

NASD REGULATION AWARD

In the Matter of the Arbitration Between

Name of Claimant

Estate of Howard G. Brown

96-04559

Name of Respondents

A.G. Edwards & Sons, Inc.  
John F. Golden

**REPRESENTATION**

For claimant Estate of Howard G. Brown ("claimant") appeared John R. Blake, Esq. of the law offices Bowditch & Dewey located in Worcester, Massachusetts. Estate of H  
offices Bowditch & Dew

For respondents A.G. Edwards & Sons, Inc. ("A.G. Edwards") and John F. Golden ("Golden") A.G. Ed  
Golden  
(collectively "respondents") appeared William S. Port, Esq., Associate Vice President and  
Litigation Counsel for A.G. Edwards. respondent  
Litigation Counsel for A

**CASE INFORMATION**

Statement of Claim was filed on: October 11, 1996.

Claimant's Submission Agreement was signed on: October 10, 1996.

A Joint Statement of Answer was filed by respondents on: December 3, 1996.

A.G. Edwards' Submission Agreement was signed on: December 3, 1996.

Golden's Submission Agreement was signed on: November 15, 1996.

**HEARING INFORMATION**

Hearing Dates/Sessions:	June 11, 1997	-	2 sessions
	August 13, 1997	-	2 sessions

The hearings held on June 11, 1997 were conducted at the offices of NASD Regulation, Inc. located in Boston, Massachusetts. The hearings held on August 13, 1997 were conducted at the offices of the American Arbitration Association located in Boston, Massachusetts.

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### CASE SUMMARY

In its Statement of Claim, Claimant sought damages for losses sustained from a pattern of unsuitable, high-risk investments, excessive trading, and reckless mismanagement by Respondents for the six months of 1994 preceding the death of Howard G. Brown on July 14, 1994, with respect to the accounts of Mr. Brown and A. B. Spencer Company, a company owned by Mr. Brown. During the hearing, Claimant extended the time during which it claimed wrongdoing occurred and for which it claimed damages to periods prior to 1994. Claimant alleged that Respondents ignored the conservative investment purposes of the accounts, which were primarily to generate income and some growth and engaged in a fraudulent scheme of excessive trading activity involving call option transactions and investments in speculative stocks. Claimant alleged that Respondents had fiduciary obligations to Mr. Brown and A. B. Spencer Company, and breached those obligations by engaging in fraudulent transactions and mismanaging the accounts by virtue of the above-recited activities, which ignored the interests of Mr. Brown and A. B. Spencer Company, for the purposes of generating commission income. Claimant also alleged that after Mr. Brown suffered a stroke in 1993, his wife, his son and his daughter managed Mr. Brown's affairs, were unsophisticated investors, relied on Respondents to carry out the investment objectives of Mr. Brown and A. B. Spencer Company. Claimants further alleged that all transactions in both accounts were made by the sole decision of Respondent Golden and either exercised discretionary power over the account by authority of Golden and Mr. Brown or de facto discretionary power and control over the account without any order or authorization from the Browns.

In their Statement of Answer, Respondents denied each and every allegation contained in the Statement of Claim. Specifically, Respondents denied that Mr. Brown's wife and children were unsophisticated investors. Respondents also denied that the transactions between January 1994 and July 1994 were unauthorized or unsuitable transactions. Respondents stated that there was no substantial change in trading patterns occurring during the last ten years of both accounts. Respondents also denied that there were any losses realized by Claimant as a result of the trading and that any decline in value in the months preceding Mr. Brown's death was the result of a market decline rather than any trades by Respondents. Respondents also stated that the accounts performed well and in accordance with the investment objectives for the accounts and that there were no risky options transactions in the accounts, but rather covered call writing, which is a simple and conservative strategy to increase cash flow in an account. Finally, Respondent denied that the transactions during the first six months of 1994 were engaged in solely for the purpose of generating commissions. In addition, Respondents raised affirmative defenses of ratification, equitable defenses, failure to mitigate damages, contribution to the cause of any damages, assumption of risk, failure to state a claim upon which relief can be granted and statutes of limitation.

### RELIEF REQUESTED

Claimant requested compensatory damages of \$123,333.00, costs, legal fees, interest and punitive damages.

Respondents requested that Claimants' Statement of Claim be dismissed in its entirety and that Respondents be awarded their costs associated with the defense of this matter, including reasonable attorney's fees.

### OTHER ISSUES CONSIDERED & DECIDED

In response to a Motion for Order to Compel Production of Documents by Claimant, the chairman issued an Order of Production, on behalf of the panel, dated April 16, 1997 addressed to Respondents.

Prior to the hearing day of August 13, 1997, Respondents filed a Motion to Dismiss the claims against them, to which Claimant filed an Objection and Respondents in turn filed a Response to Claimant's Objection. After deliberation, the panel denied that motion.

The parties who appeared in this arbitration have agreed that the Award in this matter may be executed in counterpart copies and the parties have agreed to receive conformed copies of the Award while the originals remain on file with NASD Regulation, Inc.

### AWARD

The panel makes the following observations in order to explain key elements of the rationale behind the award:

The central claims of this case were allegations by Claimant of fraud, breach of fiduciary duty, unsuitable and excessive trading, mismanagement and churning by Respondents, as to the accounts of Howard G. Brown and A. B. Spencer Company, during a period of from six (6) months to a number of years prior to Mr. Brown's death in July of 1994, although the initial claim for damages was restricted to the period from January 1, 1994 to the date of Mr. Brown's death. Mr. Brown had a stroke in 1983 and thereafter Mildred Brown, his wife, and Susan Brown and Richard Brown, Mr. Brown's children, were the persons responsible, from the customer's standpoint, for all affairs with respect to the accounts. Respondent Golden was the account executive responsible for the accounts for Respondent A. G. Edwards & Sons, Inc. and the Browns and A. B. Spencer Company were his customers. Starting in 1989 and 1990, Respondents embarked on an options trading program for both accounts, selling covered calls to generate revenue in the accounts. There were meetings between Respondent Golden and Susan and Richard Brown around that time to discuss the proposed new options program, although the frequency of these meetings and the extent of the discussions was disputed by the parties. Mr. Golden called Mildred Brown periodically to report on the accounts generally, but the preponderance of the evidence, including the panel's assessment of the credibility of the testimony of Respondent Golden, Susan Brown and Richard Brown (Mildred Brown died prior to the arbitration), was that Respondent Golden did not get authorization for most, if not all, trades and, exercised discretion over the accounts (to the extent there were recommendations by Respondent Golden, they were all accepted). Moreover, Respondents did not have any written authorization for discretionary trading, as required under industry and firm standards.

Accordingly, Respondents had fiduciary obligations to Claimant.

Trading in the accounts, including covered call options, increased steadily from 1990 on, until the level of trading, both in a general sense and in options, was quite high during 1993 and until July, 1994, when Mr. Brown died. There were approximately 17 trades per month during that period and commissions were approximately 35% to 40% of revenue from sale of covered call options, interest and dividends.

Under all the foregoing circumstances, supervisory red flags should have been triggered for Respondent A. G. Edwards & Sons, Inc., but they were not. Although there was testimony that branch managers (at least one of whom also handled retail accounts) and/or persons with supervisory responsibility discussed the accounts periodically with Respondent Golden, there was inadequate supervision and contact with the Browns. For example, there were no activity letters during this period to be certain the Browns were alerted and understood and approved the nature and level of the activity, and the commissions being generated. In view of Mr. Golden's fiduciary obligations to the Browns, A. G. Edwards & Sons, Inc., should have been more cognizant of their supervisory duties.

At the same time, even assuming Mrs. Brown was completely unsophisticated in financial matters, Richard and Susan Brown initially were aware of the options program, received or saw statements and confirmations and were intelligent, educated, professional persons. Thus, the Browns bore some responsibility to inquire of Respondents if they did not understand or approve of the level and types of trades in the accounts. Thus, even assuming they did not knowingly ratify the early years of the options trading program and levels of activity, they are at leastly years of barred under equitable principles from holding Respondents financially responsible for much of this activity. However, Respondents must be held financially responsible, to some extent, because of increased activity in the accounts, lack of trading authority, de facto control, breach of fiduciary duty, and lack of supervisory attention for some of the later activity in 1993 and 1994.

Claimants failed to prove actual damages, for any of the periods of time claimed, flowing from breach of fiduciary duty by Respondents, in part because its claim rested, in part, on unrealized rather than realized losses.

Nevertheless, under all the circumstances, the panel believes it is appropriate that there be an award for a portion of the commissions earned by Respondents during the last several years prior to Mr. Brown's death. In sum, the panel has decided to award the sum of \$30,000.00 to Claimants.

After considering the pleadings, testimony, evidence and arguments presented at the hearing, and the submissions of the parties, the undersigned Arbitrator has decided in full and fair resolution of all the issues submitted for determination as follows:

1. Respondents be and hereby are jointly and severally liable to Claimant in the

amount of Thirty Thousand Dollars (\$30,000.00).

2. Respondents be and hereby are further jointly and severally liable to Claimant for interest at the rate of ten per cent (10%) per annum simple interest on the amount of this award if not paid within thirty (30) days of the date hereof, which interest shall commence 30 days from the date hereof on the award or any unpaid portion thereof.
3. All other claims of the parties, including costs, attorneys' fees and punitive damages are hereby denied.

### FORUM FEES

Pursuant to Rule 10332(c) of the Code of Arbitration Procedure, the arbitrators have determined that NASD Regulation, Inc. shall retain the \$200.00 non-refundable filing fee and the \$350.00 member surcharge and have assessed the following forum fees:

4 hearing sessions x \$750.00


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\$3,000.00

~~Claimant be and hereby is liable for the sum of \$1,500.00, representing one-half of the total amount of forum fees assessed. Claimant previously deposited with NASD Regulation, Inc. \$750.00 with NASD Regulation, Inc. and, therefore, shall pay the balance of \$750.00.~~  
~~Respondents be and hereby are jointly and severally liable for and shall pay the sum of \$1,500.00, representing one-half of the total amount of forum fees assessed.~~

Fees are payable to the NASD Regulation, Inc.

### Arbitrators' Signatures

  
David Plimpton, Esq.  
Chairperson-Public Arbitrator

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**Benjamin H. Rutstein, II**  
Industry Arbitrator

**Date of Decision:** October 7, 1997

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**Arbitrators' Signatures**

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**David Plimpton, Esq.**  
**Chairperson-Public Arbitrator**

 9/29/97

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**Albert G. Besser, Esq.**  
**Public Arbitrator**

Public Arbitrator

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**Benjamin H. Rutstein, II**  
**Industry Arbitrator**

**Date of Decision:** October 7, 1997

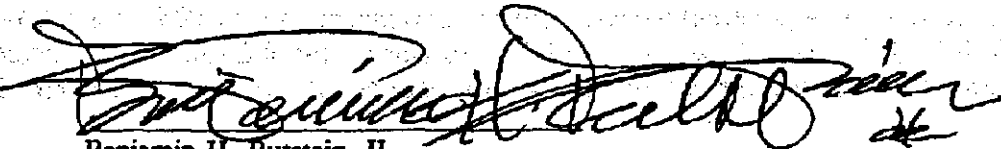
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\_\_\_\_\_  
David Plimpton, Esq.  
Chairperson-Public Arbitrator

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Albert G. Besser, Esq.  
Public Arbitrator

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Albert G. Besser, Esq.  
Public Arbitrator

  
Benjamin H. Rutstein, II  
Industry Arbitrator

BENJAMIN H. RUTSTEIN, II

Date of Decision: October 7, 1997