

NASD REGULATION, INC. AWARD

Office of Dispute Resolution

In the Matter of the Arbitration Between

Names of Claimants

Neale W. Sanchez
Marie A. Sanchez

Case No. 94-05535

Names of Respondents

Shearson Lehman Brothers, Inc.
Joseph Malarney
Thomas Paulus

REPRESENTATION OF PARTIES

For Claimants: Monica I. Salis, Esq. of the law firm of Monica I. Salis, P.A., Fort Lauderdale, Florida.

For Respondents Shearson Lehman Brothers, Inc. n/k/a Salomon Smith Barney, Inc. ("Shearson") and Joseph Malarney ("Malarney"): William A. Hohausser, Esq. of Shearson, New York, New York.

For Respondent Thomas Paulus ("Paulus"): Gary E. Lehman, Esq. of the law firm of Broad and Cassel, Miami, Florida.

CASE INFORMATION

Statement of Claim filed: December 28, 1994. Claimants' Submission Agreement signed: September 12, 1994.

Answer filed by Paulus: May 26, 1995. Paulus' Submission Agreement signed: April 6, 1995.

Answer and cross-claim filed by Shearson: June 5, 1995 and thereafter adopted by Malarney. Submission Agreements signed: June 2, 1995 on behalf of Shearson and May 20, 1997 by Malarney.

Answer to cross-claim filed by Paulus: August 2, 1995.

Counterclaim filed by Malarney March 3, 1998.

Answer to counterclaim filed by Claimants: July 9, 1998.

HEARING INFORMATION

A telephonic pre-hearing conference was conducted on April 29, 1996 with an arbitrator presiding.

The evidentiary hearing commenced on May 20, 1997 in Fort Lauderdale Florida lasting two sessions with the original panel.

Telephonic pre-hearing conferences were conducted on February 23, and March 16, 1998 with the new panel presiding.

The evidentiary hearing was conducted on March 17 and 18, 1998 in Fort Lauderdale, Florida and on July 10 and 11, 1998 in Boca Raton, Florida lasting eight sessions.

CASE SUMMARY

Claimants alleged the following: Neale and Marie Sanchez, neither of whom had completed high school, opened several accounts at Shearson through account executive Paulus at the branch managed by Malamey in the fall of 1991. Claimants opened the accounts with the proceeds from a lawsuit resulting from an automobile collision which left Mr. Sanchez permanently disabled. Approximately 67% of the invested funds were placed in full discretionary managed accounts and Claimants relied on Shearson and Paulus to invest the remaining funds. Paulus and his wife befriended the Claimants and, in February 1992, Paulus convinced the Claimants to invest in his wife's and/or his and his wife's video business. In order to induce the Claimants to make the investment, Paulus made misrepresentations of material facts and omitted to state material facts regarding the business. Based upon his representation that "Shearson would provide the money", Paulus arranged for a margin loan on the Claimants' account to fund a corporate account in the name of "Sandcastle Entertainment", a company which Paulus managed and of which his wife and the Claimants were officers. The preparation of formal purchase/sale documents was abandoned after approximately \$120,000.00 was transferred in this manner to Paulus and his wife. During this period of time, Malamey repeatedly assured Mr. Sanchez that his accounts were in good hands with Paulus, Shearson's "Golden Boy", and that "Shearson would take good care" of him.

Claimants asserted causes of action for common law fraud, breach of fiduciary duty, failure to supervise by Malamey and Shearson, and securities fraud under the Securities Exchange Act of 1934, the Investment Advisor's Act of 1990, and the Florida Securities Laws.

Respondent Paulus denied the allegations set forth in the Statement of Claim and specifically asserted the following: Claimants' personal relationship with Paulus' wife

pre-dated their relationship with the Respondents. Neale Sanchez approached Mrs. Paulus to purchase the assets of F.R. Connelly, Inc., a company of which Mrs. Paulus was president and 100% shareholder. Said purchase was Mrs. Paulus' personal business, totally unrelated to Shearson or to Paulus' employment at Shearson. Said purchase by Neale Sanchez, for the purpose of operating his own business as an entrepreneur handling the day-to-day management and control of the business, was not a "security" and, therefore, the NASD had no jurisdiction over this matter. Further, Claimants' securities claims are barred by the applicable statutes of limitations; Claimants have failed to state a claim upon which relief can be granted; Claimants did not reasonably and justifiably rely upon any statements made by Paulus because they sought and obtained independent legal and business advice; and, Paulus had no contact with Claimants after July of 1992 and any expenditures made by Claimants, after the initial \$83,000.00 paid to Paulus' wife, had nothing to do with Shearson or Paulus.

Respondents Shearson and Malarney denied the allegations set forth in the Statement of Claim and specifically asserted the following: The transaction at issue was an asset purchase by the Claimants from Respondent Paulus' wife. That private business transaction, wholly unrelated to Shearson, was not a "security" and hence not the proper subject of NASD arbitration. Shearson and Malarney were not consulted by Claimants in regard to the advisability of the purchase; had no knowledge of the transaction; and, had no reason to know of the transaction. Claimants made their own decision to invest in the franchise despite misgivings voiced by at least one of the professionals they consulted to advise them. The funds transferred to Shearson through the margin loan amounted to approximately \$83,000.00 which was transferred to a bank account controlled by Neale Sanchez and over which neither Shearson nor Malarney had any control or influence. Furthermore, the claims were barred by the doctrine of res judicata based upon Claimants' failure to join either Shearson or Malarney as indispensable party defendants in a previously concluded state court litigation. In response to specific requests from both Shearson and Malarney, Paulus stated, orally and in writing, that he was not engaged in any outside business interests. In making said inquiry, Shearson and Malarney fulfilled their duties pursuant to NASD, NYSE and SEC guidelines.

Shearson and Malarney asserted a cross-claim against Paulus, seeking contribution and/or indemnification in the event that the panel deemed Shearson and/or Malarney responsible for Claimants' investment in a video franchise. The cross-claim was asserted on the grounds that if this conduct was wrongful (and properly the subject of this proceeding), then the responsibility lies with Paulus and that, pursuant to his employment with Shearson, Paulus was forbidden to engage in any outside business interests without the express approval of Shearson.

Paulus denied the allegations set forth in the cross-claim and asserted that all transactions in the claim were carried out in accordance with Claimants' Instructions and in conformity with all applicable rules and regulations.

Malarney asserted a counterclaim against Neale and Marie Sanchez contending that the claims filed against him are untrue, defamatory in nature, and have caused him damage insofar as he has been unable to obtain a brokerage license in several states as a result of this claim appearing on his CRD record.

Claimants denied the allegations set forth in the counterclaim.

RELIEF REQUESTED

Claimant requested an award in the amount of \$290,422.00 representing compensatory damages, interest, punitive damages in the amount of \$1,000,000.00, treble damages pursuant to the RICO Act in the amount of \$580,844.00, attorney's fees, and costs. Claimants requested a dismissal of the counterclaim.

Respondent Paulus requested dismissal of the Statement of Claim, an award of attorney's fees in the sum of \$50,000.00, costs in the sum of \$3,012.00, the assessment of all NASD fees against the Claimants, and that all references to this arbitration proceeding be expunged from his Central Registration Depository ("CRD") record. Paulus also requested a dismissal of the cross-claim.

Respondents Shearson and Malarney requested that the Statement of Claim be dismissed in its entirety; that Claimants pay all costs, including attorney's fees; and, that all references to this arbitration proceeding be expunged from the CRD record of Malarney. Further Shearson and Malarney requested that, in the event an award is entered against them, that they have judgment against Paulus for the full amount of any such award. Finally, Malarney requested an award of \$50,000.00 on his counterclaim against Claimants plus punitive damages, or, alternatively, that a nominal award be entered.

OTHER ISSUES CONSIDERED & DECIDED

1. During the hearing on May 20, 1998, the initial panel recused itself upon the request of all parties. Thereafter, the undersigned arbitrators were appointed to hear and determine this matter.
2. 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 Regulation, Inc. Office of Dispute Resolution.

AWARD

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

1. Respondents Shearson and Malarney are found not liable and, therefore, all claims against them are hereby dismissed.
2. All references to this arbitration proceeding shall be expunged from the CRD record of Malarney.
3. Respondent Paulus is found liable and shall pay to Claimants the amount of \$93,000.00 plus pre-award interest from March 1, 1992 in the amount of \$47,120.00 for a total due to the Claimants of \$140,120.00. Post-award interest shall be paid pursuant to Rule 10330(h) of the NASD Code of Arbitration Procedure ("Code"). Paulus is found not liable on the cross-claim.
4. Claimants' requests for attorney's fees, costs, expenses, treble, and punitive damages are denied.
5. Respondents Shearson and Malarney's requests for attorney's fees and costs are denied and Malarney's request for punitive damages is denied.
6. Respondent Paulus' requests for attorney's fees, costs, and expungement of his CRD record are denied.
7. Claimants are found not liable on the counterclaim and, therefore, all claims against them are hereby dismissed.

FORUM FEES

Pursuant to Rule 10332(b) of the Code, a hearing session is any meeting between the parties and the arbitrators, including a pre-hearing conference with an arbitrator, which lasts four hours or less.

Pursuant to Rule 10332(c) of the Code, the panel has assessed forum fees in the amount of \$12,300.00 (one pre-hearing conference (chairperson): \$300.00 per session, two pre-hearing conferences (panel)-x \$1,000.00 per session, plus ten hearing sessions x \$1,000.00 per session).

1. Claimants are assessed the sum of \$6,150.00 for which NASD Regulation, Inc. shall retain the \$1,000.00 previously deposited in partial satisfaction thereof, leaving a balance due to NASD Regulation, Inc. of \$5,150.00.

2. Respondents are assessed the sum of \$6,150.00 payable to NASD Regulation, Inc. as follows: Shearson: \$2,050.00, Malamey: \$2,050.00, and Paulus: \$2,050.00.

OTHER FEES

1. Pursuant to Rule 10332 of the Code, Claimants have paid to NASD Regulation, Inc. the \$250.00 claim filing fee.

2. Pursuant to Rule 10319 of the Code, Paulus has paid to NASD Regulation, Inc. the \$1,000.00 postponement fee.

3. Pursuant to Rule 10333 of the Code, Respondent Shearson shall pay to NASD Regulation, Inc. the \$500.00 past due member surcharge which was previously invoiced.

4. Pursuant to Rule 10332 of the Code, Respondent Shearson shall pay to NASD Regulation, Inc. the \$500.00 past due cross-claim filing fee which was previously invoiced.

5. Pursuant to Rule 10332 of the Code, Respondent Malamey shall pay to NASD Regulation, Inc. the \$500.00 past due counterclaim filing fee

Fees are payable to NASD Regulation, Inc.

Concurring Arbitrators' Signatures

/s/

Stan West
Public Arbitrator, Presiding Chair

/s/

William Goldrich
Public Arbitrator

/s/

Richard D. Longacre
Industry Arbitrator

Date of Decision: 8-24-98