

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

---

In the Matter of the Arbitration Between

Name of Claimant

The Harrison Hills School District

94-00235

Name of Respondents

Hart Securities, Inc.  
Kenneth Schulte

---

REPRESENTATION

Claimant The Harrison Hills School District was represented by Michael S. Yashko, Esq., Worthington, Ohio.

Respondent Hart Securities, Inc. was represented by Paul S. Francis, Esq., with the law firm of Elkins & Yount, P.C., Houston, Texas.

Respondent Kenneth Schulte was represented by Harold Geringer, Esq., with the law firm of Geringer & Dolan, New York, New York.

CASE INFORMATION

The Statement of Claim was filed on January 15, 1994. The Statement of Claim was amended on December 21, 1994. A Submission Agreement was executed on behalf of claimant Harrison Hills on January 11, 1994.

Respondents Hart Securities, Inc. and Raymond James & Associates, Inc. filed a Joint Statement of Answer on March 14, 1994. A First Amended Statement of Answer was filed by Hart Securities, Inc. and Raymond James on August 18, 1994. A second Amended Statement of Answer of Hart Securities, Inc. was filed on December 30, 1994.

A Submission Agreement was executed on behalf of Hart Securities, Inc. on March 11, 1994. Raymond James did not execute a Submission Agreement.

Respondent Kenneth Schulte filed a Statement of Answer on March 28, 1994. Respondent Schulte filed a Submission Agreement which was executed on February 3, 1994.

### **HEARING INFORMATION**

Pre-hearing Date/ Session:	December 14, 1994	-	One Session
Hearing Dates/Sessions:	January 16, 1995	-	3 Sessions
	January 17, 1995	-	2 Sessions
	August 7, 1995	-	2 Sessions
	August 8, 1995	-	2 Sessions

The hearing was held at the NASD, Inc. located at 1350 Euclid Avenue, Cleveland, Ohio.

### **CASE SUMMARY**

Claimant, The Harrison Hills School District (hereinafter referred to as "Harrison Hills" or "Claimant") alleged that respondent Kenneth Schulte ("Schulte"), an investment advisor with respondent Hart Securities, Inc. ("Hart") cold-called Susan Raymond ("Raymond"), Claimant's treasurer, during the summer of 1991 in an effort to persuade Raymond to purchase Federal National Mortgage Association Interest-Only Stripped Mortgage Backed Securities ("FNMA I/O's"). It was alleged by claimant that Raymond told Schulte that she was unsure about the investment he was suggesting and that she had no experience in those or similar investments; that Claimant's current funds were invested in certificates of deposit and similar investments; and that Claimant's primary investment objectives were protecting the principals of its investment and liquidity.

It was further alleged by Claimant that respondent Schulte was advised that Claimant was prohibited by law from investing in a security with a maturity of greater than two years. Respondent Schulte allegedly recommended FNMA I/O's as a good investment and allegedly assured Raymond that such an investment was risk free and that Schulte had sold FNMA I/O's to local municipal ties and counties and was talking to other school districts about these investments.

Claimant also alleged that Schulte eventually persuaded Raymond that the FNMA I/O's were sound investments and she invested approximately Three Hundred Thousand Dollars (\$300,000.00) of Claimant's funds into the FNMA I/O's recommended by him. It was Claimant's contention that Raymond justifiably relied upon the representations of Schulte which were allegedly either false or were made with a reckless disregard as to their truth or accuracy. Claimant alleged that despite its expressed desire that its funds be invested in a conservative and liquid investment, Schulte recommended and sold an unsuitable investment; made numerous false statements and misrepresentation about his background and

the safety of an investment in I/O's; defrauded Claimant; breached his fiduciary and agency duties to Claimant; violated federal and state securities laws; engaged in unconscionable and deceptive sales practices; and breached his contractual duties to Claimant. Moreover, Claimant alleged that Hart and Raymond James & Associates ("Raymond James") either intentionally instructed Schulte to pursue the actions set forth above or negligently failed to supervise him in his handling of Claimant's account. Therefore, Claimant alleged, respondent Hart and Raymond James breached their fiduciary and agency duties to Claimant, defrauded Claimant and violated federal and state securities laws. Further, Claimant alleged that Hart and Raymond James are responsible for Schulte's actions under the doctrines of respondeat superior and aiding and abetting. It was alleged that Raymond James negligently permitted Hart and Schulte to use its name and business stature to perpetrate the actions described above and/or acquiesced therein thus allegedly damaging claimant.

Respondents Hart and Raymond James denied all allegations of wrongdoing as asserted against these respondents in the Statement of Claim. Respondent Hart denied that either it or respondent Schulte were "investment advisors" to claimant and maintained that at all times they were brokers for claimant. In addition it was asserted that at all times and with respect to all transactions, Raymond James acted only as the clearing broker and was not responsible for the conduct of the introducing broker, Hart, or of Schulte. Respondents Hart and Raymond James further denied that the mortgage backed securities purchased by Claimant were unsuitable as an investment and stated that the nature, characteristics and the risks of investing in the mortgaged backed securities were explained and well known to Claimant, and Claimant made an informed decision to purchase the securities to seek higher yield on a portion of its portfolio. Further, respondents contended that Claimant's losses were caused by its own failure to liquidate the investment in a reasonable fashion at any appropriate time or times.

Respondents Hart and Raymond James denied each and every material allegation set forth in the Statement of Claim. Specifically, Respondents denied that they, or either of them, are guilty of violations of any of the NASD Rules or Federal or State securities laws; denied that they committed any kind of fraud; denied that they were negligent; and denied that they breached any contractual or fiduciary duty to Claimant. Respondents objected to and moved to dismiss all claims for relief based on fraud, misrepresentation and/or omission to state material facts because the statement of claim did not state with specificity what was misrepresented. Respondents further objected to and moved to dismiss claims for relief for violation of federal securities acts because such claims are barred by the applicable one (1) year and three (3) year Statute of Limitations from the date of the transaction or the date that Claimant had actual knowledge or notice of facts which, had it exercised due diligence, would have led it to knowledge of the facts which form the basis of its claims; respondents objected to and moved to dismiss any claim for relief which sought a private recovery under Ohio State Securities Law; and respondents objected to and moved to dismiss any claim based on

"unconscionable and deceptive sales practices" and breach of contract. Further, respondents Hart and Raymond James stated that the claimant's claims are barred under law by claimant's failure to mitigate its damages, its failure to exercise due diligence, by the applicable Statute of Limitations, by application of the doctrines of assumption of risk, estoppel, ratification, waiver and laches, and by claimant's own negligence.

Respondent Kenneth Schulte maintained that the Statement of Claim failed to state any cause of action against him upon which relief may be granted. Schulte maintained that he first spoke with Raymond in June, 1991 and discussed investments which could possibly enhance portfolio returns for the claimant. Schulte further maintained that he was employed by Hart as a senior account executive and that he was not, nor did he represent himself as, an investment advisor. Schulte maintained that at the request of Raymond, he forwarded to her various literature concerning mortgage backed securities and fully discussed the entire concept of these securities with Raymond during various telephone conversations; that he never attempted to persuade Raymond to purchase the investment she made; and that claimant was fully familiar with all of the risks and benefits attendant thereto.

Schulte denied making any fraudulent misrepresentations to Raymond and stated that all statements made to Raymond were truthful and accurate; that Schulte never made any promises or representations concerning income to be made by the claimant by purchasing mortgage backed securities; and that Schulte never told Raymond that such an investment was risk free or that there was no way of losing money.

Schulte maintained that he acted at all times properly within the rules promulgated by both the NASD and the SEC and committed no violation thereof, nor did respondent Schulte violate any of the securities laws of the State of Ohio; further Schulte maintained that the Claimant, having substantial experience in securities and investments, was fully aware of the potential risks which exist in every securities transaction. Moreover, respondent Schulte maintained that the purchase made by claimant was made at the specific request of Raymond, acting on behalf of Claimant, after complete discussions were held between Raymond and Schulte.

As affirmative defenses, Schulte maintained that Violations of an Exchange Act rule or an NASD rule does not give rise to a private right of action; Claimant authorized and consented to the transaction complained of and is therefore equitably estopped from bringing this proceeding; Claimant by its own actions, has waived any and all claims alleged in the Statement of Claim by continuing to pursue the investment strategy after acquiring actual knowledge of the nature of that strategy and risks attendant thereto, including failure to mitigate its alleged damages; that claimant was fully aware from the onset of the risks inherent in the investment it purchased and voluntarily assumed such risk; that claimant is barred from any recovery for failure to exercise that degree of diligence required in

handling and monitoring of its securities transactions; that claimant failed to timely notify respondent schulte after the discovery of the alleged acts and omissions now complained of and is therefore barred from recovering from respondent under the doctrine of ratificat, estoppel, waivers and laches; and that claimant's claim is barred by the applicable statute of limitations.

### **RELIEF REQUESTED**

Claimant requested damages in excess of \$300,000.00 plus interest, punitive damages, attorneys fees and the costs of this arbitration.

Respondent Hart and Raymond James objected to the Statement of Claim and moved to dismiss all claims maintaining that claimant failed to identify the amount of damages it is seeking. Respondent asserted that the claim for losses "in excess of \$300,000.00" is too vague to fairly advise respondents of the extent of the damages claimed. Respondents Hart and Raymond James objected to claimant's request for punitive damages and/or attorneys fees because claimant has not alleged any claim or stated any facts which will support the award of either.

Respondent Schulte requested that claimant's demands be denied in their entirety and that such respondent be awarded the costs and disbursements of this proceeding.

Claimant amended its claim dismissing respondent Raymond James without prejudice and requested damages which are approximately \$205,000.00 plus prejudgement interest. Further, claimant requested that its damages be trebled under the CSPA to \$615,000.00. In addition, claimant requested an award of punitive damages, attorney's fees and the costs and expenses of this arbitration.

Respondent Hart requested that the Statement of Claim and Amended Statement of Claim be dismissed and requested reasonable attorney's fees and expenses incurred in having to defend against this case. Respondent Hart requested that in the event respondent Hart may be liable to claimant, the amount of claimant's damages should be reduced by the amount it has received and/or is entitled to receive under the treasurer's bond and any other officer's and bonds and insurance policies issued for claimant's benefit.

### **OTHER ISSUES CONSIDERED & DECIDED**

At the hearing, each party, through their respective attorneys, affirmatively stated that they accepted the composition of the panel which was comprised of a majority of industry arbitrators, specifically, arbitrators Shiffra, Wagner and Stamatis. Prior to each party stating their affirmative acceptance of the panel, the parties were advised both prior to the hearing, and again at the hearing, that

pursuant to Section 19 of the Code, the parties were entitled to a panel which consisted of a majority of public arbitrators. The parties were further advised that if any party objected to the composition of the panel, the NASD would reconfigure the panel to consist of a majority of public arbitrators in accordance with Section 19. Each party waived its rights to a majority of public arbitrators and affirmatively accepted the composition of the panel.

Respondents Hart and Raymond James filed a motion requesting a change of venue from the hearing situs of Cleveland, Ohio selected pursuant to Section 26 of the NASD Code of arbitration procedure (the "Code") to a place outside of the State of Ohio. Respondent maintained that claimant is a public governmental entity with a large constituency within the environs of Cleveland, Ohio and that because of the very widespread publicity which was allegedly adverse to the respondents, the atmosphere of any arbitration hearing held in the State of Ohio was likely to be tainted and affected by the high profile public attention that will be paid to these proceeding and their outcome. Respondent Schulte concurred and joined in this motion.

Claimant objected to the motion and requested that the motion be denied. Claimant maintained that it does not have a large constituency in the Cleveland environs. Claimant is located at least 140 miles from Cleveland in a small, rural village known as Hopedale, Ohio. Further, claimant maintained that respondents chose to sell securities in Ohio and, therefore, subjected themselves to the application of Ohio Law and arbitration proceedings within the state.

Respondents Hart Securities and Raymond James filed a Motion to Dismiss the Statement of Claim moving to dismiss for failure to specify with reasonable clarity the legal grounds entitling claimant to any remedy. Respondents contend that the claims failed to state any grounds upon which relief could legally be granted. Therefore, respondents requested that the claims be dismissed, or denied any right of recovery on those claims. Alternatively, respondents requested that claimant be required to replead its Statement of Claim to state with specify all facts and legal grounds upon which it seeks recovery and to state the specific amount of its claimed damages. Respondents further submitted that if claimant is not at least required to amend its Statement of Claim, respondents would have good grounds to request a court of competent jurisdiction set aside any award against them be set aside due to lack of fundamental due process. Further, respondents agreed that Claimants allegations against Raymond James failed to state any ground under which Raymond James, as the clearing broker, could be held liable to claimant.

Thereafter, Respondents Hart and Raymond James filed a motion for a pre-hearing Determination of Motion to Dismiss the Statement of Claim.

A pre-hearing conference was held with the full panel presiding. The parties were afforded the opportunity to present oral arguments on the issues of the

Motion for Change of Venue; Motion to Dismiss; and Motion to require Claimant to replead its Claim.

The panel determined to deny the motion for a change of venue; denied the motion to Dismiss the Statement of Claim; and denied the motion seeking to require claimant to amend the Statement of Claim. Further, the panel accepted and approved the agreement of the parties to dismiss without prejudice Raymond James Association, Inc. as a respondent in this matter.

At the hearing, respondent Hart Securities renewed their request that the claimant be ordered to replead their claim. Claimant stated their objection to this renewed motion. The panel again denied the motion.

Claimant advised the panel that it reconsidered its position with respect to amendment of the Statement of Claim. The panel accepted an amended Statement of Claim and respondent Hart's Second Amended Statement of Answer and received them into Arbitrators's Exhibit 1.

On March 3, 1995 Respondent Hart Securities, Inc. filed a Voluntary Petition for relief under Chapter 11 of the U.S. Bankruptcy Code.

#### **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. Respondent Kenneth Schulte be and hereby is liable and shall pay to the Claimant The Harrison Hills School District the sum of \$169,302.00, inclusive of interest.
2. All claims for treble damages be and hereby are denied.
3. All claims for punitive damages be and hereby are denied.
4. Each party shall bear their respective costs, including expert witness fees and attorneys' fees.
5. All other claims be and hereby are denied.

#### **FORUM FEES**

Pursuant to Section 43c of the Code of Arbitration Procedure, the following Forum Fees are assessed:

10 hearing sessions x \$1,000.00 per session = \$10,000.00

10 hearing sessions x \$1,000.00 per session = \$10,000.00

1. Claimant be and hereby is liable and shall pay to the NASD the sum of \$5,000.00 representing one-half of the forum fees assessed against the parties. Claimant previously deposited a hearing session deposit in the amount of \$1,000.00. Therefore, the amount due and owing from Claimant is \$4,000.00.
2. Respondent Kenneth Schulte be and hereby is liable and shall pay to the NASD the sum of \$5,000.00 representing one-half of the outstanding forum fees assessed against the parties.

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

Arbitrator's Signature  
Name

Robert Shiffra, Esq.

Thomas C. Wagner  
Thomas C. Wagner, Esq.

John N. Stamatis

Date of Decision: December 5, 1995



10 hearing sessions x \$1,000.00 per session = \$10,000.00

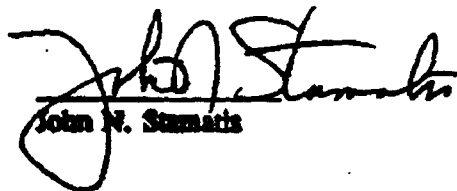
1. Claimant be and hereby is liable and shall pay to the NASD the sum of \$5,000.00 representing one-half of the forum fees assessed against the parties. Claimant previously deposited a hearing session deposit in the amount of \$1,000.00. Therefore, the amount due and owing from Claimant is \$4,000.00.
2. Respondent Kenneth Schulte be and hereby is liable and shall pay to the NASD the sum of \$5,000.00 representing one-half of the outstanding forum fees assessed against the parties.

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

Arbitrator's Signature  
Name

Robert Shiffra, Esq.

Thomas C. Wagner, Esq.

  
John N. Stamatis

Date of Decision: December 5, 1995

10 hearing sessions x \$1,000.00 per session = \$10,000.00

1. Claimant be and hereby is liable and shall pay to the NASD the sum of \$5,000.00 representing one-half of the forum fees assessed against the parties. Claimant previously deposited a hearing session deposit in the amount of \$1,000.00. Therefore, the amount due and owing from Claimant is \$4,000.00.
2. Respondent Kenneth Schulte be and hereby is liable and shall pay to the NASD the sum of \$5,000.00 representing one-half of the outstanding forum fees assessed against the parties.

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

Arbitrator's Signature  
Name

  
Robert Shiffra, Esq.

\_\_\_\_\_  
Thomas C. Wagner, Esq.

\_\_\_\_\_  
John N. Stamatis

Date of Decision: December 5, 1995