

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

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In the Matter of the Arbitration Between

Name of Claimant

Dr. Emilio Sarabia, Trustee. HTC Dentistry  
Profit-Sharing Plan

92-01165

Name of Respondents

Shearson Lehman Brothers, Inc.;  
Drexel Burnham Lambert, Inc.;  
Smith Barney Harris Upham & Co., Inc.;  
Leonard Edward Kowitz;  
Roberto Villani

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**REPRESENTATION**

For Claimant: Dr. Emilio Sarabia, Trustee, HTC Dentistry Profit-Sharing Plan ("Sarabia") was represented by Christine E. Monical, Esq. of Monical & Associates, located in Houston, Texas.

For Respondents: Shearson Lehman Brothers, Inc., ("Shearson") Smith Barney, Harris Upham & Co., Inc. ("Smith Barney") and Leonard Edward Kowitz ("Kowitz") were represented by Janiece M. Longoria, Esq. of Andrews & Kurth, L.L.P., located in Houston, Texas.

**CASE INFORMATION**

Statement of Claim filed: April 2, 1992.

Claimant's Submission Agreement signed on: March 25, 1992.

First Amended Statement of Claim filed: August 6, 1992.

Second Amended Statement of Claim filed: October 13, 1992.

Statement of Answer filed by Respondent Smith Barney, Harris Upham & Co., Inc. on: May 29, 1992.

Respondent Smith Barney, Harris Upham & Co., Inc.'s Submission Agreement signed on: May 29, 1992 by Judith C. Greene, Vice President, Smith Barney, Harris Upham & Co., Inc.

Statement of Answer to First Amended Statement of Claim filed by Smith Barney, Harris & Upham, Co., Inc. and Leonard Edward Kowitz on: October 6, 1992.  
Respondent Leonard Edward Kowitz's Submission Agreement signed: September 22, 1992.

Statement of Answer to the Second Amended Statement of Claim filed by Respondent Shearson Lehman Brothers, Inc. on: February 12, 1993.

Respondent Shearson Lehman Brothers Inc.'s Motion to Dismiss filed: February 16, 1993.  
Claimant's Response to Shearson Lehman Brothers, Inc.'s Motion to Dismiss filed: March 10, 1993.

Brief in Support of Respondent Shearson Lehman Brother, Inc.'s Motion to Dismiss filed on: March 11, 1993.  
Shearson Lehman Brothers, Inc.'s Reply to Claimant's Response to Shearson's Motion to Dismiss filed: March 17, 1993.

Respondent Smith Barney, Harris Upham & Co., Inc.'s Motion to Dismiss Certain Claims of Claimant filed: March 8, 1993.  
Claimant's Response to Smith Barney, Harris Upham & Co., Inc.'s Motion to Dismiss Certain Claims of Claimant filed: March 15, 1993.

Respondent Smith Barney, Harris Upham & Co., Inc.'s Motion for Leave to File an Answer to the Claimant's Second Amended Claim and Counterclaim filed: May 24, 1993.

### **HEARING INFORMATION**

Pre-Hearing Conference:	None Held.
Hearing Dates/Sessions:	June 8, 1993 for Two (2) sessions; June 9, 1993 for Three (3) sessions; June 30, 1993 for Two (2) sessions; and July 1, 1993 for Two (2) sessions.
Hearing Location:	Houston, Texas.

### **CASE SUMMARY**

Claimant alleged that Respondents misrepresented and placed Claimant in investments in limited partnerships, "junk bond" funds and common stocks which were unsuitable for a tax-deferred ERISA plan and because of Sarabia's lack of investment experience. Sarabia specifically alleged that:

1. In 1984 or 1985, Roberto Villani ("Villani"), an account manager with

Shearson, convinced Sarabia to open discretionary accounts with his firm, convincing him that he would be kept better informed of the investment performance. The account objectives remained long-term growth and Villani was relied upon to make all investment decisions in the account:

2. Villani invested in BalCor, an inappropriate, unsuitable tax sheltered limited partnership, which constituted a large and inappropriate percentage of the assets of the plan. This investment was made without regard for the age and risk orientation of the Plan participants:

3. In or about 1986, Villani transferred to Drexel Burnham Lambert, Inc. ("Drexel") and continued to purchase BalCor partnerships for the account. Sometime in approximately November of 1987, Respondent Kowitz replaced Villani as the account representative. Sarabia continued to rely on Kowitz as a fiduciary and Kowitz continued purchasing unsuitable investments:

4. In May, 1989, the Drexel office was taken over by Respondent Smith Barney. Kowitz did not review the assets of the plan with Sarabia, did not identify the problem with BalCor, did not identify the unsuitable investments, and did not adhere to the account objectives;

5. Smith Barney continued to cover up the decline in value of the Plan investments by valuing them at cost instead of disclosing the true value. In late 1989 or early 1990, Sarabia procured a second opinion regarding the performance of the account and called a meeting with Kowitz. At the meeting, Kowitz advised that he had not been paying attention to the account, but promised to be more responsive and assured that the account would show greater performance; and

6. On or about October 5, 1990, Sarabia moved the Plan assets away from Respondents to a certified financial planner, who unraveled the mess that had been made of the account. Respondents had placed the account in highly speculative securities in direct conflict with the express instructions of Sarabia. The majority of the losses occurred in four securities: BalCor Limited, a series of limited partnerships; junk bond funds generating high commissions; Ford Motor Company stock, a declining stock in a depressed industry; and Cellular Information systems stock, a security de-listed by the OTC and in which Respondent was a market maker.

Based upon the above allegations, Sarabia asserted the following claims: breach of contract; breach of fiduciary duty; common law fraud; "churning"; and Federal securities fraud.

Respondents Smith Barney and Kowitz denied the material allegations of the Statement of Claim.

alleging that:

1. Sarabia was an experienced, sophisticated investor who started doing business with Kowitz in 1988 after Villani left Drexel. In May of 1989, Smith Barney assumed the lease on Drexel's Houston office and hired Kowitz as an account executive. Sarabia was given the choice of transferring his accounts to any other broker and decided on Smith Barney;
2. The Smith Barney account documents signed by Sarabia stated that Sarabia had sole control of the investment and reinvestment of funds held on behalf of each participant in the Plan. No discretionary control was given to Kowitz; and
3. Very little trading was conducted in the Plan accounts except for the account of Sarabia himself. Sometime in 1990, Sarabia requested more stock trading and growth in his account. All trades were discussed and authorized by Sarabia, and he received all confirmations and statements forwarded to him. The statements showed all trades, all securities held and the market value, and the equity in the account.

In addition, Respondents Smith Barney and Kowitz asserted several affirmative defenses, including:

1. The complaint fails to state facts sufficient to constitute a cause of action;
2. The complaint is barred by Sarabia's contributory and comparative fault, and by his failure to mitigate damages;
3. The damages complained of were not caused by Smith Barney or its employees; and
4. Sarabia ratified his securities transactions with knowledge of the risks of which he complained.

Respondent Shearson denied the material allegations of the Statement of Claim, alleging several defenses, including:

1. Sarabia's claims against Shearson are ineligible under Section 15 of the NASD Code of Arbitration Procedure;
2. Villani faithfully followed the instructions of Sarabia and recommended securities based upon a reasonable belief that the securities were suitable in light of the account objectives;

3. Shearson maintained and exercised a reasonable system of supervision and control over its employees and agents;
4. Sarabia's claims are barred by the applicable Statute of Limitations, by Sarabia's contributory and comparative fault, by Sarabia's failure to mitigate his damages and by the doctrines of waiver, ratification and estoppel; and
5. The losses in the accounts are the result of independent market conditions or conduct beyond the control of Shearson.

#### **RELIEF REQUESTED**

Claimant requested entry of an award against the Respondents for actual damages in the approximate amount of \$50,000.00 for losses in the account and \$33,000.00 in lost profits; an indeterminate amount for unnecessary commissions charged from excessive account turnover; punitive damages in the amount of \$250,000.00; and attorneys' fees pursuant to Section 38.001, Texas Civil Practice and Remedies Code.

Respondents Smith Barney and Kowitz requested that the Statement of Claim be dismissed in its entirety and that costs be assessed against Claimant.

Respondent Shearson requested that the Claim be dismissed, that Shearson recover its attorneys' fees and costs, and for further relief to which it showed itself entitled.

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

By letter dated September 15, 1992, Claimant Sarabia withdrew his claims against Respondent Drexel Burnham Lambert, Inc. because of the bankruptcy proceeding initiated by Drexel on May 19, 1990. Therefore, because of the bankruptcy action and Claimants withdrawal of his claim, no further proceedings were taken against Drexel Burnham Lambert, Inc.

Respondent Roberto Villani did not appear or file a Submission Agreement or Answer. Upon review, the Panel found that Respondent Roberto Villani was not properly served with the Statement of Claim and Notice of the Hearing. They determined that Respondent Roberto Villani was dismissed without prejudice for lack of service. The present dispute and the matter arbitrated did not address the purchase of the BalCor security by Villani at Shearson nor does it address any conduct or actions of Villani because Villani was never served.

On April 12, 1993, the Panel's decision on the Respondents' Motion to Dismiss were forwarded by letter to the parties. By order signed by the Panel and forwarded to the parties on May 25, 1993, the Panel granted the Motion to Dismiss pursuant to Section 15 of the NASD Code of Arbitration Procedure filed by Shearson would be granted and that all claims asserted against

Respondent Shearson Lehman Brothers, Inc. were dismissed with prejudice. In addition, the Panel denied as moot Smith Barney's Motion to Dismiss Certain Claims, determining that Claimant's dispute is with respect to Smith Barney only and does not extend to the liability of Smith Barney for transactions at Drexel Burnham Lambert, Inc.

On June 8, 1993, the Panel heard argument on Respondent Smith Barney's Motion for Leave to Amend and Counterclaim filed with the NASD on May 24, 1994. After hearing argument, the Panel determined that the Motion would be denied.

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.

### **AWARD**

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

1. The Claims asserted by Claimant Dr. Emilio Sarabia, Trustee, HTC Dentistry Profit Sharing Plan Respondents Smith Barney, Harris Upham & Co., Inc. and Leonard Edward Kowitz are hereby dismissed and denied in their entirety;
2. The Claims asserted against Respondent Roberto Villani are hereby dismissed without prejudice;
3. Pursuant to the Panel's earlier Order, the Claims asserted against Respondent Shearson Lehman Brothers, Inc. are hereby dismissed with prejudice;
4. The parties shall bear their own costs of arbitration, including attorneys' fees, except for those specifically enumerated herein.

### **OTHER COSTS**

The Panel denies Claimant Sarabia's request for waiver of the postponement fee in his letter of October 13, 1992, and orders payment of the \$750.00 fee to the NASD.

**FORUM FEES**

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following total Forum Fees are assessed: Nine (9) hearing sessions x \$750.00 per hearing session = \$6,750.00.

The National Association of Securities Dealers, Inc. shall retain the \$200.00 claim filing fee and the \$750.00 hearing session deposit previously deposited by the Claimant, Dr. Emilio Sarabia, Trustee, HTC Dentistry Profit Sharing Plan. Claimant Dr. Emilio Sarabia, Trustee, HTC Dentistry Profit Sharing Plan is liable for and shall pay the NASD additional forum fees in the sum of \$6,000.00.

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

**Concurring Arbitrators' Signatures**

**Name**

**Date**

Donald H. Fidler, Esq.  
Donald H. Fidler, Esq.  
Public Arbitrator  
Chairperson

November 9, 1993

Jeanine M. Lehman, Esq.  
Jeanine M. Lehman, Esq.  
Public Arbitrator

November 3, 1993

Thomas A. Thornhill  
Thomas A. Thornhill, Jr.  
Industry Arbitrator

November 3, 1993

For NASD Use Only

Date of Service of Award: 11-10-93