

**NASD REGULATION, INC. AWARD**

**OFFICE OF DISPUTE RESOLUTION**

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In the Matter of the Arbitration Between

**Name of Claimant**

Kenneth George Hillman

93-02625

**Name of Respondents**

G.R. Stuart & Co. Inc.  
National Financial Services Corporation

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**REPRESENTATION**

For Claimant Kenneth George Hillman ("Claimant") appeared Richard P. Ferris, Esq., a sole practitioner located in Utica, New York.

For Respondent G.R. Stuart & Co., Inc. ("Stuart") appeared Grover S. Parnell, Jr., Esq. of the firm Davis, Malm & D'Agostine located in Boston, Massachusetts.

For Respondent National Financial Services Corporation ("National") appeared Robert A. Buhlman, Esq. of the firm Bingham, Dana & Gould located in Boston, Massachusetts.

**CASE INFORMATION**

Claimant's Statement of Claim filed on: June 18, 1993.

Claimant filed an Amended Statement of Claim on: November 2, 1993.

Claimant filed a second Amended Statement of Claim on: September 6, 1994.

Claimant's Submission Agreement signed on: June 4, 1993.

Statement of Answer filed by Respondent Stuart on: April 14, 1994.

Respondent Stuart's Submission Agreement signed on: May 17, 1994.

Statement of Answer filed by Respondent National to the second Amended Statement of Claim on: November 4, 1994.

Respondent National's Submission Agreement signed on: November 4, 1994.

Respondent National filed a Counter-claim on: November 4, 1994.

Claimant's answer to Counter-claim filed on: November 8, 1994.

**HEARING INFORMATION**

Hearing Dates/Sessions:

November 13, 1995

Two Sessions

September 8, 1997

Two Sessions

The hearings were conducted at the Marriot Hotel, located on Wolf Road in Albany, New York.

**CASE SUMMARY**

Claimant alleged that he opened an account with Financial Securities Network, whose accounts were later purchased by Respondent Stuart, therefore, Respondent Stuart is liable to Claimant. Claimant further alleged that Respondent National was the clearing house for Respondent Stuart and according to the clearing agreement were to follow all instructions of Respondent Stuart in regards to Claimant's account.

Claimant alleged that Respondent Stuart churned his account. Claimant also alleged that Respondent Stuart violated the Securities and Exchange Act of 1934 and the Investment Advisors Act of 1940, in that they defrauded Claimant into believing they were using one trading strategy when in fact they were using another. Claimant further alleged that Respondent Stuart conspired to commit fraud with respect to the purchase and sale of securities, they breached their fiduciary duty, and were negligent in the handling of Claimant's account.

Claimant alleged that under the terms of the clearing agreement between Respondent Stuart and Respondent National, Respondent National was to account for the transactions taking place in Claimant's account. Claimant asserted that this included keeping track of any margin deficiencies and notifying Respondent Stuart and/or Claimant in the event that funds were needed to make up for any margin deficiencies and that trading was to cease in the event Claimant's account balance fell below zero. Claimant further alleged that Respondent National did not notify him of the deficiency of funds and the account traded at a negative balance, incurring losses. Claimant asserted that under the terms of Section 7 of the Securities and Exchange Act and Federal Reserve Board Regulation T Respondent National had a duty to monitor Claimant's account and take action should any margin difficulty occur. Claimant further asserted that Respondent National failed to comply with these regulations.

Respondent Stuart denied all allegations contained in the Statement of Claim. Respondent Stuart maintained that they purchased certain accounts of Financial Securities Network, but Claimant's account was not purchased, therefore, they cannot be held liable to Claimant.

Respondent National maintained that Claimant recognized National's role as a clearing house when he agreed, prior to opening an account, not to hold National responsible for the gains or losses from the option trading in his account. Respondent National also maintained that clearing brokers are not liable to customers of an introducing broker for transactions in accounts maintained with such broker. Respondent National further maintained that Claimant admitted that his account was at all times under the control of Jeremiah J. Hegarty ("Hegarty"), to whom Claimant gave absolute discretionary trading authority, and at no time was the account under National's control.

Respondent National maintained that they did not learn of the trades placed by Mr. Hegarty until the day after they were placed, therefore, they did not know that Claimant's account had incurred a loss and was trading at a negative balance until they processed the paperwork the following day.

Respondent National maintained that Claimant's claim lacks legal or factual basis because Claimant expressly waived any claims against National, National acted merely as a clearing broker, and Claimant cannot state a claim as a matter of law for any alleged margin violations because there is no private cause of action for alleged margin violations.

Respondent National, in their counterclaim, asserted that Claimant opened a margin account with them through his broker. Respondent National asserted that the account was left with a debit balance. Respondent National further asserted that Claimant, to date, has refused to repay the debit balance and interest accrued. Respondent National alleged that in refusing to pay Claimant has breached his contract.

In reply, Claimant maintained the following affirmative defenses, Section 7 of the Securities and Exchange Act and Federal Reserve Board Regulation T required National to monitor Claimant's account, therefore, they can not profit from their failure to do so, and National is precluded from counterclaiming the loss on the basis of the doctrine of laches.

#### **RELIEF REQUESTED**

Claimant Hillman requested damages as follows:

- (a) \$70,000.00 in actual damages with interest at the legal rate from December 22, 1992;
- (b) \$13,643.47 in actual damages with interest at 6.5% per annum from December 22, 1992;
- (c) costs, fees, and disbursements;
- (d) attorney fees of \$20,000.00; and
- (e) punitive damages of \$100,000.00

Respondent Stuart requested that the Claimant's Statement be dismissed and that they be granted such further relief as the Panel deems just and proper.

Respondent National requests that the Statement of Claim be dismissed in its entirety.

Respondent National, in their counterclaim, request from Claimant:

- (a) payment of the debit balance of \$13,677.00;
- (b) payment of interest accrued on the debit balance from December 31, 1992 through the date the debit balance is paid;
- (c) payment of their costs, including attorneys' fees, in collecting the debt balance; and
- (d) other such relief as the panel deems appropriate.

#### **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.

Claimant dismissed Respondent Stuart from this claim in a letter dated January 22, 1997.

During the hearing, Respondent National Financial Services Corporation requested that a witness (Jeremiah J. Hegarty) affidavit offered by the claimant as evidence be denied. The panel, after hearing

arguments from both parties allowed the affidavit into evidence.

### **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. Claimant's claims for damages against Respondent National are hereby dismissed in their entirety.
2. Claimant's request for punitive damages is denied.
3. Claimant be and hereby is liable and shall pay to Respondent National the sum of \$18,267.00.
4. Each party shall bear its own respective costs, including attorneys' fees.
5. Forum Fees are to be assessed equally between Claimant and Respondent National.
6. All other claims are hereby denied.

### **FORUM FEES**

Pursuant to Rule 10332(c) of the Code of Arbitration Procedure, the arbitrators have determined that NASD Regulation will retain the \$200.00 non-refundable filing fee deposited by the Claimant and the \$500.00 non-refundable filing fee deposited by Respondent National, and have assessed the following forum fees:

4 Hearing Sessions x \$750.00	=	\$3,000.00
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Total Forum Fees	=	\$3,000.00
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1. Claimant be and is hereby liable and shall pay to NASD Regulation, Inc. the sum of \$1,500.00, representing one-half the total forum fees assessed. Claimant previously deposited \$750.00 with NASD Regulation, Inc., and, therefore, Claimant owes the balance of \$750.00.

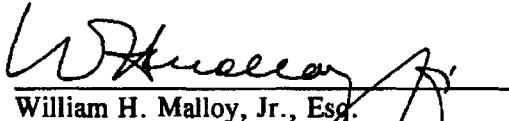
2. Respondent National be and is hereby liable and shall pay to NASD Regulation, Inc. the sum of \$1,500.00, representing one-half the total forum fees assessed. Respondent National previously deposited \$600.00 with NASD Regulation, Inc., and, therefore, Respondent National owes the balance of \$900.00.

3. Claimant be and is hereby liable and shall pay NASD Regulation, Inc. the sum of \$750.00 for the postponement fee. Claimant has not submitted the sum of \$750.00, and therefore, owes the postponement fee.

Fees are payable to NASD Regulation, Inc..

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**ARBITRATORS' SIGNATURES**

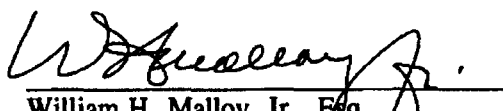
  
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William H. Malloy, Jr., Esq.  
Public Chairperson

Date of Decision November 6, 1997

\_\_\_\_\_  
Donald R. Bluth  
Public Panelist

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James J. Carroll  
Industry Panelist

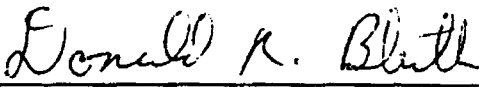
I, William H. Malloy, Jr., Esq., do hereby affirm pursuant to Article 7505 of the Civil Practice Law and Rules, that I am the individual described herein, and who executed this instrument which is my award.

  
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William H. Malloy, Jr., Esq.

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**ARBITRATORS' SIGNATURES**

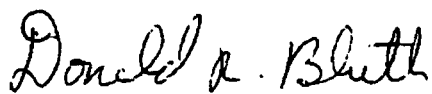
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William H. Malloy, Jr., Esq.  
Public Chairperson

  
\_\_\_\_\_  
Donald R. Bluth  
Public Panelist

Date of Decision November 6, 1997

\_\_\_\_\_  
James J. Carroll  
Industry Panelist


I, Donald R. Bluth, do hereby affirm pursuant to Article 7505 of the Civil Practice Law and Rules, that I am the individual described herein, and who executed this instrument which is my award.

  
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Donald R. Bluth

**ARBITRATORS' SIGNATURES**

\_\_\_\_\_  
William H. Malloy, Jr., Esq.  
Public Chairperson

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Donald R. Bluth  
Public Panelist

  
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James J. Carroll  
Industry Panelist

Date of Decision November 6, 1997

I, James J. Carroll, do hereby affirm pursuant to Article 7505 of the Civil Practice Law and Rules, that I am the individual described herein, and who executed this instrument which is my award.

  
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James J. Carroll