

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

In the Matter of the Arbitration Between

Name of Claimants

Lawrence C. LeBlanc and L&L Properties

vs.

92-01996

Name of Respondents

Prudential Securities Inc
Matthew Capone
Michael Lewis

REPRESENTATION

For Claimants, Lawrence C. LeBlanc and L & L Properties ("Claimants"), Peter L. Resnik, Esq. and Steven W. Kasten, Esq., from the law firm of McDermott, Will & Emery.

For Respondents, Prudential Securities Inc. ("Prudential"), Matthew Capone, ("Capone") and Michael Lewis ("Lewis"), Joseph A. Ingrisano, Esq. and Terrance S. DeWald, Esq. from the law firm Kutak Rock.

CASE INFORMATION

Statement of Claim filed on June 15, 1992.

Claimants' Submission Agreement was signed on May 12, 1992.

Joint Statement of Answer was filed by Prudential, Capone and Lewis on August 17, 1992.

Prudential Submission Agreement was signed on August 28, 1992.

Capone's Submission Agreement was signed on August 29, 1992.

Lewis' Submission Agreement was signed on September 23, 1992.

HEARING INFORMATION

Pre-hearing Conference: January 11, 1993 - One Session.

Hearing Dates/Hearing Sessions: February 24, 1993 - Two Sessions
February 25, 1993 - Two Sessions
March 12, 1993 - Two Sessions
March 15, 1993 - Two Sessions
March 16, 1993 - Two Sessions
April 22, 1993 - Two Sessions
April 23, 1993 - Two Sessions
April 28, 1993 - Two Sessions
April 29, 1993 - Two Sessions
April 30, 1993 - Two Sessions

Hearing Location: February 24th and 25th, 1993 hearings - National Association of Securities Dealers, Inc's offices located at 260 Franklin Street, Boston, Massachusetts. March 12, 1993 through April 30, 1993 hearings - McDermott Will & Emery, 75 State Street, Boston Massachusetts. The latter location was agreed to by all parties.

CASE SUMMARY

In their Statement of Claim, Claimants make a claim for losses in excess of \$1,000,000 in connection with options trading in 1990, including use of a computer technical analysis and recommendation program known as the TBSP Right Time Program (the "computer program") for some of the trades, as a result of alleged fraud, misrepresentations, omissions, breach of contract and relevant rules and regulations, breach of fiduciary duty, negligence, failure to properly supervise and unauthorized trading on the part of Respondents. Claimants allege that Claimant LeBlanc, unsophisticated and inexperienced in investments and in particular, options, was induced to enter into risky options trading, in reliance upon assurances of Respondents that, as managed by Respondents and in view of Respondents expertise in options, the options strategy proposed by Respondents could recoup investment losses earlier experienced by LeBlanc. Claimants further allege that the risks inherent in the proposed strategy were not adequately disclosed and that, although Claimants suffered losses in the options trading in early 1990, Respondents continued to misrepresent the risks and improperly convinced Claimants to enter into risky OEX index options trades, including so-called day trades, partially on the basis of the inadequately explained and risky computer program. As a result of the foregoing, Claimants allege they suffered losses in excess of \$1,000,000.00. Claimants also allege churning or excessive commissions charged by Respondent Prudential Securities Inc., conversion of funds and Racketeer Influenced and Corrupt Act (RICO) violations.

Respondents deny the allegations of Claimants, allege that Claimants have no cause of action and are not entitled to any damages. Respondents further state that Claimants' claims are without basis in fact or law and that Respondents acted properly with respect to Claimants' accounts. Respondents also assert affirmative defenses.

RELIEF REQUESTED

Claimants request a total award including compensatory damages of \$1,028,303.00, treble damages of \$3,383,089.00, prejudgment interest of \$298,180.00, attorneys fees of \$130,000.00, costs of approximately \$30,000.00 and punitive damages under Rhode Island Law, in an amount to be determined by the panel.

Respondents request that each claim of Claimants be dismissed and the relief requested by Claimants be denied.

DISCUSSION AND RATIONALE

Claimant LeBlanc is a wealthy, successful Rhode Island builder, although a significant portion of his wealth was not liquid because in the form of real estate interests. Claimant L&L Properties is controlled by LeBlanc. LeBlanc was active in construction activities of his business, including construction partnerships but he was not active in financial aspects, except for negotiation of loans. He relied on bookkeeper, CPA, and legal help in business and in investment activities. He had limited experience in investment and was introduced to Respondents Capone and Prudential because Capone, a Prudential broker, handled the investments for LeBlanc's mother's trust, of which LeBlanc was a trustee.

In 1989 LeBlanc made a substantial investment in stock of Bank of New England (BNE), but the price of the stock dropped, prompting discussions between LeBlanc, his advisors, Capone and Respondent Lewis in late 1989, regarding possible sale of the BNE stock to take losses for tax purposes. A strategy was devised by Capone and Lewis to sell the BNE stock short against the box, which was successfully implemented. These discussions led to an options trading strategy proposed by Capone and Lewis to recoup the BNE and other investment losses. Trades began in late 1989 or early 1990 and evolved from equity options trades to large OEX index options trades later in 1990, including use of the computer program, introduced and installed by Capone, starting in March or April 1990. The trades continued on a steady basis, except for the summer of 1990, until September of 1990, resulting in total trading losses in excess of \$1,000,000.00 although when netted against profitable trades, the losses were slightly in excess of \$700,000.00. LeBlanc also experienced large losses on trades in BNE stock, including trades made in 1990 after the sale against the box was implemented. However no claim is made with respect to these losses.

Although LeBlanc was uneducated and unsophisticated in financial matters, he did begin to read financial journals extensively in 1990. He referred others to Prudential and his advisors and friends invested along with him at Prudential. He was active in an entrepreneurial sense, not only in his business, but also in the banking field. He understood risk/leverage/borrowing concepts from business. LeBlanc displayed a tolerance for risk, as witnessed by ignoring advise of Capone to sell BNE stock in 1990, widely regarded as a bank at serious risk of failure.

In his dealings with Capone, LeBlanc showed himself to be impulsive, impatient, demanding and controlling. He was clearly interested in quick, sure profits. He was eager to find a magic investment bullet and was actively involved in his accounts at Prudential. He was a difficult client, but was also subject to the influence of others who he regarded as sophisticated or knowledgeable, such as Capone and Lewis. Because of these characteristics, LeBlanc may not have understood or absorbed information provided by Respondents. He clearly relied on the advice of Capone on non-bank investments. He did no trading when Capone was out of the office. The above characteristics, of which Respondents either were or should have been aware, created a burden on Respondents to be certain LeBlanc understood the risks of the options trading program. Erratic and irrational behavior by LeBlanc on BNE investments put Respondents on notice that more time should be spent explaining risks of investments. On one hand Claimant was buying BNE stock, obviously assuming or hoping it would go up while at the same time buying puts on the stock of similarly situated Northeast banks, obviously assuming or hoping the stocks of those banks would go down.

The first phase in options trades was in equities, mostly banks. Many of the ideas came from LeBlanc, who seemed to understand basics on these options. No recovery against Respondents as to these trades is warranted because LeBlanc clearly authorized the goal to play an anticipated negative move in bank stocks in early 1990. Options were a way to limit risk in this regard, because the alternative of selling short involves higher capital requirements and unlimited risk. Options involve leverage and in this case defined risk.

As to the OEX index options trades, which were clearly solicited by Capone, although LeBlanc may have been capable of understanding the risks and, in connection with some of those trades, the computer program, installed by Capone and used in conjunction with traditional market analysis tools, he did not understand or was not given enough balanced information so that he should have understood the risks. The representations by Capone were all on the positive side. The following risks were not adequately explained: betting the whole market will go up or down within certain time frame; high commission costs create need for high return on investment to make profit (over \$2,600,000.00 in OEX index option trades were executed in a several month period, which generated over \$41,000.00 in commissions for Prudential); day trades composed most of the trading, which increase risk because there is little time allowed to recoup a position if the desired quick profit is not realized; large trades and strike prices were involved, entailing more risk per trade; Capone and Lewis both had limited experience in options; the size of the trades involved (including one for over \$1,000,000.00 and many over \$100,000.00) could themselves adversely affect the market; and questionable promotional material regarding the computer program was sent to LeBlanc's representatives which constituted misstatement of material facts or at best poor judgment on the part of Respondents, because it contained unsupported promises that the computer program could be relied upon to make profitable investment decisions. This material should have been cleared by Lewis through Prudential's compliance department. The inadequate disclosure of risk regarding the OEX options trades came in the context to concerns expressed by LeBlanc regarding earlier options losses. The proposed OEX options trading strategy was in effect a response by Respondents as

to a means to assure profits for Claimants. In addition there was inadequate supervision of Capone's activities by Lewis. Also compliance, active accounts reviews and contact with LeBlanc by Lewis and Prudential to confirm the activities in the accounts was lax.

At the same time, LeBlanc was aware to the fact that there were losses, even if not the extent thereof. The options used were not the most risky, such as naked puts or uncovered calls or combo strategies and LeBlanc gained more experience, theoretically, as more options trades were done. Also, Capone did conduct a dry run series of trades using the computer program before starting real trades.

Despite LeBlanc's financial profile showing considerable wealth, the extent and size of high risk OEX index options trading carried on in Claimants' accounts was questionable given the limitations of Claimants' liquid assets and LeBlanc's frequent withdrawals from his cash account for working capital in his business. However, LeBlanc often assured Capone that money was not a problem and always determined the amount to be invested in the options trading.

The trading was consistent with at least some of Claimants' investment objectives as originally stated to Respondents. However, LeBlanc's erratic and sometimes impulsive decision-making on certain investments, including the BNE stock, should have led Respondents to clarify his objectives and the full nature of the risks relative to the risky OEX index options trading.

Although LeBlanc controlled other aspects of his trading at Prudential, the OEX index option trades were controlled by Capone. LeBlanc almost never failed to follow a recommendation of Capone even after incurring large losses. The touting of the OEX index options by Capone and then the computer program took advantage of LeBlanc's eagerness for a magic profit bullet and impressionability, without a proper explanation of the considerable risks.

Accordingly, the OEX index options trades were on balance unsuitable for Claimants and therefore in violation of applicable law and regulations. Claimants suffered net losses of over \$616,000.00 in this trading. However, Claimants bear a large share of the responsibility for those losses. They received monthly statements as well as periodic oral reports from Capone in which losses were disclosed. Nevertheless Claimants continued to follow Capone recommendations. However, some of these recommendations were accompanied by unwarranted assurances from Capone and Lewis, such as the promise of the computer program to produce profitable recommendations and trades, as well as inadequate disclosure of risks as set forth above. While such actions were wrongful, they did not constitute fraud. Under all of the circumstances Claimants are entitled to recover from Respondents a portion of these trading losses.

The arbitrators commend the parties and their respective counsel for their thorough and excellent presentations in a very complex and difficult case.

OTHER ISSUES AND SUBSTANTIVE MOTIONS 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 original remain on file with the NASD.

The parties have asked that the official record in this case not include volume 3 of the mini-transcripts (March 12, 1993). That is because that volume contains certain testimony of Mr. LeBlanc on March 12, 1993, which it was agreed would be confidential and sealed in the record. As far as the regular transcript is concerned, the sealed or confidential portion of the testimony has been identified as a separate volume III - confidential portion, pages 2-45 to 3-76 and Respondents Exhibits 14 through 17, which 4 exhibits are also confidential and sealed as far as the record is concerned. It was also agreed that these 4 exhibits would ultimately be returned to the parties and not be part of the record for this NASD arbitration. Thus, the regular transcript can serve as the official record for March 12, 1993. Otherwise, the mini-transcripts can serve as the official record.

Pursuant to agreement of counsel, the following oral order was, in substance, put on the record on April 30, 1993:

Pursuant to NASD Code of Arbitration Procedure Section 33(b), the Arbitrators hereby direct Prudential Securities, Inc. to produce the following original documents and records for review by the Arbitrators: all order tickets and associated wire confirmations as to trades in OEX options by Claimants on April 26, 1990 and April 27, 1990. Upon completion of such review, the Arbitrators will return the original documents and records produced to Joseph Ingrisano, Esq., counsel to Prudential Securities, Inc.

AWARD

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

1. Respondents Prudential, Capone and Lewis are hereby jointly and severally liable to Claimant L&L Properties in the amount of TWENTY-FIVE THOUSAND DOLLARS AND ZERO CENT (\$25,000.00).

2. Said Respondents are further jointly and severally liable to Claimant L & L Properties for interest at the rate of twelve percent (12%) per annum from the date of this Award to the date of payment.
3. Respondents Prudential, Capone and Lewis are hereby jointly and severally liable to Lawrence C. LeBlanc in the amount of TWO HUNDRED SEVENTY FIVE THOUSAND DOLLARS AND ZERO CENTS (\$275,000.00).
4. Said Respondents are further jointly and severally liable to Claimant Lawrence C. LeBlanc for interest at the rate of twelve percent (12%) per annum from the date of this award to the date of payment.
5. Prudential shall further reimburse Claimants fees paid as provided in the Forum Fees section of this decision.
6. All other claim for relief is denied.

FORUM FEES

The following Forum Fees are assessed and shall be borne entirely by Prudential.

Non-refundable Filing Fee: \$250.00

Hearing Session Fees: \$750.00 x 20 sessions = \$15,000.00

Pre-Hearing Conference \$300.00 x one session = \$300.00

Claimants deposited \$1,250.00 and are entitled to a refund in that amount.

Prudential shall reimburse Claimant \$1,250.00 and remit to the NASD \$14,300.00.

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

ARBITRATION PANEL

David Plimpton, Esq.

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Public Chairperson

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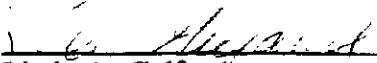
Concurring Arbitrator's Signature


David Plimpton, Esq.

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Date of Decision

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Concurring Arbitrator's Signature



Linda A. Gelfand

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Concurring Arbitrator's Signature

Brenda R. Katz
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