

N.A.S.D. REGULATION AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS REGULATION, INC.

In the Matter of the Arbitration Between

Name of Claimant

Erbach Finance Corp.

96-04070

Name of Respondents

Bear Stearns & Company
Bear Stearns Securities Corp.

REPRESENTATION

For Claimant, Erbach Finance Corp. ("Claimant"), appeared, L. Douglas Shrader, Esq., located in Westport, Connecticut.

For Respondents, Bear Stearns & Company ("Bear Stearns") and Bear Stearns Securities Corp. ("BSS"), appeared, Arthur D. Felsenfeld, Esq., of the law firm Andrews & Kurth located in New York, New York.

CASE INFORMATION

Statement of Claim filed: September 12, 1996.

Claimant's Submission Agreement signed on: September 5, 1996.

Joint Statement of Answer filed by Bear Stearns and BSS (collectively "Respondents") on: November 25, 1996.

Respondent Submission Agreement signed on: November 26, 1996.

HEARING INFORMATION

Pre-Hearing Conference: March 12, 1997/one session
Telephonic Conference

Pre-Hearing Conference: April 8, 1997/two sessions

Pre-Hearing Location: NASD Regulation, Inc.
New York, New York.

OTHER INFORMATION

This was a dispute between a public customer and two member firms of the NASD.

Respondent made a motion to dismiss the proceedings pursuant to Rule 10305 of the NASD Code of Arbitration Procedure on the grounds that Respondent had not breached any duty, contractual or otherwise, which it owed to Claimant.

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.

ARBITRATORS' REPORT

On or about December 14, 1993, Claimant opened a prime brokerage account through Bear Stearns with its wholly-owned subsidiary, BSS. In connection with the opening of such account, Claimant executed and delivered to Respondents the following documents:

1. A trading authorization (the "Trading Authorization") which, among other things, authorized Clariden Asset Management, Inc., an investment advisor registered under the Investment Advisor Act of 1940 ("Agent"), as the agent and attorney-in-fact of Claimant, to buy and sell securities and enter into various other types of securities transactions on behalf of Claimant, including transactions in foreign securities on margin. In connection therewith, Claimant expressly authorized Bear Stearns:

"... to follow the instructions of the Agent in every respect concerning the undersigned's account(s) [and]... to act for the undersigned and in the undersigned's behalf, in the same manner and with the same force and effect as the undersigned, with respect to such purchases, sales or transactions in the account(s)."

(Emphasis added.)

2. An acknowledgement in which Claimant confirmed that (a) by executing the Trading Authorization, Respondent shall have no responsibility for any losses suffered by Claimant by reason of the actions of Agent, (b) Respondents do not, "by implication or otherwise, endorse the operating methods of [Agent]", (c) Agent is not subject to the jurisdiction of any securities exchange, and (d) by giving Agent authority to exercise Claimant's right over its account, Claimant is acting at its own risk.
3. An authorization ("Confirmation Authorization") that all daily Activity Reports ("confirmations") with respect to the account being managed by Agent shall be sent only to the Agent and not to Claimant, including an acknowledgement by Claimant that:

"We understand that the elimination of our copy of the daily Activity Report will limit our ability to discover and limit errors or supervise the management of our account and that we will therefore look only to our Manager [Agent] with regard to the conduct of our account."

(Emphasis added.)

Prior to opening its account with Respondents, Claimant entered into an Investment Management Agreement with Agent (see "Investment Management Agreement") authorizing Agent to manage Claimant's account on a discretionary basis, which Investment Management Agreement expressly authorized Agent, in connection with managing Claimant's account, to actively purchase and sell securities in the world equity markets and to aggregate in "omnibus" accounts the purchases and sales of securities which Agent makes for Claimant's account with the purchases and sales of the same securities which it may be buying and selling on the same day for other clients of Agent. The Investment Management Agreement also provided that Agent would "not be responsible for the acts, omissions or solvency of any broker or agent it selects in good faith to effect any transaction for the [Claimant's] Accounts."

Claimant originally commenced this arbitration proceeding against Agent as well as Respondents, and Claimant alleged in its Statement of Claim that it invested approximately \$2.4 million in its margin account with Respondents in reliance on promises by the Agent that Claimant would realize a "considerable gain" over the ensuing year, consistent with the over 60% annual profits which Agent had produced for its other clients over the preceding three years. Claimant also alleged that the Agent authorized trading in Claimant's account which was inconsistent with the investment objectives of Claimant and that, instead of realizing gains over the ensuing year, Claimant realized losses aggregating approximately \$800,000.00.

Since Agent is not a member of any securities exchange and had not otherwise agreed to submit disputes with Claimant to arbitration, Agent was dismissed as a party to this arbitration proceeding (and Claimant has instead asserted its claims against Agent in a separate judicial proceeding). It is undisputed that Agent, a member of C.S. Holdings Group, is neither controlled by nor affiliated with Respondents.

THE SUBSTANCE OF THE CLAIMS AGAINST RESPONDENTS

The essence of Claimant's claim against Respondents is that any one or more of the following acts or omissions by Respondents constituted a breach of a duty which Respondents owed to Claimant and that such breaches of duty were the proximate cause of the losses which Claimant suffered in its account:

1. Respondents failed to assign a registered representative to oversee Claimant's account despite a statement contained in the "Truth-in-Lending" Statement delivered by Respondents to Claimant that the account would be serviced by one of Respondents' account executives who would, among other things, be responsible for providing investment advice to Claimant and executing transactions in Claimant's account.
2. Respondents honored requests by the Agent to transfer funds from Claimant's Account into an omnibus foreign bank account maintained by Agent both for the benefit of Claimant as well as Agent's other clients based on Agent's representation that such funds would be used for the purchase of certain foreign securities for Claimant's account.
3. Respondents permitted foreign broker-dealers rather than Respondents to be the custodian of the foreign securities purchased for Claimant's account with such funds of Claimant which were transferred into Agent's omnibus bank account.

Claimant has conceded that it has no basis to claim that any of the funds transferred from Claimant's brokerage account into Agent's omnibus bank account were used for any purpose other than the purchase of securities for Claimant's account or, when such securities were sold by Agent on Claimant's behalf, that any of the proceeds thereof went anywhere other than back into Claimant's account.

THE MOTION TO DISMISS

Respondents have moved to dismiss Claimant's claims against them on the ground that it has not breached any duty, contractual or otherwise, which it owed to Claimant with respect to its conduct relating to Claimant's account. In considering this motion, the panel has assumed that all facts alleged or claimed by Claimant are true. Based on such facts, we have concluded as follows:

1. Respondents did not breach any duty, contractual or otherwise, by following the instructions of Agent to transfer funds from Claimant's account into omnibus account maintained by Agent for the benefit of Claimant and Agent's other clients, particularly in view of the fact that the Investment Management Agreement expressly authorized Agent to utilize such omnibus accounts in connection with the purchase of foreign securities for Claimant's account.
2. Respondents were not required to assign a registered representative (as opposed to a clerical person) to oversee Claimant's account in view of the fact that such account was being actively managed by Agent on a discretionary basis pursuant to the Trading Authorization and that Claimant expressly agreed in the Confirmation Authorization that it would look only to Agent with regard to the conduct of its account.
3. Respondents were under no duty to refrain from permitting foreign broker dealers from being the custodian of foreign securities purchased for Claimant's accounts upon instructions to do so by Agent.
4. Respondents are not liable for any of the losses which Claimant suffered by reason of the actions of Agent in managing Claimant's account with Respondents.

RESPONDENTS' COUNTERCLAIM

Respondents claim that they are entitled to reimbursement of costs and expenses, including legal fees, in this proceeding on either of the following theories:

1. Claimant expressly agreed (a) in the Trading Authorization and (b) in the confirmation Authorization that Claimant would indemnify and hold Respondents harmless against any loss, liability, damage or expense, including (but not limited to) legal expenses, (a) incurred in connection with the use of the Trading Authorization and (b) arising from or in connection with any action, proceeding, regulatory or self-regulatory organization inquiry.
2. Respondents are entitled to an award of attorneys' fees (a) under New York law (22 NYCRR 13-1.1) and Federal law (Fed. R. Civ. P. 11) and/or (b) because Claimant made a demand for attorneys' fee in its Statement of Claim (citing, *inter alia* CS First Boston Corp. v. Schuman, N.Y.L.J., Feb. 10, 1997, p. 28, col.5 (Sup. Ct. New York County)).

With respect of this counterclaim, the panel finds as follows:

1. The indemnities referred to above do not cover claims by the Claimant against the Respondents based on alleged misconduct by the Respondents (as opposed to the alleged misconduct of the Agent), and none of the documents executed by Claimant contained an agreement to indemnify Respondents for attorneys' fees incurred by Respondents in claims asserted by Claimant (as opposed to claims asserted by a third party) against Respondents based on Respondents' own alleged wrongdoing. (See Donaldson, Lufkin & Jenrette Securities Corp. v. Terra Nitrogen Co., N.Y.L.J., April 10, 1997, p. 27, Col. 6).
2. NYCRR 130.1-1 and Fed. R. Civ. P. 11 are not applicable here since we find that the claims asserted against Respondents in this proceeding, although meritless, did not reach the level of being "frivolous" within the meaning of such provisions.
3. Attorneys' fees are not available to the prevailing party under New York law in the absence of an agreement or a statutory provision authorizing such fees. CS First Boston Corp v. Schuman, supra, cited by Respondents, merely held that an arbitration award granting attorneys' fees to a respondent based on a request for attorneys' fees made by the claimant in its statement of claim is not "wholly irrational" and thus not a ground to vacate the arbitration award granting attorneys' fees to the respondent in such case. It did not hold that applicable law requires the award of attorneys' fees to a prevailing respondent merely because the losing claimant requested attorneys' fees in its statement of claim.

RELIEF REQUESTED

Claimant requested compensatory damages of \$808,054.80, rescission of the purchases of restricted securities; punitive damages; interest; costs and reasonable attorneys' fees.

Respondents requested that the claims be dismissed and that the costs of this arbitration, including attorneys' fees be assessed to Claimant.

DETERMINATIONS

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. That Respondents' Motion to Dismiss is granted on the basis of applicable law and the absence of any triable issue of fact.
2. That Respondents' counterclaim for costs and attorneys' fees is denied for the reasons set forth above.
3. That any and all relief not specifically addressed herein is denied.

FORUM FEES

Pursuant to Rule 10332 of the Code of Arbitration Procedure, the arbitrators have determined that NASD Regulation, Inc. shall retain the \$250.00 non-refundable filing fee previously deposited by the Claimant and have assessed the following forum fees:

1 Telephonic Pre-Hearing Sessions x \$ 300.00 = \$ 300.00
2 In-Person Pre-Hearing Sessions x \$1,000.00 = \$2,000.00

Total Forum Fees \$2,300.00

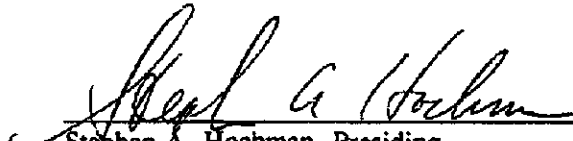
Claimant, Erbach Finance Corp., be and hereby is assessed the Forum Fees of \$2,300.00. Claimant shall receive credit for the hearing session deposit previously submitted to NASD Regulation, Inc. of \$1,000.00. Therefore, Claimant has a net assessment due of \$1,300.00.

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

DATE

July 3, 1997

CONCURRING ARBITRATORS' SIGNATURES



Stephen A. Hochman, Presiding
Public Arbitrator

John A. DeStefano
Public Arbitrator

Carolyn Condo
Industry Arbitrator

Date Decision Served by NASD Regulation:

July 16, 1997

FORUM FEES

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DATE

CONCURRING ARBITRATORS' SIGNATURES

June 20, 1997

Stephen A. Hochman, Presiding
Public Arbitrator

John A. DeStefano
Public Arbitrator

Carolyn Condo
Industry Arbitrator

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July 16, 1997

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CONCURRING ARBITRATORS' SIGNATURES

Stephen A. Hochman, Presiding
Public Arbitrator

John A. DeStefano
Public Arbitrator

7-3-97

Carolyn Condo
Carolyn Condo
Industry Arbitrator

Date Decision Served by NASD Regulation:

July 16, 1997