misrepresentations and omissions of material facts by Smith and Michaels. Johnston Lemon alleged that Delta Capital was not a security or investment opportunity that it offered. Johnston Lemon alleged that it had no knowledge of or contact with Delta Capital. Johnston Lemon therefore seeks indemnification from Michaels and Smith for damages it sustained as a result of Smith and Michaels selling Delta Capital to public customers. Johnston Lemon alleged that it was never advised by Smith or Michaels that Delta Capital Management was a limited partnership, and therefore was not afforded the opportunity to perform the type of "due diligence" it normally conducted. Johnston Lemon asserted that because Smith and Michaels recommended Delta Capital to public customers without written approval of Johnston Lemon, Smith and Michaels violated Johnston Lemon's policies. Johnston Lemon alleged that Smith and Michaels participation in recommending an investment which was sold away from the firm and constituted a violation of NASD Rules of Fair Practice, Article III, Section 40.

Johnston Lemon maintained that public customers suffered losses in Delta Capital when it declined due to the collapse of the stock price of its major holding, First Executive Corporation. Johnston Lemon maintained that, as a result of the losses that public customers suffered in Delta Capital, that the public customers initiated claims against Johnston Lemon and Smith. Johnston Lemon alleged that Smith and Michaels should be held responsible for the losses suffered by the public customers and seek indemnification and contribution against them.

Johnston Lemon maintained that Smith's cross claim for defamation, intentional infliction of emotional distress and tortious interference with business relations was improperly implead against Lemon. Johnston Lemon and Lemon maintained that Smith's cross claims are outside the scope of the NASD jurisdiction and expertise, that the cross claims do not state any legitimate basis for relief and that Smith has failed to comply with NASD rules applicable to his cross claims.

Johnston Lemon asserted a Third Party claim against Michaels, a former Johnston Lemon broker, for contribution relating to the public customers claim, which Michaels opposed. Michaels then asserted claims against Johnston Lemon and Lemon, as well as against Ryan, a senior officer at Johnston Lemon; Clem, a Johnston Lemon compliance officer; and Boorman, a Johnston Lemon senior vice president and manager of its Washington D.C. sales office. Boorman supervised Michaels' actions as a registered representative when the acts in question occurred. Michaels asserted allegations against the aforementioned parties for, among other things, defamation, intentional infliction of emotional duress and tortious interference with business relationships. Respondents Johnston Lemon, Lemon, Clem, Ryan and Boorman categorically denied all allegations and requested immediate dismissal.

Respondent Smith filed a Third Party claim against Morgan Stanley and its employees Ricciardelli and Nolan which sought, among other things, indemnification for any awards against him arising out of these public customers complaint or from a prior customer claim (National Association of Securities Dealers Arbitration #91-02381 - Mayhew vs. Johnston Lemon and Smith).

The above is not a complete summary of the issues alleged and defenses maintained, but rather an overview of the case.

### **RELIEF REQUESTED**

Johnston Lemon requested that Smith and Michaels be required to pay it \$150,000 pursuant to its claim against them for contribution and indemnity arising out of

settlement of this arbitration with the original public customer claimants. Johnston Lemon also requested that Smith and Michaels' claims for defamation, intentional infliction of emotional distress and tortious interference with contractual relationships against Johnston Lemon, Lemon, Ryan and Clem be dismissed and that no compensatory or punitive damages be awarded to either Smith or Michaels. Johnston Lemon requested sanctions be imposed against Smith and Michaels and Michaels' counsel for alleged prosecution of frivolous claims against Johnston, Lemon, Lemon, Ryan and Clem. Johnston Lemon requested that sanctions be imposed to require Michaels and Smith to pay the attorney's fees incurred by Johnston Lemon in this arbitration for the period forward from January 8, 1993 to the conclusion of this case (\$118,802.00 as of March 30, 1994).

Smith requested dismissal of Johnston Lemon's claims against him. He requested that his claims against Johnston Lemon for defamation, intentional infliction of emotional duress and tortious interference with business relationships, and malicious prosecution be upheld. He requested that the panel require Johnston Lemon pay him the following: (1) for defamation \$422,000; (2) intentional infliction of emotional duress \$50,000; (3) tortious interference with business relationships \$211,000; (4) and malicious prosecution \$50,000; (5) Smith also requested an award of \$184,202.77 in costs, expenses, forum fees, attorney's fees and reasonable reimbursement of time in lieu of attorney's fees and finally \$50,000 in exemplary damages.

Michaels requested that Johnston Lemon's claims against her be denied. She requests that the panel uphold her claims against Johnston Lemon, Lemon, Ryan and Clem for malicious prosecution, defamation, intentional infliction of emotional duress and tortious interference with business relationships, and that sanctions be imposed against Johnston Lemon and punitive damages be assessed. Michaels requested damages and payment in the following amounts: (1) lost earnings \$14,332.00; (2) attorney's fees \$63,634.00; (3) transcription costs, \$7,057.00; (4) interference with business relationships \$7,154.00; (5) defamation \$92,177.00; (6) abuse of process \$92,177.00; (7) emotional duress \$92,177.00; (8) sanctions for Johnston Lemon conduct during the arbitration \$25,000.00 and (9) punitive damages of \$184,354.00. Michaels also asked that all forum fees be assessed against Johnston.

#### **OTHER ISSUES CONSIDERED & DECIDED**

On July 27, 1992 a separate arbitration panel in the Mayhew case, found Johnston Lemon liable and awarded the Mayhews \$164,875.50. There was no award against Smith. Johnston Lemon's cross claimed against Smith was denied in its entirety, Johnston Lemon's efforts to have Mayhew panel allow it to assert a Third

Party claim against Michaels for contribution was denied twice. The last denial was after Michael's testimony in that case in late February 1992. The panel in the Mayhew case also made a disciplinary referral to the NASD recommending a review by the NASD of Johnston Lemon's supervisory procedures.

On January 6, 1993, the original public customer claimant settled their claims against Johnston Lemon, and its employees, etc., in consideration of payment of \$150,000 to them by Johnston Lemon. The public customer claimants then ceased to be a party to this arbitration.

On October 12, 1993, the first day of hearings in this arbitration, the panel dismissed Smith's claims against Morgan Stanley, Ricciardelli and Nolan since it found there was no duty owed to Smith and therefore no breach of a duty to him by those parties. On the same day the panel also dismissed Michaels' claims against Boorman. By virtue of Boorman's employment by Johnston Lemon this panel found that any breach of duty to or tortious conduct toward Michaels, in which he may have engaged in the course of his employment, was attributable to Johnston Lemon, his employer. Therefore the panel found there was no need to continue him as a defendant. This left the remaining claims for the panel to adjudicate.

During closing arguments Johnston Lemon renewed its motion to dismiss Smith and Michaels claims against it. That motion is 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. All claims against Lemon, Ryan and Clem are denied in their entirety since the conduct in which they engaged in the course of their employment is attributable to their employer Johnston Lemon.
2. Johnston Lemon claims for indemnification and/or contribution against Smith and Michaels are denied in their entirety.

Johnston Lemon's claims against Michaels and Smith are denied since essentially the same facts and claims were resolved against Johnston Lemon in the Mayhew Arbitration, (NASD Arbitration #91-02381). Additionally this panel has heard the evidence in this intensely contested proceeding and is satisfied that the Mayhew

results were supported by the evidence and disposed of the essential issues we face here.

Johnston Lemon's supervisory procedures were so lax in its institutional sales department that neither Johnston Lemon nor its counsel could attest to who was in charge when the events giving rise to this proceeding occurred. Smith was employed in that department and was responsible for introducing the limited partnership interests in Delta Capital to Johnston Lemon. Delta Capital was introduced by Smith to Michaels and Johnston Lemon's Washington sales office through Boorman. Boorman had suggested Smith talk with certain rookie brokers in his office and call Johnston Lemon's Virginia office about Delta Capital. At Johnston Lemon there was an informal verbal method of reviewing and clearing some compliance issues which, while inconsistent with written supervisory procedures, was followed by the firm generally. Michaels and Smith followed those informal procedures in clearing for sale the limited partnership interests of Delta Capital. They had no reason to doubt that they were acting consistent with Johnston Lemon's requirements and procedures as normally followed.

Johnston Lemon's case was largely based on the testimony of Boorman, who asserted that Smith never informed him that a limited partnership was involved in the Delta Capital offering. He testified he was told a money management account was being offered. The overwhelming weight of the evidence supports our finding that Johnston Lemon and its supervisory personnel either knew, or should have known, that the offering of interests in Delta Capital by Smith and Michaels involved the sale of limited partnership interests. Therefore contrary to Johnston Lemon's assertions and consistent with the Mayhew decision, the panel finds neither Smith nor Michaels sold Delta Capital Limited partnership interests away from Johnston Lemon.

3. This panel accepts that Johnston Lemon believed the testimony of Boorman. However, the Mayhew panel resolved essentially the same issues involving essentially the same facts as those raised by Johnston Lemon in this proceeding. They dismissed the case against Smith. In spite of all this, Johnston Lemon has chosen to continue to pursue Smith and Michaels. We understand Smith and Michaels refused to settle this arbitration in a manner acceptable to Johnston Lemon. However, the panel can not understand how Johnston Lemon can, in good conscience, pursue them still on discredited claims. That course of conduct totally disregarded the Mayhew decision and is inconsistent with the overwhelming weight of the evidence. Smith and Michaels attribute this to maliciousness and vindictiveness. One of the panelists agrees, but the majority of the panel would not go that far. However, we all agree that the conduct of Johnston Lemon had been so unfair and unreasonable, even if followed honestly, that the only way to adequately compensate Smith and Michaels for the improper



conduct is to assess compensatory damages as follows:

- (a) That Respondent Johnston Lemon is liable to Michaels and shall pay to Michaels the sum of \$175,000.00; this amount is exclusive of interest.
- (b) That Respondent Johnston Lemon is liable to Smith and is directed to pay to Smith the sum of \$100,000.00; this amount is exclusive of interest.

4. The panel feels that all parties failed to cooperate adequately each with the other in following the discovery rules contained in the Code of Arbitration Procedure. However the panel finds that Johnston Lemon was largely responsible for substantial delays in this proceeding by failing to produce required documents in a prompt manner. In fact, Johnson Lemon failed to honor certain of the panels orders for production of documents until called to account for its conduct. In view of the above, the panel assesses all forum fees against Johnston Lemon.

5. The panel hereby directs Johnston Lemon to file, with the appropriate regulatory authorities amended U-5s on behalf of Smith and Michaels consistent with the terms of this award. If the current U-5s filed by Johnston Lemon on behalf of Smith and Michaels reflect that Michaels and/or Smith committed fraud, sold away or wronged Johnston Lemon and/or the original public customer claimants in regard to Delta Capital, Johnston Lemon is directed to file Amended U-5s redacting such language.

6. The parties shall bear their own costs, including attorneys' fees, except as specifically provided for herein

7. The panel hereby dismisses all claims and requests, including all claims for punitive damages, inconsistent with this ruling.

### **FORUM FEES**

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following Forum Fees are assessed against Johnston Lemon as indicated in Section 4 above.

28 hearing sessions x \$1,000 = 28,000 minus Johnston Lemon's hearing session deposit of \$600 and Smith's hearing session deposit of \$1,000 and Michaels hearing session deposit of \$1,000 = \$25,400 net forum fees due.

Johnston Lemon Award  
Case No. 92-00218  
Page 10

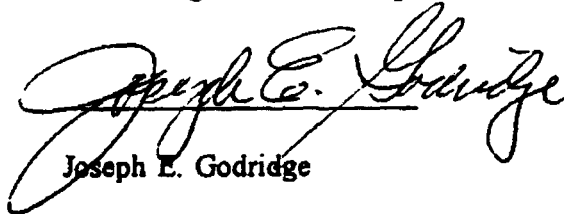
Johnston Lemon shall pay forum fees in the amount of \$25,400 directly to the National Association of Securities Dealers, Inc.

Johnston Lemon shall refund to Smith his previously filed hearing session deposit of \$1,000.

Johnston Lemon shall refund to Michaels her previously filed hearing session deposit of \$1,000.

Concurring Arbitrator's Signature

Public/Industry



Joseph E. Godridge

Industry

NASD Date of Decision: July 8, 1994

Johnston Lemon Award

Case No. 92-00218

Page 10

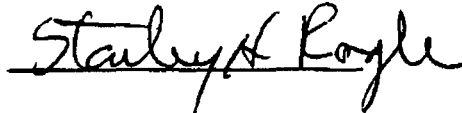
Johnston Lemon shall pay forum fees in the amount of \$25,400 directly to the National Association of Securities Dealers, Inc.

Johnston Lemon shall refund to Smith his previously filed hearing session deposit of \$1,000.

Johnston Lemon shall refund to Michaels her previously filed hearing session deposit of \$1,000.

Concurring Arbitrator's Signature

Public/Industry

A handwritten signature in cursive script, reading "Stanley H. Ragle", is written over a horizontal line.

Stanley H. Ragle, Esq.

Industry

NASD Date of Decision: July 8, 1994

Johnston Lemon Award  
Case No. 92-00218  
Page 10

Johnston Lemon shall pay forum fees in the amount of \$25,400 directly to the National Association of Securities Dealers, Inc.

Johnston Lemon shall refund to Smith his previously filed hearing session deposit of \$1,000.

Johnston Lemon shall refund to Michaels her previously filed hearing session deposit of \$1,000.

Concurring Arbitrator's Signature

Steven R. Bralove

Steven R. Bralove

Public/Industry

Industry

NASD Date of Decision: July 8, 1994