

**N.A.S.D. AWARD**

**NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.**

In the matter of the Arbitration Between

**Name of Claimants**

The City of San Marino  
The City of Lawndale  
The City of Palmdale  
The Community Redevelopment  
Agency of the City of Palmdale

NASD Arbitration  
No. 93-03374

**Name of Respondents**

E.F. Hutton & Co., Inc.  
Shearson Lehman Brothers, Inc.  
Richard Alan Lavery  
Frederick W. Parodi

**Name of Third Party Claimant**

Shearson Lehman Hutton, Inc.

**Name of Third Party Respondent**

First Investment Securities, Inc.

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**REPRESENTATION**

For Claimants: Mark S. Flynn, Milford W. Dahl, Jr., Esq. and  
Robert Adel, Esq., Rutan & Tucker, Costa Mesa, California

For Respondents E.F. Hutton & Co., Inc. and Shearson Lehman  
Brothers, Inc.: Mitchell Albert, Esq., Haight, Brown & Bonesteel,  
Santa Monica, California and Stephen Young, Esq., Keesal, Young &  
Logan, Long Beach, California

### CASE INFORMATION

Statement of Claim filed: June 24, 1993

Claimants' Submission Agreements signed as follows:

The City of San Marino: August 19, 1993

The City of Lawndale: August 23, 1993

The City of Palmdale and The Community Redevelopment Agency of  
the City of Palmdale: August 19, 1993

Joint Statement of Answer filed by Respondents Shearson Lehman  
Hutton, Inc., formerly known as E.F. Hutton & Co., Inc. and as  
Shearson Lehman Brothers, Inc., and Richard Alan Lavery and Third  
Party Claim filed by Respondent Shearson Lehman Hutton, Inc.:  
November 18, 1993

Respondents' Submission Agreements signed as follows:

E.F. Hutton & Co., Inc. and Shearson Lehman Brothers, Inc.:  
September 14, 1993

Richard Alan Lavery: January 18, 1994

### HEARING INFORMATION

Pre-Hearing Conference Date(s)/Session(s):

August 15, 1994 (one session)

Hearing Date(s)/Session(s): August 22, 1994 (two sessions)

August 23, 1994 (two sessions)

August 24, 1994 (two sessions)

August 25, 1994 (two sessions)

August 26, 1994 (one session)

September 8, 1994 (two sessions)

September 9, 1994 (two sessions)

September 19, 1994 (one session)

Hearing Location:

Los Angeles, California

### CASE SUMMARY

Claimants, three cities and a public agency, brought their  
claim against E.F. Hutton & Co., Inc. (Hutton) and its successors  
in interest, for losses suffered in accounts at Hutton and later at  
First Investment Securities, Inc. (FIS). Claimants alleged that

two Hutton brokers invested their funds in unsuitable and illegal high-risk leveraged securities, churned the accounts, and fraudulently misstated and omitted certain material facts. Claimants further alleged that Hutton management was negligent in its supervision of the brokers, and that Hutton management breached its fiduciary duty to Claimants by failing to inform Claimants of the brokers' errant conduct once Hutton became aware of that conduct. Claimants further alleged violations of state and federal securities laws, violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), intentional misrepresentation, negligent misrepresentation, breach of fiduciary duty, constructive fraud and professional negligence with respect to its investments.

Respondents alleged that Claimants are all governmental entities located in Southern California and each opened an account at Hutton in September 1986; that Claimants' accounts were handled by C. Raymond Wood (Wood), who was employed by each of the cities either as Director of Finance or Treasurer; that in or about March 1987, each of Claimants transferred its account to FIS; and that Claimants made investments in U.S. government zero coupon bonds and the ten-year treasury bond in their accounts. Respondents denied the material allegations of Claimants' Statement of Claim and alleged that each and every transaction in Claimants' Hutton accounts were authorized by Wood, Claimants' duly authorized representative. Respondents further claimed that the bonds traded in Claimants' Hutton account were backed by the full faith and credit of the U.S. government and were suitable investments for the cities. Respondents further claimed that all of Claimants' losses were incurred after the accounts transferred to FIS and raised the affirmative defenses, among others, that Claimants failed to mitigate damages and were guilty of contributory negligence.

#### RELIEF REQUESTED

Claimants requested damages as follows:

1. City of San Marino:

a. Realized losses at Hutton plus prejudgment interest at 7% from January 1988: \$41,621.00;

b. Unrealized losses at Hutton at time of transfer plus prejudgment interest at 7% from January 1988: \$223,484.00;

- c. Losses on zero coupon bonds purchased at Hutton plus prejudgment interest from January 1988: \$1,109,708.00;
- d. Losses on zero coupon bonds purchased at FIS plus prejudgment interest from January 1988: \$960,447.00;
- e. Losses on leveraged day trades at FIS plus prejudgment interest from January 1988: \$372,688.00;
- f. Punitive damages: At discretion of the panel;
- g. Treble damages: Two times the total above amount (for a total of three times the actual award); and
- h. Attorneys' fees: Proof of attorneys' fees will be immediately provided upon request of the Panel.

2. City of Lawndale:

- a. Realized losses at Hutton plus prejudgment interest at 7% from January 1988: \$23,882.00;
- b. Unrealized losses at Hutton at time of transfer plus prejudgment interest at 7% from January 1988: \$223,484.00;
- c. Losses on zero coupon bonds purchased at Hutton plus prejudgment interest from January 1988: \$1,080,871.00;
- d. Losses on zero coupon bonds purchased at FIS plus prejudgment interest from January 1988: \$932,330.00;
- e. Losses on leveraged day trades at FIS plus prejudgment interest from January 1988: \$372,688.00;
- f. Punitive damages: At discretion of the Panel;
- g. Treble Damages: Two times the total above amount (for a total of three times the actual award); and
- h. Attorneys' fees: Proof of attorneys' fees will be immediately provided upon request of the Panel.

3. City of Palmdale:

- a. Realized losses at Hutton plus prejudgment interest at 7% from January 1988: \$42,036.00;
- b. Unrealized losses at Hutton at time of transfer plus prejudgment interest at 7% from January 1988: \$168,069.00;
- c. Losses on zero coupon bonds purchased at Hutton plus prejudgment interest from January 1988: \$1,136,288.00;
- d. Losses on zero coupon bonds purchased at FIS plus prejudgment interest from January 1988: \$932,504.00;
- e. Losses on leveraged day trades at FIS plus prejudgment interest from January 1988: \$372,688.00;
- f. Punitive damages: At discretion of the Panel;

g. Treble damages: Two times the total above amount (for a total of three times the actual award); and

h. Attorneys' fees: Proof of attorneys' fees will be immediately provided upon request of the Panel.

4. Community Redevelopment Agency of the City of Palmdale:

a. Realized losses at Hutton plus prejudgment interest at 7% from January 1988: \$41,352.00;

b. Unrealized losses at Hutton at time of transfer plus prejudgment interest at 7% from January 1988: \$168,069.00;

c. Losses on zero coupon bonds purchased at Hutton plus prejudgment interest from January 1988: \$1,136,288.00;

d. Losses on zero coupon bonds purchased at FIS plus prejudgment interest from January 1988: \$932,651.00;

e. Losses on leveraged day trades at FIS plus prejudgment interest from January 1988: \$372,688.00;

f. Punitive damages: At discretion of the Panel;

g. Treble damages: Two times the total above amount (for a total of three times the actual award); and

h. Attorneys' fees: Proof of attorneys' fees will be immediately provided upon request of the Panel.

OTHER ISSUES CONSIDERED AND DECIDED

Prior to the hearing, the panel of arbitrators was advised of the parties' agreement to dismiss Respondent Richard Alan Lavery from this proceeding.

At hearing, the panel of arbitrators was advised of bankruptcy filings with respect to Respondent Frederick W. Parodi and Third Party Respondent First Investment Securities, Inc., thereby staying all judicial proceedings against said parties.

The parties have agreed that the Award in this matter may be executed in either 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 National Association of Securities Dealers, Inc. (NASD).

AWARD

After considering the pleadings, the testimony, 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. Respondents E.F. Hutton & Co., Inc. and Shearson Lehman Brothers, Inc., also known as Shearson Lehman Hutton, Inc., are jointly and severally liable for and shall pay to The City of San Marino the sum of \$122,427.00, calculated as follows: a) compensatory damages, including interest to October 1, 1994, in the amount of \$29,055.00; b) plus punitive damages in the amount of \$200,000.00 pursuant to Pusateri v. E.F. Hutton & Co. (1986) 180 Cal.App.3d 247, 253; and c) minus a credit in the amount of \$106,628.00.

2. Respondents E.F. Hutton & Co., Inc. and Shearson Lehman Brothers, Inc., also known as Shearson Lehman Hutton, Inc., are jointly and severally liable for and shall pay to The City of Lawndale the sum of \$122,127.00, calculated as follows: a) compensatory damages, including interest to October 1, 1994, in the amount of \$29,055.00; b) plus punitive damages in the amount of \$200,000.00 pursuant to Pusateri v. E.F. Hutton & Co. (1986) 180 Cal.App.3d 247, 253; and c) minus a credit in the amount of \$106,928.00.

3. Respondents E.F. Hutton & Co., Inc. and Shearson Lehman Brothers, Inc., also known as Shearson Lehman Hutton, Inc., are jointly and severally liable for and shall pay to The City of Palmdale the sum of \$122,140.00, calculated as follows: a) compensatory damages, including interest to October 1, 1994, in the amount of \$28,757.00; b) plus punitive damages in the amount of \$200,000.00 pursuant to Pusateri v. E.F. Hutton & Co. (1986) 180 Cal.App.3d 247, 253; and c) minus a credit in the amount of \$106,617.00.

4. Respondents E.F. Hutton & Co., Inc. and Shearson Lehman Brothers, Inc., also known as Shearson Lehman Hutton, Inc., are jointly and severally liable for and shall pay to The Community Redevelopment Agency of the City of Palmdale the sum of \$121,533.00, calculated as follows: a) compensatory damages, including interest to October 1, 1994, in the amount of \$28,161.00; b) plus punitive damages in the amount of \$200,000.00 pursuant to Pusateri v. E.F. Hutton & Co. (1986) 180 Cal.App.3d 247, 253; and

c) minus a credit in the amount of \$106,628.00.

5. The parties shall each bear their respective costs including attorney's fees.

#### FINDINGS

The panel finds breach of fiduciary duty, fraud and professional negligence by Hutton and failure to properly supervise. All other claims, including RICO, are dismissed.

#### FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following forum fees are assessed: The NASD shall retain the \$1,500.00 hearing session deposit previously deposited by the Claimants. Forum fees are to be split between the parties and are calculated as follows:

|  |   |             |
|--|---|-------------|
| One pre-hearing session @ \$300.00/session   | = | \$ 300.00   |
| Fourteen hearing sessions @ \$750.00/session | = | \$10,500.00 |
| Total fees assessed                          | = | \$10,800.00 |

|   |   |             |
|---|---|-------------|
| Claimants' share, jointly and severally (50%) | = | \$ 5,400.00 |
| Credit for hearing deposit                    | = | \$ 1,500.00 |
| Balance due                                   | = | \$ 3,900.00 |

|  |   |             |
|--|---|-------------|
| Respondents' (E.F. Hutton & Co., Inc. and Shearson Lehman Brothers, Inc.) share, jointly and severally (50%) | = | \$ 5,400.00 |
| Balance due  | = | \$ 5,400.00 |

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

#### ARBITRATORS

| <u>Name</u> | <u>Public / Industry</u> |
|-------------|--------------------------|
|-------------|--------------------------|

|                       |                     |
|-----------------------|---------------------|
| Gerald A. Koris, Esq. | Public Arbitrator   |
| Richard S. Mannheimer | Public Arbitrator   |
| Luther Delano Prater  | Industry Arbitrator |

Concurring Arbitrators' Signatures

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Gerald A. Koris, Esq.

\_\_\_\_\_  
Richard S. Mannheimer

Luther Delano Prater  
Luther Delano Prater

Date Served: 11-10-94

Date of Decision: \_\_\_\_\_



Concurring Arbitrators' Signatures

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Gerald A. Koris, Esq.

*Richard S. Mannheimer*  
Richard S. Mannheimer

\_\_\_\_\_  
Luther Delano

Date Served: 11-10-94

Date of Decision: *9 Sept 94*

Concurring Arbitrators' Signatures

Gerald A. Koris  
Gerald A. Koris, Esq.

\_\_\_\_\_  
Richard S. Mannheimer

\_\_\_\_\_  
Luther Delano

Date Served: 11-10-94

Date of Decision: \_\_\_\_\_