

**NATIONAL ASSOCIATION OF SECURITIES DEALERS
AWARD**

In the Matter of the Arbitration Between

NASD No. 93-4698

DORRIS ASH, individually and on behalf of the
DORRIS ASH IRA and the DORRIS ASH IRA
ROLLOVER and as the trustee for the J & D
ASH ENTERPRISES, INC. PROFIT SHARING
PLAN; J & D ASH ENTERPRISES, INC.;
JOHN ASH, individually and on behalf of the
JOHN G. ASH and the JOHN G. ASH IRA
ROLLOVERS,

Claimants,

v.

SUTRO & CO., INCORPORATED and
DAVID KIRKSEY,

Respondents.

Representation

For Claimant: Jeffrey Jones, Esq. and Archibald Mull, Esq. of Law Offices of Archibald Mull, Sacramento, California

For Respondent Sutro and Co.: Mark Kassabian, Esq., Daniel McMillan, Esq. and Gerald Palmer, Esq. of Jones, Day, Reaves & Pogue, Los Angeles, California; For Respondent David Kirksey - David Studley, Esq., San Francisco, California

Case Information

Statement of Claim filed: November 9, 1993

Claimant's Submission Agreement signed: November 3, 1993 and December 22, 1993

Statement of Answer filed on: February 25, 1994

Respondents' Submission Agreement signed on: Sutro & Co. - February 24, 1994, David Kirksey - March 14, 1994

Hearing Information

Prehearing Conference Date(s) Sessions: October 26/one, 27/one, November 3/one, 1994; January 9/one, June 9/one, and December 8, 1995/one

Hearing Date/Sessions: November 8/two, 9/two, 10/two, 11/two, 15/two, 16/two, 17/two, 18/one, 21/two, 22/two, 23/two, 1994; January 16/two, 17/two, 18/two, 19/two, 20/two, February 21/two, 22/two, 23/two, 24/two, December 6/one, 18/two, 19/two, 20/two, 21/two, 22/two, 1995; January 3/two, 4/two, 5/two, 8/two, 9/two, 10/three, 11/two, 12/two, 15/three, 17/one, 1996.

Hearing Location: San Francisco, California

Case Summary

Claimant Dorris Ash (Ash) alleged that respondents breached their fiduciary obligation to her, committed fraud, conspired to defraud in their handling of her purchase of thirty-two (32) interests in limited partnerships and Real Estate Investment Trusts (REITS), between February, 1987, and February, 1991. Ash further alleged that respondents made negligent misrepresentations, acted negligently, intentionally inflicted emotional distress, and violated the Racketeer Influenced and Corrupt Organization Act (RICO). Claimant alleged that she entrusted retirement monies to respondents for investment purposes, that respondents knew she was retiring, that she had limited investment experience, and that her investment objectives were conservative, seeking safety of income and principal.

Claimant further alleged Sutro instructed its brokers, including David Kirksey, (Kirksey) to disregard offering prospectuses of the limited partnerships and REITS and to sell them to claimant and other investors as safe investments, with nominal risks similar to that in purchasing a certificate of deposit. Ash maintained that in fact the risks in the purchase of the limited partnerships and REITS were high, they were speculative and not suited for claimant's conservative investment goals. She further alleged that the sale of the limited partnerships and REITS by respondents was facilitated by carefully crafted, internal use only, marketing materials that did not adequately set forth the risks inherent in the purchases.

Respondents denied all allegations of wrong doing and alleged that claimant's investment objectives were consistent with the investments she purchased through respondents. They further alleged that her investment goals were to invest in securities, limited partnerships and REITS with higher than average risks in order to obtain tax advantages and high return. They alleged that claimant was not seeking the nominal risk and safety inherent in the purchase of certificates of deposit. Respondents asserted that claimant knew that the investments she was making through respondents were inherently risky, that they were not conservative, and that she knowingly assumed those risks in order to earn greater profits. They alleged that claimant was a sophisticated investor, with deep business and investment experience, who was capable of understanding and evaluating the suitability of the risks involved in purchasing the limited partnerships and REITS she made through respondents.

Respondents alleged that they provided claimant with all information they had received from issuers and sponsors of the investments purchased by claimant, including written prospectuses which detailed the risks of each investment. They further argued that claimant received written confirmations of each transaction immediately following its execution. They alleged claimant never complained about the investments she made through respondents.

Respondents also maintained they conducted appropriate investigation and due diligence in the investments purchased by claimant and that all employees were properly supervised.

Relief Requested

Claimant requested:

- a. Special damages, in the minimum of \$2,850,000;
- b. General damages for the suffering of emotional distress and damage to

- creditworthiness;
- c. Punitive damages;
- d. In the alternative, rescission of all purchases through respondents with statutory interest to date of rescission;
- e. Treble damages pursuant to California Civil Code §3345;
- f. Treble damages according to 18 U.S.C. Section 1964(c);
- g. Attorneys' fees and costs.

Other Issues Considered and Decided

The parties have agree that the Award in the 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.

Interim rulings during the course of the hearing were made as follows:

1. Respondent Kirksey's Motion in Limine regarding the exclusion of certain facts relating to subsequent conduct was granted;
2. Respondent Sutro's Motion to Dismiss, which was joined by respondent Kirksey, based upon the Statute of Limitations, was denied;
3. Respondents' Motion to Dismiss all allegations regarding violations under RICO was granted;
4. Claimant's Motion to Disregard Putative Tax Benefits in calculating damages applicable was granted insofar as any investments that were not primarily motivated by tax considerations;
5. Respondents' Motion to Introduce evidence of a settlement of a lawsuit between claimant and Dean Witter & Company was granted;
6. On Motion of the Panel of Arbitrators, claimant Dorris Ash's case was

bifurcated and severed from claimant John Ash's case at the hearing.

Award

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

1. All claims of Dorris Ash are denied;
2. The claims for punitive damages and treble damages are denied;
3. Each party shall bear their own respective attorney's fees;
4. Each party shall bear their own respective costs.

Findings of Fact

Claimant Dorris Ash (Ash) was 71 years old at the conclusion of this case. Throughout its eighteen month duration, she appeared to be in good health, mentally alert, physically fit, and demonstrated an accurate recollection of the events transpiring seven to nine years ago. She described herself as a "self made" woman who was "driven, and a hard worker". Prior to the transactions in question in this case she "did not ever recall losing any money."

As a young woman Ash was employed by the United States Military in various civilian capacities. She traveled and worked in Guam, Japan, Korea, Los Angeles and finally Sacramento where she took up permanent residence and eventually married her former husband, co-claimant John Ash.

Ash's education consisted of high school, an Associate of Arts (A.A.) degree in Accounting, a Registered Nursing (R.N.) degree and a Bachelor's of Arts (B.A.) degree in Nursing Administration, the latter two having been obtained after she was forty (40) years of age.

In 1958, Ash married and for the next twenty years she and her husband developed a multi-million dollar business in the building and operation of nursing and convalescent homes ("Homes"). By the time of her divorce in 1974, she and John Ash had built and/or purchased more than five separate convalescent homes, comprising over 280 beds and employing an estimated 200 persons.

Two of the facilities were developed from raw rural land purchased near Sacramento, requiring close work with city and state regulatory officials, as well as supervision and oversight of architects, contractors, and the continuing operation of their ongoing business. The work also involved all of the construction developments and purchase of existing facilities utilized bank financing.

Ash and her husband were "hands on" operators of their business. They lived on the premises and did all the jobs, "cooking, housekeeping, nursing" and the running of the business.

The administration of the nursing/convalescent home operation was conducted in an office building owned by claimant and John Ash. Through the advice of their Certified Public Accountant, title to the office building was divided into four twenty-five percent (25%) segments, each ownership of the segments being divided between claimant, John Ash and two corporations they owned.

In addition to their nursing homes, the Ashs ran a property management company, leasing office and residential space.

Other real estate holdings of the Ashs consisted of numerous single family residences which they started purchasing as investments early in their relationship. At the time of purchase most were financially and physically distressed. They were preferably "three-bedroom homes, as they were easier to rent". As they purchased the homes the Ashs would renovate and rent them. By 1987, claimant estimated she alone owned "15 or so."

In the early 1980's, Ash invested \$50,000 in a Sacramento dress shop. Several years later it closed due to operating losses.

As part of her divorce settlement in 1974, Ash received the convalescent facility, Ashland Manor. It contained 89 beds at the time. When it was sold by her in 1982, she had

expanded the facility from 89 to 162 beds. This was accomplished through a physical expansion of the facility accommodated by additional bank financing. Ashland Manor sold for approximately \$1,600,000. Ash received \$155,000 in 1982. The remainder was received in 1986. She was 61 years old at the time and ready to retire.

Prior to the sale of Ashland Manor, Ash had sold her other nursing/convalescent homes. All of the sales were partially seller financed, each secured by a mortgage. One sale involved a "wraparound" promissory note in which she continued to pay on a low interest note she had given to the person from whom she had bought the property. Ash took back a note on the sale, "wrapping" the old note which she continued to pay. As the new note yielded a considerably higher rate of interest, Ash profited from the difference or "spread" between the interest rates on the two promissory notes.

Starting in the late 1970's, claimant developed an extensive portfolio in limited partnership and securities holdings. By 1987 she had engaged in over 200 securities transactions into which she had invested more than \$3,000,000. These investments included equities, limited partnerships, bonds, certificates of deposit, and treasury bills. During this period, more than \$580,000 was invested in limited partnerships, which by 1986 numbered fifteen (15), of which the asset base was primarily real estate.

In approximately 1986, claimant and her former husband consulted attorneys regarding the failure of limited partnership investments at Dean Witter & Company. The consequent litigation resulted in a settlement of over \$250,000 in 1993. In another instance claimant participated in a class action resulting from a real estate based limited partnership in the early 1980's and received a settlement from it.

In 1983 and 1984, claimant was audited by the Internal Revenue Service because of investments in limited partnerships. Thereafter she was required to report as income in excess of \$120,000 which the IRS disallowed as deductions generated by the limited partnerships.

Claimant on several occasions entered into partnerships formed for the purpose of lending money secured by second deeds of trust. Typically, the money was loaned on single family homes that had sufficient equity cushion to cover the deeds of trust. As part of these transactions, Ash was provided information regarding appraised value, existing encumbrances, protective equity, interest rates, cash flow, and annual yields.

In February, 1987 claimant was introduced to respondent Kirksey, who was employed by respondent Sutro & Co. (Sutro). The introduction was made by then former husband, John Ash. She was impressed with Kirksey, particularly because he had impressed her "hard-headed ex-husband" of his worth. Kirksey specialized in limited partnership investments. During the years between 1985 through 1990, he derived more than half of his income from commissions generated from the sale of limited partnerships. He was ranked in the top five in sales commissions generated from limited partnerships in Sutro & Co. from 1985 through 1990.

Commencing in February, 1987 through February, 1990, claimant purchased through Sutro, and on the recommendation of Kirksey, thirty-two (32) interests (Investments) in limited partnerships or REITS. Claimant paid over \$1,500,000 for these investments which are the subject of this arbitration.

When she commenced doing business with Kirksey, Ash completed customer account forms stating that her investment objectives were basically conservative (i.e. safety of income and principal). The investments she purchased through Kirksey were not conservative, rather they were mostly limited partnerships whose asset base was leveraged real estate. The investments for the most part had little if any liquidity. These investments included nursing homes, hotels, apartments, raw land developments, low cost housing, mortgage loans, boat marinas, as well as leasing and film enterprises. The risk categorization of almost all of these investments was high...or "business man's" risk. They all had a large potential for growth and projected large dividend payouts. In all but a few instances, the general or managing partner had impressive track records in prior business enterprises.

Each time Ash made a purchase she was provided with a prospectus or offering memorandum which detailed the risks inherent in the investment. Claimant typically prepared and/or signed, in connection with most of the investments purchased, an investor questionnaire which set out in detail her business and investment experience, financial data, and stated that she understood the risks inherent in that investment.

The recommendations to purchase invariably were made by Kirksey. The decisions to purchase was made by claimant independently, typically days after Kirksey made his recommendation to claimant. She also determined the number of units to be purchased, and she determined what account would make the purchase. There was no indication that Kirksey exercised undue influence over claimant in her purchase decisions. To the contrary, she appeared at all times to have made considered judgments in her investment decisions, whether

they were with respondents or with others.

Claimant purchased these investments in four different accounts owned by her. These were a personal account, a profit sharing plan account, an IRA account, and a corporate account in which she was sole owner, the same that held title to the office building.

Commencing in the late 1980's, the United States economy went into a severe recession. This, coupled with a change in the taxability of real estate in the United States, caused a steep decline in the value of most investments, especially those with leveraged, real estate based assets. These conditions, and the fact that many of Ash's investments were leveraged and consequently more susceptible to loss in a recessive economy, caused them to lose much of their value, and in some instances to go out of business.

Claimant executed customer agreements in each of her accounts. Each contained the following provision regards attorneys' fees:

"In the event we have to employ counsel or a collection agency to collect any debt balance which you owe, you hereby authorize us to charge you for the reasonable costs of collection including, but not limited to attorney's fees...."

Conclusions of Law

Respondent Sutro and their employee Kirksey as brokers on behalf of claimant, owed to her a fiduciary obligation. It is this obligation claimant contends respondents breached by their recommendations to purchase and their sale of highly risky and therefore unsuitable securities to her given her stated, conservative investment goals.

The case of *Twomey v. Mitchell*, 262 Cal. App. 690, 69 Cal. Repr. 222, states the applicable principle as:

"The relationship between a broker and principal is fiduciary in nature and imposes upon the broker the duty of acting in the highest of good faith towards the principal."

Section 2, Article III, of the NASD Rules of Fair Practice regarding recommendations to customers, codifies and details this fiduciary obligation of the broker in the

recommendations he/she makes to customers. It states that

"the member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

This fiduciary obligation is even more pervasive in situations where the recommendation to purchase is made by the broker. In such a case it is axiomatic that such recommendations must be made in good faith and must be suitable for the customer's objectives based on their stated investment goals, their other security holdings, their financial situation, and their needs.

No question is raised that Kirksey made most if not all of the recommendations to Ash to purchase the investments in question. The evidence clearly supports the conclusion that these recommendations were made in good faith. He was honest and forthright in his dealings with Ash and his communications were accurate to the extent of his understanding.

Kirksey also had reasonable grounds for believing the recommendations he made to Ash were suitable for her. This is so despite the fact her account forms stated conservative investment goals. Although Kirksey made the recommendations to purchase, it was claimant who ultimately made the decision to purchase. She also made the choice of the amount of the purchase and the decision of which account would make the purchase. In making those decisions she was guided not only by Kirksey, but also by her own extensive, successful background in business and investing.

As the NASD Rules of Fair Practice point out, the investment objectives of Ash were just one rung of the ladder upon which Kirksey was entitled to rely in forming his opinion of whether his recommendations for Ash's purchases were suitable for her. Subsection (b) of Section 2 states:

"Prior to the execution of a transaction recommended...a member shall make reasonable efforts to obtain information concerning:

- (i) the customer's financial status;
- (ii) the customer's tax status;
- (iii) the customer's investment objectives; and

(iv) such other information used or to be considered to be reasonable...in making recommendations to the customer."

Such "other information" in claimant's case was that she had been (and still was) an energetic and very successful businesswoman. Ash had single handedly run and expanded a large and complex business enterprise. With such a successful experience in her background, Kirksey was entitled to conclude that Ash possessed an unusual degree of common sense, skill in risk analysis, fiscal responsibility, strategic planning, and the talent to perceive and solve problems. Her intellectual prowess was clearly demonstrated by her several academic degrees.

It was also reasonable for Kirksey to conclude that Ash was comfortable analyzing financing transactions, time value of money and debt ratios. She not only possessed a Associate of Arts degree in accounting, but she had personally arranged the financing for the development of her own business and was personally loaning money in the real estate marketplace.

Kirksey also had grounds to conclude Ash was adept in real estate transactions. She and her former husband had, as their earliest form of investment, bought and sold numerous parcels of real property. She individually owned 15 such properties in 1987. Presumably, each purchase involved detailed assessment of market conditions, appraised values, financing and cash flow analysis. Because of her diligence, prior to her dealings with respondents, she testified she "didn't recall ever losing any money."

Ash was not a stranger to investing in limited partnerships. And although limited partnerships, due to being primarily start up enterprises, are more risky than securities in companies with proven track records, Kirksey was reasonable in his assumption that Ash had ample opportunity to analyze these risks. Ash's experience was not just limited to investment in limited partnerships. By the time she had met Kirksey, she had presumably gained a lot of insight into their operational problems by virtue of her involvement with the Internal Revenue Service and two lawsuits.

Finally, as a more commonplace investor, Ash had experience in the purchase of equities, bonds and money market funds prior to meeting Kirksey. By 1987 she had consummated over 200 securities transactions involving an estimated \$3,000,000.

It was not an unreasonable conclusion that Ash was her own person, quite capable of taking care of herself, and possessing the intellectual and experiential background to do so.

There was no evidence that Kirksey took advantage of a weak willed or senile person. Quite the contrary, claimant exhibited strength, vigor and perspicuousness throughout the hearings and, while it was evident that a bond of friendship existed between Kirksey and claimant nonetheless, the level of dependency required to conclude that Kirksey dominated or unduly influenced claimant was clearly absent.

Most if not all of the investments recommended and sold by Kirksey were high risk. Despite the risks involved, and whatever shrewdness or lack thereof may have been involved in claimant's investment decisions, the fact remains that commencing in the late 1980s, the U.S. economy in general and real estate market in particular were caught in a series of economic coincidences that were disastrous for the economy. Very few were spared, regardless of how well managed or well placed they were. Obviously if this could have been foreseen, there would have been virtually no investments made.

In light of the above, claimant's actions must fail.

The attorney fee clause contained in the customer agreements executed by claimant has no application in this case. The wording of the attorney fee clause relates solely to the collection of "balance which you owe." The causes of action by claimant do not make such a claim.

The Application of Code of Civil Procedures Section 123.5 relating to an award of attorney's fees as sanctions, has no application in this case.

Arbitrator Charles Farnsworth dissented as follows:

I dissent.

Dorris Ash's prior business and investment experience did not relieve David Kirksey and Sutro of their fiduciary obligations toward her as her broker in this case. When she came to Sutro in 1986 she was 61 years old, and had recently retired and received the proceeds from the sale of her convalescent home business. Ash informed Sutro representatives of these facts and instructed them that her investment objectives for the future were "income and

appreciation safety." This placed her in the most conservative investor category listed on Sutro's New Account Form. According to Kirksey, her goals never changed, and he regarded her as a conservative and cautious investor who wanted secure investments and did not want to risk her capital. He believed that she would not invest where there was any risk of losing her capital.

Kirksey testified that he recommended a number of limited partnerships to Ash, and that she bought nearly all of them. He thought they all met her goals of income and appreciation safety. He specifically testified that he thought none of them involved a "businessman's risk," that is, none required an independent analysis of risk. Even where a limited partnership prospectus contained warnings that "Investment is Speculative" he still recommended it because he thought it met Ash's safety objectives. At one point Kirksey testified that the term "speculative" in the limited partnership context meant the same degree of risk as it would in the stock and bond contexts, but at another point said it didn't equate with the term as used in the New Account Form. In any event, he knew that she did not want to take high risks with her capital.

In fact, however, the evidence was undisputed that many of the limited partnerships did not meet the standards of "income and appreciation safety." Both claimant's expert Jack Christiansen and respondents' expert David Ware testified that at least these 13 investments involved risks higher than Ash's stated goals of safety: Anaheim Hotel; Cheyenne Associates; East Hampton Associates; Sacramento Foothills, Blue Oaks and Sunset Ltd; Continental Renaissance; Post Street Renaissance; California Residential Ventures; Tuscon Downtown Hotel; Spanos Park Development; Star Partners I and II; and PS Marina Investors. Christiansen characterized these as either involving "high risk" or "inconsistent" with her stated goals. Ware described them as involving a "businessman's risk" and not meeting either or both "income" and "appreciation" safety goals.

Ware went on to say, however, that he thought Ash was capable of undertaking a "businessman's risk," as he defined it, although not as Sutro's Investment Executive Manual defined it, namely, as "speculation." Under his definition, she could take on a businessman's risk because of her sophisticated judgement, account control, real investment objectives, and information made available to her. But evidence that Ash had built and run a nursing home business, that she had once bought limited partnerships as tax shelters, and that she had an undergraduate college degree in administration does not mean that she could evaluate lengthy, complex limited partnership ventures in raw land, hotels, and films which were concededly not

safe for either income or appreciation. Respondents failed to repudiate claimant's evidence that she could not evaluate these matters and that she trusted Kirksey to recommend appropriate "safe" investments. Kirksey, who knew her well, did not try to describe Ash as a "sophisticated" investor. Nor was the account really under her control; while it was not a discretionary account, she bought over 90% of what Kirksey recommended, and he recommended almost nothing except limited partnerships and few REITs. What went into the account depended almost entirely upon what Kirksey recommended; Ash never made a single unsolicited purchase.

Respondents contend that a client's real investment objectives are reflected in her past pattern of investing and in other information known to the broker. But this approach would allow a broker to sell speculative securities to a client who expressly wanted safety, simply because the client had speculated in the past with her past and had other wealth. It would cripple a client's efforts to part with her past practices and to plan for a new phase of life, such as retirement. It would make a mockery of any semblance of client control of the account. In short, it would allow the broker to withhold the "safe" investments expressly requested and to offer only the "businessman's risk" or "speculative" investments that the broker believes are reflective of her past experiences.

Respondents also contend that claimant had sufficient information to determine that certain investments involved high risk. Yet they gave claimant only the prospectus and private placement memoranda—documents that Kirksey himself, as a licensed broker, said that he could not make a risk analysis from and, in any case, thought warnings of "speculation" did not really mean "risky." The evidence demonstrates that Ash was less adept at analyzing these documents than her fiduciary broker who was providing them to her. Sutro never provided Ash with any internal evaluations of risk level.

Kirksey generally testified that he did not personally evaluate the level of risk in any of the limited partnerships coming to him from Sutro's Direct Investment Department but that he merely familiarized himself with the partnerships' stated objectives, and relied upon the DID's approval of the partnership. (None of the prospectuses or private placement memoranda stated "income and appreciation safety," or some equivalent, as their investment goals.) Later, he said that he did go over all the risks and made his own assessment that the partnerships were "not risky," although it was not clear that he meant by that term.

Kirksey said that neither DID nor any other branch of Sutro ever instructed its brokers

to offer the limited partnerships only to certain risk categories of customers. The DID never said anything negative about any of the partnerships, so, Kirksey said, he never warned Ash of any risk considerations.

On his own, however, he did conclude that a limited partnership would not be a "high risk" if the general partner had a good prior track record. (Respondents' expert Ware testified that this would not always be true.) In learning about the partnerships, he paid more attention to the issuer's marketing materials than to the prospectus or private placement memorandum itself, which he only "scanned."

From February 1987 to February 1990, Kirksey recommended about 26 limited partnerships to Ash, and she bought 24 of them. He didn't know whether she rejected some because of lack of cash or for other reasons. He recommended almost nothing else to her. Although he testified that he was not a "full-service broker," he also said that he offered limited partnerships to only about one-third of his customers.

Kirksey considered Ash and her ex-husband, John, to be his friends, and they occasionally met at her home or had lunch together. In Kirksey's view, she trusted him. He met with Ash and her CPA to discuss the tax aspects of two or three limited partnerships designed to yield tax credits, but otherwise did not know if she consulted with any financial or investment advisors. Although at least one subscription agreement recites that she consulted financial advisors, others state that she relied only on herself and her broker in making investment decisions. He knew that some of the prospectuses contained complex financial arrangements, and did not know whether she understood them.

Kirksey admitted that limited partnerships had inherent "recapture" and "phantom income" risks, but said he did not understand these risks and did not attempt to explain them to Ash. A primary characteristic of a limited partnership is that losses are passed through, and he tried to match such passive losses with passive income for Ash after the 1986 Tax Reform Act, but said he was hampered by not knowing how much income had been distributed to her by each partnership. Knowing that such losses would be unusable in tax qualified pension or retirement account, Kirksey nonetheless sold Ash 10 limited partnerships into such accounts.

Kirksey believed that he had recommended to Ash a broad array of limited partnerships, and had made a good asset allocation of her Sutro account. He did not worry about an excessive concentration in real estate partnerships, even though over 75% of her

portfolio was so invested. He thought the account was "diversified."

Thus, while it is true that Ash had considerable investment and business administrative experience when she came to Sutro in 1986, it is also true that: (1) she had just recently retired at 61; (2) she expressly recorded her investment objectives at Sutro as "income and appreciation safety;" (3) these objectives never changed; (4) Kirksey knew her to be a cautious, conservative, risk-adverse investor who wanted to preserve her capital; (5) Kirksey recommended almost nothing but 26 limited partnerships and REITs over a three-year period, although he dealt in other products; (6) he believed that all the partnerships met her goals of "safety;" (7) he himself knew little about important aspects of limited partnerships and could not evaluate them from the official documentation; (8) Sutro's Direct Investment Department never restricted the partnerships to any category of investor and did not instruct Kirksey on any of the likely risks of the investments; (9) Kirksey had built a relationship of friendship and trust with Ash; (10) Kirksey knew that Ash was probably relying upon him for guidance, rather than on any outside consultant; (11) he undertook certain tax strategies and diversification for her account without knowing the real risk level of the investments.

All of this evidence must be considered, along with the evidence of her prior financial and investment experience, in making a balanced evaluation of the degree of fiduciary duty owed to Ash and the performance of that duty owed by Sutro and Kirksey during 1987-90. It is not enough to simply conclude that because Ash had prior investment and business experience, respondents owed no duty to her beyond transacting investment decisions that they had initiated and recommended. The fiduciary duty here required more than the caveat emptor of the used car lot.

California law requires a broker to serve as a fiduciary toward his customer, to perform "diligent and faithful service" in the same manner as a trustee, and to act with the "utmost good faith and integrity." Twomey v. Mitchum, Jones & Templeton, Inc. (1968) 262 Cal.App.2d 690,709. This fiduciary duty is owed whether the customer is naive about investments or is experienced; it is the scope and extent of the fiduciary duty which depends upon the facts of each case. Duffy v. Cavalier (1989) 215 Cal.App.3d 1517, 1535. In Duffy, the President of an electrical supply company and trustee of its profit-sharing plan, with experience in options trading, was deemed to be an unsophisticated investor to whom the broker owed--and violated--a fiduciary duty to avoid investing in options even though they had been requested by the trustee. The court imposed a duty of determining the customer's actual needs on top of the standard duty of "carrying out the stated objectives of the

customer." (p.1538.) In the present case, Ash only sought "safe" investments; respondents have not attempted to prove that she "actually" needed the high risk limited partnerships they recommended.

Nor is investor sophistication an absolute bar to recovery under Ash's related claim of negligent misrepresentation in this case. In Blankenheim v. E.F. Hutton & Co. (1990) 217 Cal. App. 3d 1463, the court held that reliance by a financial vice-president and an accountant-controller on the misrepresentations of a sales representative concerning limited partnerships could be deemed reasonable because they had neither expertise in the structuring of limited partnerships nor in the nature of the underlying assets. A similar conclusion is appropriate for the present case.

Sutro actually sold Ash limited partnerships into four separate accounts: her individual, a corporate, an IRA, and a profit-sharing plan (later rolled over in an IRA). Ash entirely controlled the corporate account, however, which had become a shell, holding only the proceeds of the sale of her business, so Sutro owed the same fiduciary duty to it as to her individual account. Claimant has not asserted any higher standard for the retirement accounts, so all four accounts may be judged in the same manner under the law described above.

In evaluating respondents' exercise of their fiduciary duty, consideration may be given to the extent to which they complied with the obligations imposed on the brokerage industry by Article III, Section 2 of the NASD Rules of Fair Practice. The provision does not create a separate cause of action, Jablon v. Dean Witter & Co. (9th Cir. 1980) 614 F.2d 677, but at least in part "reflects the standard to which all brokers are held." Vucinich v. Paine, Webber, Jackson & Curtis, Inc. (9th Cir. 1986) 803 F.2d 454, 461. Section 2 requires a broker to have "reasonable grounds" for recommending a security purchase, such grounds consisting of the customer's financial status, tax status, investment objectives, and any other pertinent information. A broker, therefore, is not justified in recommending as "safe" a risky security to a customer whom he knows to be experienced if that customer has expressed more conservative investment goals. Moreover, in California, Twomey requires the broker not only to have these "reasonable grounds," but also to perform "diligent and faithful" service in the same manner as a trustee.

The evidence shows that Kirksey neither had "reasonable grounds" nor performed "diligent service" in recommending investments to Ash. Respondents' own expert testified that 13 limited partnerships did not meet the income and appreciation safety goals, and Kirksey

clear that he never warned Ash of any of their unfavorable aspects. Article III, Section 2 requires that a broker make an inquiry into each security's level of risk and to match that with the customer's "investment objectives." And the trustee-type "diligent service" required by Twomey surely demands that a licensed securities dealer do more than simply hand a client such as Ash a prospectus with nothing more than an uninformed recommendation to buy. At a minimum, Kirksey was required to take reasonable steps to accurately advise Ash whether or not the investment matched her express investment goals.

Likewise, Twomey's "diligent service" required Sutro to provide adequate evaluations of the investments to its brokers, or sufficient information for them to make their own evaluations. Sutro attempted to do so through its DID and marketing department. However, Kirksey was led to believe that 13 of the partnerships that he recommended to Ash were "safe," when, in fact, they were not. Ash bought them under the assumption that they were "safe." Sutro has not attempted to justify these mistaken recommendations as being reasonable, the consequence of misrepresentations by the issuer, or otherwise excusable.

I would find a breach of fiduciary duty toward Ash by Respondents as to the aforementioned 13 limited partnership investments, and would award appropriate compensatory damages. In other respects, I concur with the majority's decision.

Forum Fees

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following forum fees are assessed: The National Association of Securities Dealers, Inc. shall retain the \$1,500 hearing session deposit previously paid by the claimants. Forum fees are assessed as follows:

| | | |
|--|----|---------|
| Total Forum Fees Assessed (Six prehearing sessions at \$300/session plus 71 hearing sessions at \$1,500/session) | \$ | 108,300 |
| Claimant Dorris Ash's assessment | | 54,150 |
| Amount paid by Claimant Dorris Ash | | 7,950 |
| Claimant Dorris Ash's balance due | | 46,200 |
| Respondents Sutro's and Kirksey joint and several assessment | | 54,150 |
| Amount paid by respondents | | 7,950 |
| Respondents' balance due | | 46,200 |

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

Arbitration Panel

Alfred Knoll, Esq.

Public Arbitrator

William Smales,

Industry Arbitrator

Charles Farnsworth, Esq.

Public Arbitrator

Concurring Arbitrators' Signatures

Alfred P. Knoll, Esq. Public Arbitrator

William Smales, Industry Arbitrator

Dissenting Arbitrator's Signature



Charles Farnsworth, Esq. Public Arbitrator

Dated: 3/6/96