

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

In the Matter of the Arbitration Between

Name of Claimant

Kimberley W. Thornton

92-01524

Name of Respondents

Merrill Lynch, Pierce, Fenner & Smith, Inc.;
Randall J. Battiste

REPRESENTATION

For Claimant: Kimberly W. Thornton was represented by Stephen C. Whicker, Esq. of Atlanta, Georgia.

For Respondents: Merrill Lynch, Pierce, Fenner & Smith, Inc. was represented by V. James Mann, Esq. of Merrill Lynch, Pierce, Fenner & Smith, Inc., New York, New York.

Randall J. Battiste was represented by Thomas L. Krebs, Esq. and Stephen Gregory, Esq. of Ritchie & Redicker, P.C., located in Birmingham, Alabama.

CASE INFORMATION

Statement of Claim filed: May 4, 1992.

Claimant's Submission Agreement signed on: June 22, 1992.

Statement of Answer filed by Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. on: August 7, 1992.

Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc.'s Submission Agreement signed on: August 3, 1992 by V. James Mann, Vice President and Senior Counsel, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Statement of Answer and Supplement filed by Respondent Randall J. Battiste on: August 21, 1992.

Respondent Randall J. Battiste's Submission Agreement signed on: August 13, 1992.

HEARING INFORMATION

Pre-Hearing Conference: None Held.
Hearing Dates/Sessions: April 27, 1993 for Two (2) sessions;
April 28, 1993 for Two (2) sessions;
June 22, 1993 for Two (2) sessions.

Hearing Location: New Orleans, Louisiana.

CASE SUMMARY

Claimant Kimberly W. Thornton ("Thornton") alleged that Respondent Randall J. Battiste ("Battiste"), while employed by or acting as an agent for Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"), placed her monies in unsuitable investments, misrepresented the risks of the investments, failed to inform Thornton of the risk of trading stocks on margin and took monies from the accounts without authorization. Thornton specifically alleged that:

1. Thornton was an unsophisticated investor who, prior to 1989, had no substantial savings, owned no real or personal property of any substantial value and was devoid of any investment experience;
2. In November of 1989, Thornton was awarded \$950,000.00 for claims brought as a result of the wrongful death of her child. Battiste had devised an "investment plan" for Thornton prior to her receiving the award and in December of 1989, he received the funds to invest pursuant to the plan. Battiste informed Thornton that he would manage the portfolio very conservatively, investing primarily in bonds and blue chip stocks, and that there would be enough income generated for her to live comfortably from month to month;
3. Thornton signed several documents in blank prior to receiving the money. Battiste informed her that he would complete the documents and mail her copies of the completed documents at a later time. None of the documents were ever explained to Thornton and copies were not received;
4. Battiste purchased for Thornton's account Merrill Lynch sponsored bonds

totaling approximately \$475,000.00 dollars. He further invested \$100,000.00 each in two separate stock trading accounts and set up a joint cash management account ("CMA") for the use of Thornton and her husband. Battiste never informed Thornton that the CMA was a margin account. Thornton had no knowledge of margin accounts, never signed a margin agreement, and was not informed of the operation and risks of the account;

5. After the accounts were formed, Battiste assumed complete control and discretion over the transactions. In February of 1990, Battiste suddenly recommended a sale of the Merrill Lynch sponsored bonds and the purchase of other bonds of substantially the same quality, advising Thornton that these new bonds were better. The transaction was contrary to Thornton's investment objectives and ended up costing her approximately \$36,000.00 in losses and commissions;

6. In March of 1990, Battiste recommended a seven (7) year twenty-five thousand (\$25,000) dollar fund, representing that there would be a life insurance policy issued through Monarch Life Insurance Company which would be necessary to protect the investment and a \$6,150.00 management fee for purposes of managing this account during the seven year period. The \$6,150.00 was taken from Thornton's CMA account by check made payable to Thornton and was endorsed in blank and given to Battiste. However, the fund never existed, no funds were received by the Monarch Life Insurance Company and is believed that Battiste converted the funds to his own use. In August of 1990, Battiste appeared at Thornton's home and gave her a check for \$6,150.00 as repayment of the management fee and advised her not to mention the payment to Merrill Lynch;

7. The two stock trading accounts were eventually closed by Battiste and the balance of funds paid into Thornton's CMA. At that time, Thornton discovered that Battiste had made huge purchases of Wall-Mart, Intel and All-Waste stocks in her account on margin, and had been buying and selling on margin in her account. As a result, in August of 1990 there existed a margin debit of \$255,000.00. Substantial liquidation of Thornton's CMA had to be made to satisfy the margin debit and resulted in large losses which would have not occurred had the account not been on margin; and

8. Upon learning of these losses, Thornton consulted with Merrill Lynch and made demand for the losses incurred. Thornton closed her accounts when no action was taken.

Based upon the above allegations, Thornton asserted claims for violation of the Federal and State securities laws; violation of the rules and regulations of the NASD and other Exchanges; breach

of fiduciary duty; common law fraud; breach of contract; and misrepresentation. In addition, Thornton asserted liability against Merrill Lynch based upon the "controlling person" section of the Securities Exchange Act of 1933, 15 U.S.C. Par. 77o and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. Par. 78t(a), and the doctrine of respondeat superior.

Respondent Merrill Lynch denied the material allegations of the Statement of Claim, alleging that:

1. On November 15, 1989, Thornton executed a Cash Management Account agreement to establish a CMA account with Merrill Lynch which consists of a conventional securities account which, unless the customer designates otherwise, is a margin account, a choice of money market accounts and a checking/debit card account. Thornton and her husband had previously opened a joint CMA. Thornton advised Battiste that her investment objectives were long term price appreciation and income, and that she was willing to invest in investment grade and good quality securities in an attempt to achieve these objectives;
2. On December 1, 1989, Thornton invested in two income oriented mutual funds which were consistent with her objectives. In February of 1990, Thornton sold her shares and invested the proceeds in a diversified portfolio of corporate bonds and two unit trusts. The new investments were different in several respects, including payment of a fixed, predictable dividend. The positions were held until they were transferred out of Merrill Lynch in October of 1990;
3. Throughout the nine month period that the accounts were open, Thornton engaged in a pattern of spending vastly in excess of the income her accounts were generating, withdrawing approximately \$475,000.00 by August of 1990. Consistent with Thornton's desire for more income to support her spending, Battiste suggested writing covered calls against securities held in the CMA. Therefore, in June of 1990, Thornton established positions of 2,500 shares each in Allwaste, Blockbuster Entertainment, Laidlaw Inc. and Intel Warrants. These positions, except Allwaste, were sold in July at a profit, and the proceeds used to purchase shares of Helmerich Payne, Wal Mart and Intel common stock. Battiste sent Thornton Options Agreements for signature, but they were never returned and the program was never begun. These stocks were sold at Thornton's request after Battiste left Merrill Lynch; and
4. Merrill Lynch had no independent knowledge of the circumstances regarding the issuance of the \$6,150.00 check, but noted that: a) the check was requested three weeks before the Monarch application was signed by Thornton; b) the check was payable to Thornton instead of Monarch or Battiste; c) Monarch notified Thornton that it would not issue a policy a short time later, yet no inquiry was

made until approximately four months later after Battiste's resignation; and
d) Thornton received the monies back from Battiste.

In addition, Merrill Lynch asserted as affirmative defenses that:

1. Thornton failed to state a claim upon which relief could be granted;
2. Thornton failed to mitigate damages;
3. The claim is barred because of the applicable statute of limitations;
4. Thornton's losses were proximately caused by her own conduct or negligence or that of a third party;
5. Thornton expressly ordered, approved, authorized, participated in and ratified the acts and transactions complained of and upon which recovery is sought. Therefore, Thornton is estopped from recovery; and
6. The parties have agreed that the disputes between them are governed by New York law and under New York law an arbitration panel cannot award punitive damages. Therefore, Thornton cannot be awarded punitive damages.

Respondent Battiste denied the material allegations of the Statement of Claim, alleging that:

1. The investment plans drafted were done at Thornton's express direction based on different amounts she speculated she might receive in settlement of her lawsuit. The decision to invest with Merrill Lynch was not at Battiste's direction, but was arrived at by Thornton after she considered and rejected proposals from at least two other investment managers;
2. The decision to purchase each security in Thornton's accounts was made by her after full disclosure of the merits and risks of the investment, and with her express prior approval. Thornton controlled the decision-making during the period of her association with Merrill Lynch and Battiste did not "manage" the portfolio;
3. Each plan submitted to Thornton by Battiste stressed the need for establishment and maintenance of a budget. However, Thornton could not restrain her spending. Within twenty-four hours of funding her accounts, she withdrew \$99,569.53. Within 23 days of opening the accounts, \$120,237.40 had been withdrawn. Within sixty days, Thornton had withdrawn \$252,081.35 and by the end of 1990, she had withdrawn in excess of \$475,000.00. These cash

withdrawals derailed the appropriate and suitable investment plan recommended by Battiste;

4. The account documents were complete when Thornton signed them and Battiste spent a great deal of time explaining the documents and the operation of the accounts. While the funds were to be conservatively invested, at no time did Battiste state that they would be invested with no risk;

5. Battiste did not recommend the sale of the bond funds, but was contacted by Thornton to ask whether the funds could be sold and invested into higher-yielding instruments. Battiste warned of the sales charges that would result, but was told to sell the funds by Thornton. Battiste did not advise Thornton that they were "better" bonds and the transactions were solely her idea;

6. The check for \$6,150.00 was not a management fee for the Monarch Life investment, but was a loan to Battiste. The policy was not purchased when Monarch refused to issue the policy after Thornton failed the physical and the \$25,000.00 check for purchase of the policy was destroyed at her direction. The check for \$6,150.00 was evidenced by a promissory note and full repayment was made;

7. The closing of the other accounts and their transfer into the CMA occurred because Thornton had exhausted the readily available cash in the account. The decision to trade on margin was made solely by Thornton after she was confronted with the necessity to either sell her income producing securities to purchase higher yielding securities or utilize the margin features of the account; and

8. The alleged damages were incurred because of Thornton's failure to act when Iraq invaded Kuwait and not because of the margin trading.

In addition, the following affirmative defenses were asserted:

1. The Statement of Claim fails to state a claim upon which relief can be granted;
2. Thornton authorized each transaction, maintained control of her account, was fully apprised of all transactions and received all confirms and statements;
3. Thornton ratified all transactions after being apprised of the considerations attendant to each transaction;

4. Thornton is estopped from asserting the putative claims because Battiste implemented each transaction on Thornton's order;
5. These claims were dismissed by the NASD district office which determined that no action was warranted. Therefore, this action should be dismissed;
6. The alleged losses were proximately caused by Thornton's own conduct or negligence and are not in fact losses;
7. Punitive damages cannot be awarded because the parties have agreed that New York law applies.

RELIEF REQUESTED

Claimant Thornton requested entry of an award against Respondents for actual damages in excess of \$100,000.00; punitive damages in a sum equal to at least three (3) times her actual damages; and all costs, interest and disbursements, including reasonable attorneys' fees incurred in pursuing the arbitration.

Respondent Merrill Lynch requested that the Statement of Claim be dismissed in its entirety with costs assessed against the Claimant.

Respondent Battiste requested that the claim be dismissed and that he receive an award of costs and attorneys' fees incurred in this proceeding.

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.

AWARD

After considering the pleading, 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 Statement of Claim is hereby dismissed and denied in its entirety; and

2. The parties shall bear their own 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 Forum Fees are assessed: Six (6) hearing sessions x \$750.00 per session = \$4,500.00.

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, Kimberly W. Thornton. Claimant Kimberly W. Thornton is liable for and shall pay to the NASD additional forum fees in the sum of \$3,750.00.

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

Concurring Arbitrators' Signatures

Name

Date

Frederick S. Ellis
Frederick S. Ellis
Public Arbitrator
Chairperson

September 8, 1993

Clayton J. Borne, Jr.
Clayton J. Borne, Jr.
Public Arbitrator

September 8, 1993

Robert R. Wolf
Robert R. Wolf
Industry Arbitrator

September 14, 1993

For NASD Use Only

Date of Service: 9-21-93