

AWARD

NASD Regulation, Inc. Office of Dispute Resolution

In the Matter of Arbitration Between

Mount Vernon Mortgage Co., through and by its general
partner Mount Vernon Sales & Mortgage Corp.,
Eugene Glick and Marilyn Glick, and
EBG Insurance Agency, Corp.,

Claimants,

and

No. 96-00868

Bear, Stearns & Co., Inc. and Douglas Sharon,

Respondents.

REPRESENTATION OF PARTIES

Claimants, Mount Vernon Mortgage Company, through and by its general partner Mount Vernon Sales & Mortgage Corporation, Eugene Glick and Marilyn Glick, and EBG Insurance Agency, Corporation, (hereinafter collectively referred to as "Claimants") were represented by Steven N. Fuller, Esquire, and Deborah L. Thaxter, P.C., of Peabody & Brown, located in Boston, Massachusetts, and Mark E. Maddox, Esquire of Maddox Koeller Hargett & Caruso, located in Indianapolis, Indiana.

Respondents, Bear, Stearns & Co., Inc. and Douglas Sharon ("Mr. Sharon") (hereinafter collectively referred to as "Respondents"), were represented by Michael J. Dell, Esquire of Kramer, Levin, Naftalis, Nessen, Kamin & Frankel, located in New York, New York.

CASE INFORMATION

Claimants' Statement of Claim was filed on or about February 26, 1996.

The Submission Agreement of Mount Vernon Mortgage Company, through and by its general partner Mount Vernon Sales & Mortgage Corporation, was signed on February 15, 1996 by Eugene B. Glick, President, Mount Vernon Sales & Mortgage Corp., G.P. Mount Vernon Mortgage Company.

Eugene Glick and Marilyn Glick's Submission Agreement was signed on February 15, 1996.

EBG Insurance Agency, Corporation's Submission Agreement was signed on February 15, 1996 by Eugene B. Glick, its President.

Respondents' Joint Statement of Answer was filed on or about April 24, 1996.

Bear, Stearns & Company, Incorporated's Submission Agreement was signed on May 8, 1997 by Mark E. Lehman, its Senior Managing Director.

Douglas Sharon's Submission Agreement was signed on May 22, 1997.

HEARING INFORMATION

A Large and Complex Administrative Conference was held on July 2, 1996 for one (1) session.

Pre-hearing conferences were held on: May 5, 1997 for one (1) session; June 30, 1997 for one (1) session; and September 18, 1997 for one (1) session.

The hearing was held on: July 21, 1997 for two (2) sessions; July 22, 1997 for two (2) sessions; July 23, 1997 for two (2) sessions; July 24, 1997 for three (3) sessions; July 29, 1997 for two (2) sessions; July 30, 1997 for two (2) sessions; July 31, 1997 for two (2) sessions; August 1, 1997 for two (2) sessions; October 13, 1997; October 14, 1997; and October 15, 1997.

The hearing was held in Indianapolis, Indiana.

CASE SUMMARY

Claimants brought this action against Respondents seeking damages allegedly arising out of Respondents' misrepresentations and omissions of material facts in connection with Respondents' January 17, 1992 sale of a real estate mortgage backed planned amortization class ("PAC") collateralized mortgage obligation ("CMO") derivative described as FNMA 1991-160 PT IO (the "Interest Strip"), contained in a \$1.6 billion Fannie Mae real estate mortgage investment conduit (the "Investment") to Mount Vernon Mortgage Company ("Mount Vernon"). Claimants alleged that Respondents' made materially false and misleading statements and omissions about the Investment's (1) safety, (2) sensitivity to early repayment of underlying mortgages, (3) liquidity in an environment of declining interest rates and increasingly faster mortgage prepayment speeds, (4) risk being limited to its rate of annual yield, and its (5) suitability as a short-term vehicle to safely earn income at rates above Mount Vernon's cost of borrowed funds. Claimants asserted that Respondents' wrongdoing included Mr. Sharon's best and worst case yield and price predictions about the Investment that were without factual support. Claimants also stated that Mr. Sharon's price predictions materially misrepresented the safety and suitability of the Interest Strip as an investment for a federally regulated

mortgage company. Moreover, Claimants added, Respondents systematically and continually engaged in a fraud over the course of approximately three years during which they reported monthly to Claimants' representative, Mr. Thomas Grande ("Mr. Grande"), current market values and yields for the Interest Strip that were false and misleading. Claimants' reasoned that Mr. Sharon computed this false and misleading data using PSA speeds he knew, or was reckless in not knowing, were not adjusted to reflect the Interest Strip's sensitivity to early mortgage prepayments. According to Claimants, they relied on Respondents' numerous assurances, including price quotations for the Investment's current market value and its yields to maturity that were false and misleading. Claimants stated that, as a result, they held the investment instead of selling it at a much smaller loss than that which it ultimately incurred.

Claimants asserted the following causes of action: (1) intentional misrepresentations; (2) negligent misrepresentation; (3) fraud and constructive fraud; (4) violations of the anti-fraud provisions of the federal securities laws, 15 U.S.C. § 78j(b); (5) violations of the anti-fraud provisions of the Indiana securities laws, I.C. 23-2-1-12, et seq.; (6) failure to supervise under federal and state securities laws; (7) sale of unregistered securities, and rescission; (8) violations of M.G.L. c. 93A; (9) breach of contract; (10) breach of implied covenant of good faith and fair dealing; and (11) breach of fiduciary duty.

Respondents denied the allegations set forth in the Statement of Claim as they relate to any wrongdoing on their part. Respondents stated that the risks of the investment were fully disclosed, the investors could have sold without a significant loss at any time within five months after the date of purchase, and the investors incurred a loss only because of an unprecedented change in the market. According to Respondents, after the value of the Claimants' Investment began to decline, the investors refused to follow their brokers' advice to cap their losses by hedging or selling the Investment. Respondents stated that the PAC investment was an interest only CMO with the risk protection features of a planned amortization class. Respondents added that the consensus among sophisticated investors and analysts on January 17, 1992 did not consider the PAC Investment to be highly speculative. However, Respondents contended, Mr. Grande knew that the then expected yield on the investment of approximately 7.8% was substantially above general market levels for alternate investments, and that this extra possible yield entailed additional risk. Respondents noted that Claimants did not request a low-risk investment at the time they made the investment at issue. Respondents asserted that the potential risks of the Investment, including the possibility that virtually all of it could be lost if mortgage prepayment rates rose steeply, which could happen if interest rates fell steeply, were fully disclosed to Mr. Grande prior to Mount Vernon's purchase and were repeatedly disclosed thereafter during the five-month period in which Mount Vernon could have cancelled or sold the Investment without incurring a substantial loss. These risks were ultimately realized only because interest rates fell to thirty-year lows and mortgage prepayment rates increased to historically unprecedented levels, according to Respondents. Respondents also asserted various affirmative defenses.

RELIEF REQUESTED

Claimants requested an award for: compensatory damages of \$5,976,772.68, plus interest costs and expenses; double or treble compensatory damages, together with interest, costs and attorney fees under Claimants' eighth cause of action; interest at 8%, costs and attorneys fees under Claimants' fifth and sixth causes of action, pursuant to Indiana law codified at I.C. 23-2-1-19; rescission of Mount Vernon's purchase of the Interest Strip; and punitive damages and exemplary damages.

Respondents requested that the claims asserted against them be dismissed and that they be awarded their costs of this arbitration.

OTHER ISSUES CONSIDERED AND DECIDED

Claimants moved to preclude Bear Stearns from using various software with operating instructions and certain modeling information. After considering this motion and all responses thereto, the undersigned panel of arbitrators ordered that the software operating instructions were to be supplied, if they were still available. Claimants moved for copies of Bear Sterns fixed income "blotter." After considering this motion and all responses thereto, the undersigned panel of arbitrators denied this motion.

Respondents moved to preclude Claimants' use of price PSA, OAS and other analytical material, and dynamic simulation material to be presented for Claimants' failure to furnish copies to Respondents, twenty (20) days prior to the hearing date. After considering this motion and all responses thereto, the undersigned panel of arbitrators denied this motion.

Respondents moved to dismiss the Statement of Claim. After considering this motion and all timely responses thereto at the commencement of the hearing in this matter, the panel of arbitrators decided to rule on this motion at the end of the hearing; the panel then denied Respondents' motion.

Respondents moved to compel by subpoena or otherwise the relevant files of Claimants' outside investment advisors and consultants, although not expert witnesses. After considering this motion and all responses thereto, the undersigned panel of arbitrators denied this motion.

Respondents moved to have all documents to be declared confidential. After considering this motion and all responses thereto, the undersigned panel of arbitrators decided that only those documents marked "confidential" will remain confidential. The panel also ruled that documents produced to the experts would also be deemed confidential.

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

1. That Respondent Bear Stearns & Co. and Douglas Sharon are jointly and severally liable for and shall pay to Claimants, Mount Vernon Mortgage Company, through and by its general partner Mount Vernon Sales & Mortgage Corporation, Eugene Glick and Marilyn Glick, and EBG Insurance Agency, Corporation the sum of \$2,179,774.21 in actual damages;
2. That Respondents Bear Stearns & Co. and Douglas Sharon are jointly and severally liable for and shall pay to Claimants, Mount Vernon Mortgage Company, through and by its general partner Mount Vernon Sales & Mortgage Corporation, Eugene Glick and Marilyn Glick, and EBG Insurance Agency, Corporation the sum of \$507,354.86 in attorneys' fees, costs and expenses, pursuant to the Indiana Statute, "Blue Sky Law" §23-2-2-19;
3. Other than forum fees, which are addressed below, 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 \$1,500 per hearing session and \$300 for each pre-hearing conference, if any. There were three (3) pre-hearing conferences x \$300 and there were Seventeen (17) hearing sessions x \$1,500 = \$26,400 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 of \$300 and shall retain as forum fees the hearing session deposit of \$1,500 previously deposited with the NASD Regulation, Inc. Office of Dispute Resolution by Mount Vernon Mortgage Company. Claimants, Mount Vernon Mortgage Company, through and by its general partner Mount Vernon Sales & Mortgage Corporation, Eugene Glick and Marilyn Glick, and EBG Insurance Agency, Corporation, are liable for and shall pay to the NASD Regulation, Inc. Office of Dispute Resolution the sum of \$11,700.00 (\$26,400 in forum fees divided evenly between Claimants and Respondents for \$13,200.00, minus the \$1,500.00 previously deposited by Claimants.) Respondents, Bear Stearns & Co. and Douglas Sharon are jointly and severally liable for and shall pay to NASD Regulation, Inc. Office of Dispute Resolution the sum of \$13,200.00 in forum fees (half of the \$26,400 total forum fees required.)

Pursuant to § 10333 of the Code, the NASD Regulation, Inc. Office of Dispute Resolution shall retain the non-refundable member surcharge of \$500 previously deposited with the NASD Regulation, Inc. Office of Dispute Resolution by Bear Stearns & Company, Incorporated.

The NASD Regulation, Inc. Office of Dispute Resolution shall retain postponement fees of \$1,500 previously deposited with the NASD Regulation, Inc. Office of Dispute Resolution by Bear Stearns & Company, Incorporated.

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

Concurring Arbitrators' Signatures

/s/ Charles E. Jones

November 14, 1997

Honorable Charles E. Jones, Esquire
Chairperson
Public Arbitrator

Dated:

/s/ Stanley G. Rives

November 14, 1997

Stanley G. Rives, PhD
Panelist
Public Arbitrator

Dated:

/s/ Richard E. Neal

November 14, 1997

Richard E. Neal
Panelist
Industry Arbitrator

Dated: