

**NASD FINAL ORDER**

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

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**In the Matter of the Arbitration Between**

**Name of Claimant**

**Zinsmeyer Trusts Partnership**

**and**

**Names of Respondents**

**PaineWebber, Inc.,  
PaineWebber Group, Inc.,  
Mitchell Hutchins Asset Management, Inc.,  
William J. Reik, Jr.,  
William D. Witter, Inc.,  
Morgan Stanley & Company, Inc. and  
Kidder, Peabody & Company, Inc.**

94-00460

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**REPRESENTATION OF PARTIES**

**Claimant, Zinsmeyer Trusts Partnership was represented by Thomas Douglas, Esq., Ellen Bonacorsi, Esq., Ray Grunder, Esq. and Kevin Barry, Esq. of Coburn & Croft located in St. Louis, MO.**

**Respondents, PaineWebber, Inc., PaineWebber Group, Inc. and Mitchell Hutchins Asset Management, Inc. were represented by Robert Higgins, Esq. and Kenneth Lyons, Esq. of Dickstein, Shapiro & Morin located in Washington, D.C.**

**Respondent, William J. Reik, Jr. was represented by Richard Martens, Esq. and Debra Jenks, Esq. of Boose Casey Ciklin Lubitz Martens McBane & O'Connell located in West Palm Beach, FL.**

**Respondent, William D. Witter, Inc. was represented by Anthony De Toro, Esq. and Donald M. Spector, Esq. of De Forest & Duer located in New York, NY.**

**Morgan Stanley & Company, Inc. was represented by I. Scott Bieler, Esq., Robert C. Reuland, Esq. and Roger J. Hawke, Esq. of Brown & Wood located in New York, NY.**

**Kidder, Peabody & Company, Inc. was represented by Thomas A. Dubbs, Esq. and David Rivera, Esq. of Kidder Peabody, Inc. located in New York, NY.**

### **CASE INFORMATION**

The Statement of Claim was filed on or about January 7, 1994.

The Submission Agreement of Claimant, Zinsmeyer Trusts Partnership was signed on February 4, 1994 by Andrew R. Zinsmeyer.

The Joint Statement of Answer of Respondents, PaineWebber, Inc., PaineWebber Group, Inc. and Mitchell Hutchins Asset Management, Inc. was filed on or about April 15, 1994.

The Statement of Answer of Respondent, William J. Reik, Jr. was filed on or about April 15, 1994.

The Submission Agreement of Respondent, William J. Reik, Jr. was signed on March 24, 1994.

The stipulation between Claimant and Respondent, William J. Reik, Jr. agreeing to arbitrate this claim before the NASD was filed on or about January 24, 1994.

The Statement of Answer and Motion to Dismiss of Respondent, William D. Witter, Inc. was filed on or about May 2, 1994.

The Submission Agreement of Respondent, William D. Witter, Inc. was signed on April 28, 1994 by William D. Witter, President.

The Statement of Answer of Respondent, Morgan Stanley & Company, Inc. was filed on or about April 15, 1994.

The Statement of Answer of Kidder, Peabody & Company, Inc. and Cross-Claim against William D. Witter, Inc. was filed on or about January 9, 1995.

The Answer to the Cross-Claim of William D. Witter, Inc. was filed on or about February 7, 1995.

### **HEARING INFORMATION**

Pre-hearing conferences were held on the following dates:

- January 17, 1995 for two (2) sessions before one arbitrator
- March 20, 1995 for one (1) session before three arbitrators

The hearing was held in St. Louis, MO on the following dates with the exception of May 15, 16 and 17, 1995 which were held in New York, NY:

- March 27, 1995 for two (2) sessions
- March 28, 1995 for two (2) sessions

- March 29, 1995 for three (3) sessions
- April 10, 1995 for two (2) sessions
- April 11, 1995 for two (2) sessions
- April 12, 1995 for two (2) sessions
- May 15, 1995 for two (2) sessions
- May 16, 1995 for two (2) sessions
- May 17, 1995 for two (2) sessions
- June 28, 1995 for two (2) sessions
- June 29, 1995 for two (2) sessions
- June 30, 1995 for two (2) sessions
- September 27, 1995 for two (2) sessions
- September 28, 1995 for two (2) sessions
- September 29, 1995 for two (2) sessions
- October 30, 1995 for two (2) sessions
- November 1, 1995 for two (2) sessions
- November 2, 1995 for two (2) sessions

for a total of thirty-eight (38) hearing sessions before three arbitrators and two (2) hearing sessions before one arbitrator.

#### **CASE SUMMARY**

Andrew R. Zinsmeyer ("Zinsmeyer"), the Managing Partner of the Zinsmeyer Trusts Partnership (the "Partnership") alleged that he retained Respondent, William J. Reik, Jr. ("Reik") on or about January 26, 1986 as an investment advisor for a portion of the assets of the Partnership. According to Zinsmeyer, Reik at that time was employed as a Managing Director of Respondent, Mitchell Hutchins Asset Management, Inc. ("Mitchell Hutchins"). Zinsmeyer alleged that he signed a discretionary investment advisory agreement with Mitchell Hutchins on behalf of the Trust, giving Mitchell Hutchins sole discretion to manage investments of the Zinsmeyer Trusts Partnership. Zinsmeyer contended that Respondent, Mitchell Hutchins was a registered investment advisor and was a wholly owned subsidiary of Respondent, PaineWebber, Inc. ("PWI"). Zinsmeyer further contended that Respondent, PaineWebber Group, Inc. ("PWGI") is the holding company for PWI.

Zinsmeyer alleged that Reik primarily invested the assets of the Partnership in three stocks: Neutrogena, Tejon Ranch, and Frisch's Restaurants. Zinsmeyer contended that these stocks, as well as others that Reik made investments using the Trust's assets, were thinly-traded, illiquid and subject to a high degree of volatility and risk. Zinsmeyer also contended that the markets for these stocks were manipulated and controlled by Reik. Zinsmeyer maintained that Reik was the portfolio manager for Cypress Fund, Inc. (the "Fund"), a close-end management investment company, controlled by PWI. In this capacity, Zinsmeyer alleged that Reik invested a significant portion of the Fund's portfolio in Neutrogena, Tejon Ranch, and Frisch's Restaurants. Zinsmeyer

contended that Reik invested the assets of other investment advisory clients' accounts in Neutrogena, Tejon Ranch, and Frisch's Restaurants. Zinsmeyer alleged that Reik further maintained significant personal holdings in Neutrogena, Tejon Ranch, and Frisch's Restaurants. According to Zinsmeyer, these circumstances permitted Reik to manipulate and control the relatively inactive markets for these three particular stocks.

Zinsmeyer alleged that Reik repeatedly encouraged the use of margin in the Trust's account because it enabled Reik to make larger purchases of the stocks at issue and because Reik's and Mitchell Hutchins's management fee was tied to the value of the portfolio. Zinsmeyer alleged that, as the value of the assets of the Trust declined, margin calls were issued. Zinsmeyer maintained that he provided approximately 144,500 shares of Novellus stock, valued at 1.3 million dollars, to prevent the Trust's account from being liquidated. Zinsmeyer alleged that he pledged the stock subject to conditions agreed to by Reik, which included a condition that the Novellus stock was not to become part of the margin account for initial margin purposes or part of the managed account for management fee purposes.

Zinsmeyer maintained that Reik was terminated on or about February 8, 1991 from employment by Mitchell Hutchins for compliance problems and, thereafter, joined Respondent, William D. Witter, Inc. ("William Witter"). Zinsmeyer contended that he then retained William Witter as an investment advisor for the assets previously managed by Mitchell Hutchins and opened a margin account at Respondent, Morgan Stanley & Co., Inc. ("Morgan Stanley"). According to Zinsmeyer, during the transfer of assets of the Partnership, PWI and Reik failed to disclose and Morgan Stanley failed to learn the conditions under which Zinsmeyer pledged the Novellus stock. As a result, Zinsmeyer alleged, Morgan Stanley accepted the Novellus stock into the Trust's margin account contrary to the conditions agreed to by Reik. Zinsmeyer contended that Reik used the Novellus stock for initial margin purposes in order to purchase Frisch's Restaurants and Tejon Ranch stock on margin.

Zinsmeyer alleged that Reik insisted in June, 1991 that the Claimant transfer its account from Morgan Stanley to Kidder, Peabody & Co., Inc. ("Kidder, Peabody"). According to Zinsmeyer, Reik failed to disclose to Kidder Peabody and Kidder, Peabody failed to learn of the conditions under which the Novellus sock had been pledged. Once the assets has been transferred over to Kidder Peabody, Zinsmeyer alleged that Reik continued to use the Novellus stock for initial margin purposes in order to purchase additional Frisch's Restaurants and Tejon Ranch stock on margin.

Claimant asserted the following claims against Respondents: (1) Federal Securities Fraud against Respondents, PWGI, PWI, Mitchell Hutchins, William Witter and Reik; (2) Market Manipulation against Respondents, PWGI, PWI, Mitchell Hutchins, William Witter and Reik; (3) Investment Advisors Act claim against Respondents, Mitchell Hutchins, William Witter, and Reik; (4) Common Law Fraud against Respondents, PWGI, PWI, Mitchell Hutchins, William Witter and Reik; (5) Breach of Fiduciary Duty against Respondents, PWGI, PWI, Mitchell Hutchins,

William Witter and Reik; (6) Negligent Supervision against Respondents, PWGI, PWI, Mitchell Hutchins and William Witter; (7) Breach of Contract against Respondents, PWI, Mitchell Hutchins, Morgan Stanley, Kidder Peabody and William Witter; and (8) Negligence against Respondents, PWGI, PWI, Mitchell Hutchins, Morgan Stanley, Kidder Peabody, William Witter and Reik.

In his Statement of Answer, William J. Reik, Jr. denied any liability to Claimant. Reik contended that he never represented to Zinsmeyer that his investment strategy was conservative. Reik alleged that Zinsmeyer is an extremely wealthy and sophisticated investor with a net worth of approximately \$40,000,000. Reik asserted that Zinsmeyer was always informed and in control of all his investments. Reik alleged that there was never any aspect of the Partnership's portfolio managed by Reik with which Zinsmeyer was not immediately and intimately familiar. Reik alleged that Zinsmeyer specifically instructed Reik to utilize maximum leverage, through the use of a margin account, to enhance his level of participation in the market. Reik contended that, as a seasoned margin investor, Zinsmeyer was intricately familiar with the structure, mechanisms and rules of a margin account. Reik alleged that Zinsmeyer was fully cognizant that his shares of Novellus were fully commingled with the other equity investments in the Claimant's account. Reik maintained that he never promised to put the Novellus stock in a separate maintenance account because such an account does not exist and such a deposit would not have solved the margin calls. Reik alleged that neither he, nor the other brokerage firms, could have complied with Zinsmeyer's requests because stocks deposited to cover margin calls cannot be segregated under any circumstances.

In their Statement of Answer, PaineWebber Group, Inc., PaineWebber, Inc. and Mitchell Hutchins Asset Management, Inc. requested that the Statement of Claim be dismissed in its entirety. In its Answer, William D. Witter, Inc. denied any liability to Claimants. Respondent, Morgan Stanley & Co. Incorporated also denied any liability to Claimants in its Answer. Respondent, Kidder Peabody & Co., Inc. denied the allegations of wrongdoing asserted by the Claimant alleging that William D. Witter, Inc. indemnify and contribute to all costs, expenses and liabilities.

#### **RELIEF REQUESTED**

Claimant, Zinsmeyer Trusts Partnership requested an award in the amount of \$14,800,000.00 in actual damages and \$10,000,000.00 in punitive damages as well as costs and other relief as the arbitrators deemed proper and just.

In their Answers, PaineWebber, Inc., PaineWebber Group, Inc. and Mitchell Hutchins Asset Management, Inc. and William J. Reik, Jr. requested that the Statement of Claim be dismissed in its entirety.

In their Statements of Answer, William D. Witter, Inc. and Morgan Stanley, & Company, Inc. requested that the Statement of Claim be dismissed and that they be awarded their costs and attorneys' fees.

Respondent, Kidder, Peabody, Inc. demanded that William D. Witter, Inc. indemnify and contribute for costs, expenses and liabilities.

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

Respondents, PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Assets Management, Inc., Morgan Stanley & Company, Inc. and Kidder, Peabody & Co., Inc. did not file with the NASD properly executed submissions to arbitration but are required to submit to arbitration pursuant to Section 12 of the NASD Code of Arbitration Procedure (the "Code") and having answered the claim and appeared at the hearing are bound by the determination of the arbitration panel on all issues submitted.

Respondents, Morgan Stanley & Company, Inc. and Kidder, Peabody, Esq. were dismissed by the arbitrators on or about September 11, 1995 after the arbitrators reviewed and considered their Renewed Motions to Dismiss, all related submissions and the testimony and evidence presented at the hearing.

During the hearing sessions held on or about November 2, 1995, Respondents, PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Asset Management, Inc., William J. Reik, Jr. and William D. Witter, Inc. made an oral motion for dismissal of the entire matter. The arbitrators heard the oral arguments presented by the parties concerning dismissal and requested that the parties submit briefs regarding the issue of causation. Subsequent to reviewing the briefs on causation, the arbitrators determined on or about November 13, 1995 that the Respondents, PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Asset Management, Inc., William J. Reik, Jr. and William D. Witter, Inc.'s request for dismissal of the arbitration case was granted.

#### **ORDER**

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

1. The Statement of Claim is hereby dismissed in its entirety;
2. All requests for relief not specifically granted herein are hereby denied in their entirety; and

3. The parties shall bear their own costs including attorneys' fees except for those specifically enumerated herein.

#### **FORUM FEES**

Forum fees are calculated at the rate of \$1,500.00 per hearing session and \$300.00 for each pre-hearing conference session with one arbitrator. There were thirty-eight (38) sessions x \$1,500.00 plus two (2) pre-hearing sessions x \$300.00 = \$57,600.00 in forum fees. Pursuant to Section 43(b) of the Code of Arbitration Procedure, a hearing session is any meeting between the parties and the arbitrator(s), including a pre-hearing conference with an arbitrator, which lasts four (4) hours or less.

Pursuant to Section 43(c) of the NASD Code of Arbitration Procedure, the National Association of Securities Dealers, Inc. ("NASD") shall retain the non-refundable filing fee in the amount of \$300.00 and shall retain as forum fees the hearing session deposit in the amount of \$1,500.00 previously deposited with the NASD by the Claimant. The NASD shall retain the postponement fees in the amount of \$2,000.00 which were previously submitted by the Claimant. The NASD shall retain the interim forum fees paid by the Claimant in the amount of \$14,400.00 paid pursuant to an order entered by the arbitrators in accordance with Section 43(a) of the Code. Claimant, Zinsmeyer Trusts Partnership is hereby liable for and shall pay to the NASD the sum of \$12,900.00 in additional forum fees.

The NASD shall retain the interim forum fees in the amount of \$3,857.14 previously deposited with the NASD by Respondents, PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Asset Management, Inc., William J. Reik, Jr., William D. Witter, Inc., Morgan Stanley & Company, Inc. and Kidder, Peabody & Company, Inc. paid in accordance with an order of the arbitrators under Section 43(a) of the Code. The NASD shall also retain the \$500.00 non-refundable claim filing fee and the hearing session deposit in the amount of \$1,500.00 previously submitted by Respondent, Kidder, Peabody & Company, Inc. Respondents, PaineWebber, Inc., PaineWebber Group, Inc., Mitchell Hutchins Asset Management, Inc., William J. Reik, Jr. and William D. Witter, Inc., jointly and severally, are hereby liable for and shall pay to the NASD the sum of \$23,442.86 in additional forum fees.

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

Arbitrators' Signatures:

Dated:

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Thomas A. Cipolla, Esq.  
Public Arbitrator, Presiding Chair

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Charles A. Seigel, Esq.  
Public Arbitrator

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Sherie Catlett  
Industry Arbitrator

Date served by the NASD: November 30, 1995