

NATIONAL ASSOCIATION OF SECURITIES DEALERS REGULATION, INC.

Hearing Location: Omni Hotel
Richmond, Virginia

CASE SUMMARY

Claimant alleged claims against Respondent based on negligence, breach of fiduciary duty, breach of contract, and breach of professional standards. Claimant alleged each of her claims to be governed, to one extent or another, by state law. Claimant did not claim Respondent violated any Federal statute. Claimant alleged Respondent violated New York Stock Exchange ("NYSE") Rule 405, the know-your-customer for each trade rule, along with violating Respondent's own compliance manuals containing similar language in relevant portion. Additionally, Claimant contends Respondent had constructive knowledge of her being a "changed-condition" customer for the "know-your-customer" rule. By illustration, Claimant maintained that she executed trades far exceeding the trading profile shared previously with Respondent via its application forms. Furthermore, Claimant asserted her pattern of substantial trading losses in a relatively short period of time should have constructively notified Respondent of customer problems. Likewise, Claimant asserted that withdrawing \$65,000 in approximately 5 months should have indicated to Respondent she was a customer with income needs, lacking a tolerance for risk. Claimant further asserted Respondent did not continually monitor her quickly diminishing accounts and their balances for trading appropriateness.

Respondent denied all allegations of wrong-doing as asserted in the Statement of Claim. Respondent maintained, as a discount broker, it owed no duty to determine the suitability of Claimant's securities transactions and further, owed no fiduciary duty to Claimant, either. Also, Respondent maintained that there was no private right of action for alleged violations of NYSE Rules and/or Respondent's internal guidelines. Respondent additionally contended it owed Claimant no duty to refuse to execute her transactions. Further, Respondent asserted Claimant could not sustain a negligence claim against Respondent, as she could not demonstrate Respondent violated any duty it owed to her. Alternatively, Respondent contended, Claimant was barred from recovering on any negligence claim(s) because she could not demonstrate or prove any alleged breach of Respondent's duty proximately caused her trading losses.

RELIEF REQUESTED

At the hearing, Claimant amended her claim for relief from \$296,874 to one for fair, reasonable, and equitable relief.

Respondent requested that Claimant's claims be dismissed in their entirety, and that litigation expenses, costs, attorneys' fees, and all filing and forum fees be assessed to Claimant.

OTHER ISSUES CONSIDERED & DECIDED

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.

At the hearing on June 24, 1997, Claimant's Counsel confirmed on the record the claims of Ms. Julia Given had been withdrawn and that she had been removed as a party by way of a letter to the NASD Regulation on October 14, 1996. In addition, Claimant's Counsel orally moved that Ms. Given be allowed to testify by telephone conference call and "out-of-order" procedurally; Respondent's Counsel did not object. The Panel noted the confirmation and granted this oral Motion, and the previously-issued Subpoena Duces Tecum on Ms. Given was correspondingly amended by notation of such at the hearing by the Chairperson.

Likewise, Claimant's Counsel orally moved to amend Claimant's Statement of Claim concerning the claim for relief; he moved to amend the request from \$296,874 to one for fair, reasonable, and equitable relief. Further, Claimant's Counsel moved to delete and withdraw from Claimant's Statement of Claim all claims related to Respondent's alleged improper action(s) in establishing and opening accounts for Claimant as its customer. Respondent's Counsel did not object to these amendments. The Panel granted these oral Motions.

Claimant's Counsel orally moved to invoke the rule concerning the presence of Respondent's Compliance Officer in addition to their corporation representative and also Respondent's Expert Witness. Respondent objected to Claimant's Motion. After hearing argument from, the Panel ruled Respondent's Compliance Officer was to be excluded from the hearing until she testified and was ordered that she not be informed of the testimony of any other witnesses prior to her own testimony. The Panel further ruled Respondent's expert witness could remain during the proceedings.

DISCUSSION AND RATIONALE

Claimant asserted that she is a Virginia resident, that she graduated from Sweet Briar College, and that she later received another degree from V.C.U. and successfully completed 3 of the 4 parts of the national CPA exam. Claimant maintained that she prepared her own tax returns for many years and that she was a successful businesswoman who had briefly worked for an accounting company. Claimant also stated she was knowledgeable concerning business and financial matters, and that she read a number of business journals and magazines and watched business programs on television.

Claimant testified that she had a history of chronic medical problems, resulting in hospitalizations. These conditions later re-manifested themselves during some of the relevant time-periods, the severity of such conditions again causing Claimant to be hospitalized. However, while Claimant was not alleging diminished capacity, she asserted that Respondent had constructive notice and should have known of her subsequent, medically-impaired business judgment. For example, Claimant contended that she experienced difficulties placing electronic telephone trades and in utilizing her PIN#, and that she often engaged in lengthy telephone conversations with Respondent's brokers, the content of a few such conversations referred to Claimant's sometimes bizarre or inappropriate statements. However, Claimant admitted that she did not, nor did anyone acting on her behalf, ever actually notify Respondent of Claimant's prior medical conditions, nor of their reoccurrence.

Claimant alleged that she was a beneficiary of a sizable "sprinkle trust" and she further asserted that for years, the trustee of such trust was NationsBank. Claimant stated that she borrowed from this trust and requested NationsBank make stock trades; in companies not on its "Buy List", in significant amounts especially in light of the size of the trust, and on at least one occasion, in a highly-speculative company which was in bankruptcy. Claimant desired aggressive investments in "growth" stocks specifically in the technology-sector. Effectuating stock trades via the trustee usually required additional time, documentation, and the like, as well as greater transactional costs than Claimant wished. Desiring lower fees, more expeditious execution of her investment directions, and in general, far greater autonomy and discretion over her financial matters, Claimant liquidated the trust, placed the assets solely in her name, and withdrew all the funds from NationsBank. She specifically sought a discount brokerage company and selected Respondent, as her brother had previously done. Claimant met Respondent's minimum equity and trading activity requirements.

Claimant admits Respondent adhered to its company rule, in that Respondent never recommended nor solicited stock transactions from Claimant. Further, Claimant conceded she did not seek investment advice from Respondent. Claimant similarly conceded she never saw any of Respondent's internal

guidelines. In initiating this business relationship with Respondent, at all times Claimant was knowledgeable none of her accounts were trust accounts. Similarly, it was demonstrated that these were all non-discretionary accounts and thus Claimant had complete control. When applying to Respondent for these accounts, on at least one application form, Claimant represented her occupation as "Investments" with an annual income over \$100,000 and substantial net worth. She indicated that her goal was "trading profits", and that she had an average margin debit balance of \$100,000 or 20-25% of her portfolio.

Respondent accepted Claimant as a customer, including approving her for margin trading at her discretion. Claimant neither sought, nor was assigned, a broker; rather, Claimant began making investment decisions, exercising her independent judgment and discretion. Initially, some of her trades were profitable; however, as time progressed, Claimant sustained substantial trading losses, resulting in margin calls and corresponding interest costs.

The Claimant maintained that many of her losses occurred during the time-period when Claimant suffered from re-occurring medical problems which affected and/or altered her business judgment. Most of such losses were due to short-term, high-volume trades, usually in very liquid companies where there were rather significant weekly, often daily, market-price movements. For example, Claimant often traded frequently in the same stock, such as Intel. Respondent was not a market-maker in the stocks Claimant independently selected. Further, often Claimant utilized Respondent's Touchtone system, buying or selling telephonically, thereby obtaining an additional 10% discount from Respondent's otherwise lowest-commission rate.

The parties stipulated that Respondent was considered to be the "Cadillac" of discount brokerages. Respondent offered lower transactional costs in a variety of ways; primarily charging lower commissions. Respondent's strict rule is that it will not make recommendations to, nor solicitations of, its customers; rather, it simply takes orders and executes them; then generating and transmitting order confirmations.

In response to Claimant's assertion of constructive notice, Respondent countered it had no duty to monitor Claimant's trading habits. Likewise, Respondent asserted, for security purposes, it would definitely prefer not to know a customer's PIN#, but rather, would hold such in its computer-memory storage. Similarly, Respondent contends it was under no obligation to determine the suitability of Claimant's selected transactions nor to ascertain if transactions were consistent with the financial objectives Claimant stated on Respondent's application forms. Furthermore, Respondent elicited testimony that, during much of the time period-in-question, even Claimant's immediate family with whom she had frequent personal contact did not know nor perceive the extent of her medical problems. For example, one of Claimant's daughters is a highly-trained businesswoman, married to an attorney, and during this time-period, prior to being rehospitalized, Claimant was allowed to solely supervise and baby-sit their younger children (her grandchildren). Further, such daughter testified she spoke with Claimant on the telephone two or three times a week and, in essence, her mother appeared competent to handle her own affairs until approximately August, 1995.

AWARD

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

1. That Claimant's Statement of Claim with Exhibits and all other claims and causes of action are denied in their entirety.
2. That each party is to bear its own costs and expenses, including attorney's fees, with the exception of forum fees as specified below.
3. That any and all relief not specifically addressed herein, is denied.

OTHER COSTS

Pursuant to Rule 10333 Respondent Fidelity Brokerage Services, Inc. is assessed a member surcharge of \$350.00.

FORUM FEES

Pursuant to Rule 10332(c) of the Code, the following Forum Fees are assessed:

6 Sessions x \$750.00 = \$4,500.00

Forum Fees are assessed against Claimant. Claimant is to receive credit for the \$750.00 hearing session deposit previously submitted to the NASD Regulation, leaving a net-assessment due of \$3,750.00.

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

DATE

CONCURRING ARBITRATORS' SIGNATURES

9-11-97

Kitty G. Grubb
Kitty G. Grubb, Presiding
Public Arbitrator

James F. Tucker
Public Arbitrator

John M. Mathews
Industry Arbitrator

Date Decision Served by NASD Regulation:

September 24, 1997

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