

AWARD

NASD Regulation, Inc. Office of Dispute Resolution

In the Matter of Arbitration Between

Raymond E. Hospelhorn, Margaret E. Hospelhorn,
and Ray Electric Defined Benefit Plan,

Claimants,

and

No. 95-05782

Smith Barney, Inc., and Steven A. Scott,

Respondents.

REPRESENTATION OF PARTIES

Claimants, Raymond E. Hospelhorn, Margaret E. Hospelhorn, and Ray Electric Defined Benefit Plan, were represented by Robert D. Mitchell, Esquire of Law Offices of Robert D. Mitchell, P.C., located in Phoenix, Arizona.

Respondents, Smith Barney, Inc. and Steven A. Scott, were represented by Thomas Galbraith, Esquire of Lewis & Roca, located in Phoenix, Arizona.

CASE INFORMATION

Raymond E. Hospelhorn, Margaret E. Hospelhorn, and Ray Electric Defined Benefit Plan's Statement of Claim was filed on or about December 11, 1995.

Raymond E. Hospelhorn and Margaret E. Hospelhorn's Submission Agreement was signed on December 1, 1995.

Ray Electric Defined Benefit Plan's Submission Agreement was signed on January 10, 1996 by Raymond E. Hospelhorn.

Smith Barney, Inc. and Steven A. Scott's Statement of Answer was filed on or about February 22, 1996.

Smith Barney, Inc. and Steven A. Scott's Amended Statement of Answer was filed on or about June 3, 1996.

Smith Barney, Inc.'s Submission Agreement was signed on July 10, 1996 by Mary Reisert, Esquire,

Senior Vice President of Smith Barney, Inc.

Steven Scott's Submission Agreement was signed on May 30, 1996.

HEARING INFORMATION

Pre-hearing conferences were held on: October 2, 1996 for one (1) session; and February 3, 1997 for one (1) session.

The hearing was held on: July 7, 8, 9, 10, and 11, 1997 for two (2) sessions each day in Scottsdale, Arizona for a total of 10 sessions.

CASE SUMMARY

Claimants, Raymond E. Hospelhorn ("Mr. Hospelhorn"), Margaret E. Hospelhorn ("Ms. Hospelhorn"), and Ray Electric Defined Benefit Plan (hereinafter collectively referred to as "Claimants"), brought this action to recover losses on investments made in limited partnerships through Respondents, Smith Barney, Inc. and its registered representative, Steven A. Scott ("Mr. Scott") (hereinafter collectively referred to as "Respondents").

Claimants alleged that Respondents made misrepresentations and omissions in connection with investment recommendations. According to Claimants, Respondents were informed of Mr. Hospelhorn's conservative investment objectives for both his company pension plan as well as his personal and IRA accounts, and that Mr. Hospelhorn did not want to invest in stocks because he did not want to invest in anything that was risky, and that he wanted investments that were safe and liquid. Claimants stated that Mr. Scott recommended limited partnerships, represented that they would be safe and secure investments, and that they were the best investments to put Mr. Hospelhorn's retirement savings into for return and safety. Claimants averred that they never made any investment decisions with respect to their accounts and followed Respondents' recommendations explicitly and without exception. The limited partnerships purchased for the Ray Electric Defined Benefit Plan, and the respective amounts invested, which represented as much as 60% of the Plan, included:

Insured Income Properties 83	\$56,000
Insured Pension Investors	25,000
Shelter Properties VI Limited Partnership	25,000
Guaranteed Hotel 85	65,000
Participating Income Properties 86, L.P.	25,000
Commonwealth Mortgage of America, L.P.	25,000

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Capitol Source II, L.P.	25,000
Jetstream Limited Partnership	<u>10,000</u>
TOTAL	<u>\$256,000</u>

The limited partnerships purchased in Mr. Hospelhorn and Ms. Hospelhorn's personal account, and the respective amounts invested, which represented 100% of the assets in this account, included:

Hutton/PRC Technology Partners, L.P.	\$5,000
Integrated Cattle L.P.	5,000
Granada Cattle L.P.	10,000
Americal Assoc. L.P.	95,000
Kee Oil	15,000
National Oil	<u>5,000</u>
TOTAL	<u>\$135,000</u>

The limited partnerships purchased in Mr. Hospelhorn and Ms. Hospelhorn's IRA account, and the respective amounts invested, which represented 100% of the assets in this account, included:

(a) Ray Hospelhorn IRA

Shelter Properties VII Limited Partnership	\$3,000
Carlyle Real Estate Limited Partnership-XII	2,500
Hutton Commercial Properties I L.P.	<u>3,500</u>
TOTAL	<u>\$9,000</u>

(b) Margaret Hospelhorn IRA

Shelter Properties VII	\$3,000
Aetna Real Estate Associates, L.P.	2,500
Hutton Commercial Properties I L.P.	<u>3,500</u>
TOTAL	<u>\$9,000</u>

Claimants asserted that Mr. Scott never discussed the need for or benefit of diversification of the

investment portfolio to reduce risks of the investments. Claimants further averred that virtually all of the limited partnerships are now worthless or unmarketable, and beyond when Mr. Scott represented the partnerships would be cashed out. Claimants alleged that they have suffered principal losses of at least \$300,000. Claimants made the following legal claims: fraudulent concealment; failure to supervise; Arizona securities fraud; common law fraud; negligence; breach of fiduciary duty; breach of contract; punitive damages; and attorneys' fees.

Respondents denied the allegations set forth in the Statement of Claim as they relate to any wrongdoing on their part. Respondents stated that all of the investments recommended to Claimants were consistent with their stated investment objectives and were, therefore, suitable recommendations. Respondents contended that they did not misrepresent or omit any material fact regarding any of the challenged investments. According to Respondents, Claimants received, and asserted that they read, a prospectus for each investment, which described the material risks associated with owning these securities. Respondents further asserted that Mr. Hospelhorn is a wealthy investor, experienced in investing in partnerships, particularly real estate partnerships. Therefore, Respondents contended, Claimant fully understood the risks of the investments he made. Respondents also made the following defenses: (1) § 15 (now known as § 10304) of the NASD Code of Arbitration Procedure bars consideration of all the claims since each investment was purchased before June 2, 1989; (2) Claimants' claims are barred by the applicable statutes of limitation; (3) the Kee Oil limited partnership was not purchased through Respondents; (4) Claimant's had actual notice of the risks of their investments, and their claims are barred by the "bespeaks caution" doctrine, because of the detailed risk warning clearly stated and repeated in the offering memorandums; (5) the Statement of Claim is barred by the equitable doctrine of laches; (6) Claimants cannot show the required causation between any of the alleged wrongs and their purported losses; and (7) Claimants' claims are barred by ratification, waiver, and estoppel.

RELIEF REQUESTED

Claimants, Raymond E. Hospelhorn, Margaret E. Hospelhorn, and Ray Electric Defined Benefit Plan, requested an award for: actual damages; interest on said sums at the rate allowed by law until paid in full; attorneys' fees pursuant to A.R.S. §§ 12-341.01, and 44-2001; and for court and arbitration costs incurred herein plus accruing costs.

Respondents, Smith Barney, Inc. and Steven A. Scott, requested that the claims asserted against them be dismissed, an order that the NASD expunge any record of this arbitration proceeding from Steven A. Scott's U-4 form, and an award of their attorneys' fees and costs.

OTHER ISSUES CONSIDERED AND DECIDED

This case was initially filed in the Superior Court of Arizona, Maricopa County. Pursuant to *Hospelhorn v. E. F. Hutton & Co., Inc.*, No. CV 95-10253 (Superior Ct. of Ariz. Maricopa County Nov. 17, 1995), said case was stayed and referred to the NASD for further proceedings as

appropriate pursuant to the Code of Arbitration Procedure.

Prior to the hearing in this matter, Smith Barney, Inc. and Steven A. Scott moved to dismiss the Statement of Claim. A pre-hearing conference was held on October 2, 1996 to address the motion. The panel denied Respondents' motion, which was communicated to the parties by letter from the Chairman dated October 2, 1996.

A pre-hearing conference was held on February 3, 1997 to address certain discovery issues.

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 original(s) 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 undersigned arbitrators have decided in full and final resolution of the issues submitted for determination as follows:

1. Respondent Steven A. Scott is liable for and shall pay to the Claimants Raymond Hospelhorn and Margaret Hospelhorn, together, the sum of Twenty-Two Thousand Four Hundred Dollars (\$22,400); plus simple interest of 10% per annum, from the date on which this award is delivered to Respondent Scott until it is paid in full, as satisfaction of any and all claims made against Respondent Scott.
2. Respondent E.F. Hutton & Co., Inc./Smith Barney, Inc. (now Smith Barney Shearson, Inc.) is liable for and shall pay to the Claimants Raymond Hospelhorn and Margaret Hospelhorn, together, the sum of One Hundred Forty-Six Thousand Eight Hundred Thirty-One Dollars (\$146,831); plus simple interest of 10% per annum, from the date on which this award is delivered to Respondent Smith Barney Shearson, Inc., until it is paid in full, as satisfaction of any and all claims made against Respondent Smith Barney Shearson, Inc.
3. Respondent Smith Barney Shearson, Inc. shall further pay to the Claimants Raymond Hospelhorn and Margaret Hospelhorn, together, the sum of One Thousand (\$1,000) Dollars as an award of Claimants' filing costs for this arbitration.
4. All other claims and requests for relief not specifically awarded here are, and each of them, hereby denied with prejudice.

FORUM FEES

Forum fees are calculated at the rate of \$1,000 per hearing session and \$300 for each pre-hearing conference, if any. There were two (2) pre-hearing conferences x \$300 and there were 10 hearing sessions x \$1,000 = \$10,600 in forum fees. Pursuant to § 10332(b) of the NASD Code of Arbitration Procedure (the "Code") 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 § 10332(c) of the Code, the NASD Regulation, Inc. Office of Dispute Resolution shall **retain** the non-refundable filing fee in the amount of \$250 and shall **retain** as forum fees the hearing session deposit in the amount of \$750 previously deposited with the NASD Regulation, Inc. Office of Dispute Resolution by Claimants.

Pursuant to § 10333 of the Code, the NASD Regulation, Inc. Office of Dispute Resolution shall **retain** \$500 of the \$750 previously deposited with the NASD Regulation, Inc. Office of Dispute Resolution by Smith Barney, Inc. for the non-refundable member surcharge.

Additional forum fees in the amount of \$9,600 (\$10,600-\$750-\$250 overpayment of member surcharge) are assessed by the arbitrators against Respondent Smith Barney Shearson, Inc.

Fees are payable to the NASD Regulation, Inc. Office of Dispute Resolution.

Concurring Arbitrators' Signatures

Michael E. Duckworth
Michael E. Duckworth
Chairperson
Public Arbitrator

/s/

July 22, 1997
Dated:

Sara Jo Dew
Sara Jo Dew
Panelist
Public Arbitrator

/s/

July 22, 1997
Dated:

Seymour L. Lubliner
Seymour L. Lubliner
Panelist
Industry Arbitrator

/s/

July 22, 1997
Dated: