

NASD REGULATION AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS REGULATION

In the Matter of the Arbitration Between

Name of Claimants

Alan Bernstein
Sparkle Car Wash, Inc.

Case No.
96-01569

Name of Respondents

Lee B. Spahn
Chesapeake Securities Research Corp.

REPRESENTATION

Claimants Sparkle Car Wash, Inc. ("Sparkle Car Wash") and Alan Bernstein ("Bernstein") were represented by Paul N. Sameth and Jeffrey M. Orenstein of Adelberg, Rudow, Dorf, Hendler & Sameth, LLC, Baltimore, MD.

Respondents Chesapeake Securities Research Corporation ("Chesapeake") and Lee B. Spahn ("Spahn") were represented by Thomas Taylor, President of Chesapeake, Towson, MD.

CASE INFORMATION

Claimants Sparkle Car Wash and Bernsteins' (collectively "Claimants") Statement of Claim was filed on April 11, 1996.

Sparkle Car Wash's Uniform Submission Agreement was signed on March 26, 1996.

Bernstein's Uniform Submission Agreement was signed on March 26, 1996.

Respondents Chesapeake and Spahn's (collectively referred to as "Respondents") Joint Statement of Answer was filed on June 10, 1996.

Chesapeake's Submission Agreement was signed on June 6, 1996.

Spahn's Submission Agreement was signed on July 22, 1996.

HEARING INFORMATION

Pre Hearing Conference: January 22, 1997- 1 session

Hearing Dates/Sessions: February 18, 1997 - 2 sessions

February 19, 1997 - 2 sessions
February 20, 1997 - 1 session
March 4, 1997 - 2 sessions
March 5, 1997/2 sessions

Hearing Location: Tremont Plaza - Baltimore, Maryland

CASE SUMMARY

Claimants alleged, among other things, that Respondents churned Claimants' accounts, made unsuitable investments in Claimants' accounts, engaged in unauthorized trading in Claimants' accounts, breached their fiduciary duty to Claimants. Claimants also alleged that Chesapeake failed to supervise the activities of Spahn.

Claimants further alleged the following:

Prior to 1990, Claimants maintained a money market account at Maryland National Bank. The account was made up of proceeds from the car wash and were being held in reserve for capital repairs and improvements. Such funds were necessary to ensure continued operation of the car wash and, as a result, the funds had never been used for speculative purposes. Prior to 1993, some of the funds were invested in shares of Baltimore Gas & Electric Company and Nuvene NIO. These investments, while not returning maximum yields, satisfied Claimants objectives of consistent growth and minimum risk. In early 1993, Bernstein was referred to Spahn, a registered representative with Chesapeake. Bernstein was advised that Spahn could help Claimants increase their return. Because of their investment objectives, Claimants were hesitant to pursue new investment options; however, after a period of time, they determined they would invest a minimal amount of money with Spahn. Spahn had Claimants execute Customer Agreements and prepared a Report of New Account on Bear Stearns Securities Corp.'s form. Among other items, the Report of New Account disclosed the following information:

"INVESTMENT OBJECTIVE - Growth

Account will be trading- CASH X MARGIN COMMODITY

DOES AE HAVE TRADING AUTHORITY? YES NO X"

Despite the specific instructions provided on the Report of New Account, the trading activity of Claimants' accounts at Chesapeake indicates that the trades undertaken by Spahn were not made in conformance with the instruction or with Claimants' interests in mind. Spahn's activities were beyond the scope of his authorization from Claimants. By way of example only, Spahn ignored the instruction that the investments were to be growth investments. Rather, Spahn placed Claimants into highly speculative investments. Spahn further ignored the instruction the account was to trade in cash only. Rather, without authorization, Spahn regularly traded on margin. Further, Spahn made trades without

Claimants specific authorization. Such trades were also in direct conflict with the explicit instructions provided. Specifically, between August 1, 1993, and April 30, 1994, Respondents engaged in at least 37 separate commission generating transactions which generated commissions of approximately \$10,000 and service charges. Among the commissions generated were commissions on trades to reverse previous trades.

Respondents categorically denied all allegations of wrongdoing asserted by Claimants. Respondents maintained that Claimants authorized all complained of transactions and are sophisticated investors.

Respondents further maintained the following:

At the time the Sparkle Car Wash account was opened, Bernstein, the sole owner, was a 47 year old man with no dependents other than his wife. He has a B.S. degree and a J.D., but could not pass the bar exam due to a problem with cluster headaches. He had been involved in various aspects of the legal profession for a number of years and had managed several commercial businesses before acquiring Sparkle in the early 1980s. Sparkle was successful enough to allow him to buy out the underlying real estate, buy his own home, hire a full-time manager, and still accumulate surplus to the point that he was advised by his accountant in 1991 to start investing the surplus. Sparkle opened accounts at Merrill Lynch for conservative stock purchases and at Stratton Oakmont for speculative stock purchases.

In March 1993, when the account opened, Spahn had known Bernstein for approximately eight years because of his frequent visits to the car wash. Bernstein told Spahn that the bank had computed his net worth at \$800,000 in 1992 and in July 1993, signed a subscription agreement to a private placement of Top Source, Inc. that attested to this status as an accredited investors. Bernstein was unable to specify his objectives other than to say he was unhappy with his other two accounts and wanted to at least do as well as the market, which he defined as 10-12% per year.

The initial purpose of the account was simply to buy 100 shares of Chrysler (Bernstein's idea) and a small position in bonds. In June 1993, however, Bernstein transferred in approximately \$65,000 in securities from Merrill Lynch which were to be liquidated and reinvested. By the end of November, when this process was complete, the portfolio structure was 40% bonds, 50% growth and emerging growth stocks, and 10% cash.

When Bernstein wanted to become more aggressive, Spahn recommended to obtain the services of an investment advisor and sent him extensive materials on Evans Investment Advisors, an established Washington, D.C. RIA. Bernstein was impressed with the track record of this group, but did not want to lose direct control of his investments. It was decided to use some of the group's ideas to gradually increase the equity exposure of the account to approximately 100%, which took place in the spring of 1994. In July, Spahn ceased active responsibility for the account.

Respondents maintained that Spahn frequently spoke to Bernstein and that the trades were authorized. Respondents maintained that Bernstein did not want a buy and hold account, but that he had wanted Spahn to sell stocks that were not performing well and put the money in stocks that would. Respondents maintained that Spahn followed Claimants' investment objective and that they did not churn Claimants' accounts. Respondents maintained that Bernstein understood everything that went on in the account and was actively involved in the decision making. Respondents maintained that this precludes any finding that Spahn had become a de facto fiduciary.

Respondents specifically denied Claimants allegation that Respondents made unsuitable investments for Claimants. Bernstein had the education, experience and prior investment background necessary to be able to understand what level of commitment he could afford and to represent himself fully in his relationship with Spahn and Chesapeake. The accounts were balanced and represented less than 10% of Bernstein's net worth. Moreover, contemporaneous with several substantial withdrawals made from Claimants accounts, Bernstein was buying highly speculative securities at Stratton Oakmont, which he did not reveal to Spahn. All of the securities purchased in Claimants' accounts were under research coverage. Moreover, on two instances, Bernstein signed subscription agreements and in four instances received prospectuses that detailed at length the kinds of risks entailed in the type of security he was buying. Respondents maintained that Claimants' signed and opened a margin account. Respondents maintained that Claimants accounts were properly handled and supervised. Chesapeake maintained that it properly supervised Spahn

RELIEF REQUESTED

Claimants requested in their Statement of Claim \$77,997 exclusive of interest, as well as costs attributable to this arbitration and attorney's fees.

Respondents requested that the Statement of Claim be dismissed in its entirety.

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 original remains on file with the NASD Regulation.

The Panel considered Claimants' motion for sanctions for discovery delays and the Panel determined that Claimants' request should be denied.

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. Claimants' claims for damages are denied in their entirety.
2. Claimants motion for sanctions is denied.
3. The parties shall bear their own costs and attorney's fees, except as forum fees are addressed below.
4. Any and all claims not specifically addressed herein are denied.

FORUM FEES

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

$(9 \text{ hearing sessions} \times \$500.00) + (1 \text{ pre hearing conference} \times \$300) = \$4,800.00$

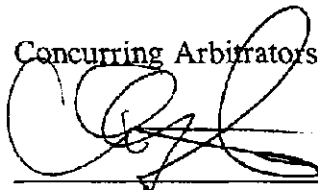
Forum Fees are assessed at \$2,400.00 to Claimants, jointly and severally and \$2,400.00 to Respondents, jointly and severally. Claimants are to receive credit for the \$500.00 hearing session deposit previously submitted to the NASD Regulation, leaving a net assessment due from Claimant of \$1,900.00. Respondents have an assessment due of \$2,400.00

Fees are payable to the NASD Regulation, Inc.

Date

April 8, 1997

Concurring Arbitrators' Signatures



Marvin Elster, Chairman
Public Arbitrator

Patrick Sean Dolan, Panelist
Public Arbitrator

M. Teri Ranieri, Panelist
Industry Arbitrator

Date Decision Served by NASD Regulation: April 15, 1997

Date

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4/10/97

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