

AWARD

NASD Regulation, Inc. Office of Dispute Resolution

In the Matter of Arbitration Between

Lamar County Water Supply District
Profit Sharing Plan and Trust,
Claimant,

and

No. 97-00174

Addison Securities, Inc., and
Charles Schwab & Company, Inc.
Respondents.

REPRESENTATION OF PARTIES

Claimant, Lamar County Water Supply District Profit Sharing Plan And Trust (hereinafter, "Claimant") was represented by Corbet F. Bryant, Jr., Esquire of Carrington Coleman Sloman & Blumenthal, located in Dallas, Texas.

Respondent, Addison Securities, (hereinafter, "Addison,") was represented by Cheryl Jerome Moore, Esquire of Arter & Hadden located in Dallas, Texas. Respondent Charles Schwab & Company, Inc., (hereinafter, "Schwab,") was represented by Steven Lanum, Esquire of Schwab, located in San Francisco, California.

CASE INFORMATION

Claimant's Statement of Claim was filed on or about February 7, 1997, Amended Statement of Claim was filed on or about May 9, 1997, and Second Amended Statement of Claim was filed on or about June 5, 1997. Claimant's Submission Agreement was signed on January 9, 1997 by Craig Hatanville, January 21, 1997 by Anita Henry and January 21, 1997 by Alton Dockrey, the trustees of Claimant.

Respondent, Addison's Statement of Answer was filed on or about May 20, 1997. Respondent, Addison's Answer to the Cross-Claim was filed on or about May 28, 1997. Respondent, Addison's Submission Agreement was signed on June 5, 1997, by John Stein, President of Addison.

Respondent, Charles Schwab's Statement of Answer and Cross-Claim was filed on or about May 7, 1997. Respondent, Charles Schwab's Submission Agreement was signed on April 30, 1997 by Linda Drucker, Senior Corporate Counsel of Charles Schwab.

HEARING INFORMATION

There was a telephonic pre-hearing conference held on April 28, 1997 at 11:00 a.m., for one (1) session held by then Chairperson, Marc. A. Myrin, Esquire. The hearings were held on January 20, 1998 at 9:00 a.m., for two (2) sessions, on January 21, 1998 at 9:00 a.m., for one (1) session in Dallas, Texas.

CASE SUMMARY

Claimant Lamar County Water and Supply District Profit Sharing Plan asserted that it is a qualified profit sharing plan originally begun by written plan effective May 1, 1982, and operated pursuant to the Employee Retirement Income Security Act of 1974 ("ERISA"). Claimant further asserted that it opened and maintained at Addison between 1992 and 1996 securities accounts based upon the promises and representations that the accounts would be appropriately handled and, that they were indeed profitable. Claimant forwarded to Addison a series of nine checks for investment for a total of \$415,000.00 between February 7, 1992 and July 5, 1996.

Claimant alleged that it learned in the second half of 1996 that Addison has made untruthful statements to it and delivered false information concerning the status of its accounts including fabricating financial statements. Claimant further alleged that its investments at Addison were handled solely for the benefit of Addison and its registered representative Cheryl Rodgers ("Rodgers"), and not in the best interest of the Claimant. Claimant asserted that Rodgers was securities vagabond that had been sued many times in the past and that Addison was aware of this information. Addison, according to Claimant, made a practice of hiring registered representatives who had been fired by prior employers after serious customer complaints.

The final investment check Claimant sent to Addison in the amount of \$100,000.00 was made payable to "Charles Swabb", the clearing firm used by Addison. The check was received and endorsed by Schwab, but never deposited into Claimant's account. Rather, Schwab apparently place the money into the account of a friend and roommate of Rodgers. Rodgers continued to invest Claimant's funds in various securities. She switched investments for no justifiable reason and transacted inappropriate option trades. In 1993, one of the Claimant's trustees, Alton Dockrey, ("Dockrey"), questioned the option trading by Rodgers and asked that she instead invest in mutual funds. Despite that request, Addison continued to enter the same types of transaction as had previously been done and did not limit the trading to mutual funds.

In 1995 and 1996, Addison forwarded to Claimant, statements which showed balances in the account over \$500,000.00 at Schwab. Addison informed Claimant that it was making substantial profits on Robertson Stephens Contrarian Fund, in which the bulk of the Claimant's funds were invested, and Govett Smaller Companies Fund. Claimant later

learned that no investment was ever done for Claimant at or through Schwab, although an account had been opened. The final balance in Claimant's investment in \$74,407.56.

Based upon the facts alleged above, Claimant brought causes of action against Addison and Schwab as follows: Negligence and Gross Negligence, Conversion, Unsuitable Transactions, Unauthorized Trading, Misrepresentation and Fraud, Churning, Breach of Fiduciary Duty, Failure to Supervise, Breach of Contract and Warranty, Texas Deceptive Trade Practices Act, Federal Securities Law, Texas Securities Act, Texas Business and Commerce Code, Section 27.01, Negligent Hiring and Retention and Intentional Disregard of Wrongful Conduct.

Addison denied the Claimant's allegations and requested that the Claim against it be dismissed in all respects and that the costs of the proceeding be assessed against Claimant. Addison submitted that the style and nature of the investments in Claimant's account were determined by the investment decisions of Dockrey, trustee of Claimant. Dockrey was the authorized representative of Claimant to handle the investment decisions for Claimant's account at Addison as trustee of Claimant. During the entire five-year period Claimant had an account at Addison, Dockrey never once complained of unauthorized trading by Rodgers.

Addison further contended that Dockrey is a knowledgeable investor, who complains in hindsight. Respondent Addison stated that Claimant's statement of Claim contained mistaken factual allegations and legal Claims. Addison states that it did not mishandle Claimant's account and at all times acted in good faith consistent with Claimant's explicit instruction and stated investment objectives.

Schwab denied the allegations in The Statement of Claim. Schwab stated that the Claim asserts an action for fraud and other acts of malfeasance on the part of its selected financial advisor, Rodgers, and her employer, Addison. The advisor had no affiliation with Schwab. Schwab further asserted that none of the Claimant's funds were ever invested at Schwab, and no Schwab representative was ever involved in providing advice concerning any specific investment strategy.

Schwab alleged that the Claimant's sole allegation set forth against them, relates to the deposit of a July 5, 1996 check made payable in the amount of \$100,00.00. Schwab contended that its processing of the check comported with applicable law and it therefore denied any and all liability for the claims against it.

Schwab also asserted a Cross-Claim against Addison. In executing the Financial Advisor Agreement, Addison agreed that it would comply with all applicable state and federal laws. Schwab asserted that Addison breached this agreement, giving rise to an absolute obligation to indemnify Schwab for the Claims brought against it. Schwab also asserted that Addison is equitably obligated to indemnify it and that Addison's agent committed intentional torts. Addison also asserted affirmative defenses including the

doctrine of contributory negligence, comparative negligence, responsibility of others and failure to state a claim.

In response to the Cross Claim of Schwab filed against it, Addison asserted that Schwab's Claim for indemnification lacked merit and was based upon sheer supposition. Addison contended that the \$100,00.00 check was deposited at Schwab's North Dallas office into the account of Leigh Anne McKinney without Schwab receiving an appropriate letter of authorization from Claimant. The Financial Advisory Agreement only authorized Rodgers to transfer funds from one on Claimant's account to another of Claimant's account, which transfers were handled through the Schwab office in Phoenix, not Dallas. Addison requested that Schwab's Cross-Claim be dismissed in all respects and that the cost of the Cross-Claim be assessed against Schwab.

RELIEF REQUESTED

Claimant, the Lamar County Water Supply District Profit Sharing Plan and Trust, requested an award for \$340,592.44 in actual damages, actual damages for lost opportunity costs consisting of the sums that would have been generated by prudently handled accounts, (either reflected by the Dow Jones increase, a ten percent [10%] per annum increase per year, plus ten percent [10%] per annum on sums awarded by the panel post-judgment,) treble damages, or in the alternative \$500,000.00 in punitive damages, commissions paid Addison, and reasonable attorneys fees and costs related to this action. Prior to the hearing of this matter, Claimant settled all issues with Respondents but the losses associated with Claimants final investment check in the amount of \$100,000.00. Therefore, the relief sought at the hearing was \$100,000.00.

Respondent, Addison Securities, Inc., requested that the claims asserted against it be dismissed in their entirety and that they be awarded their costs and attorney fees. Respondent, Charles Schwab & Company, Inc., requested that the claims asserted against it be dismissed in their entirety and that they be awarded their costs and attorney fees. Respondent, Charles Schwab & Company, Inc., requested that Addison Securities, Inc., fully indemnify it in this action both pursuant to contractual and equitable obligations, for any award against them, as well as for attorneys fees and costs related to this action.

OTHER ISSUES CONSIDERED AND DECIDED

Upon agreement of the parties, a sole arbitrator selected by the parties, Marc A. Myrin, was appointed to rule upon the Motion for severance. After the Motion for severance was granted, the arbitrator recused himself, and an entirely new panel of three arbitrators was appointed.

Upon granting the motion for Severance, this Claimant, Lamar County Water Supply District Profit Sharing Plan's case was severed from those claims of the other original Claimants, Jimmy and Anita Thompson, the Anita Thompson IRA, N. Jo Edler and Alton Edler as assignees of Alternative Food Company, N. Jo Edler and Alton Edler as

successors in interest to Edlers, Inc., the N. Jo Edler IRA, the Alton Dale Edler IRA, N. Jo and Alton Dale Edler.

Prior to the hearing of this matter, Claimant settled all issues with Respondents but the losses associated with Claimants final investment check in the amount of \$100,000.00. Therefore, the relief sought at the hearing and the only issue determined by the panel was the losses associated with the final investment of \$100,000.00.

Upon review of the file and the representations made by Claimant, the Lamar County Water Supply District Profit Sharing Plan and Trust, the undersigned Arbitrators have determined that Respondents, Addison Securities, Inc., and Charles Schwab & Company, Inc., have been properly served with the Statement of Claim pursuant to Rules 10302 and 10314 of the NASD Code of Arbitration Procedure ("the Code.") The undersigned Arbitrators have also determined that Respondents, Addison Securities, Inc., and Charles Schwab & Company, Inc., did receive due notice of the hearing as required under Rule 10318 of the Code.

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 post-hearing submissions, the undersigned Arbitrators have decided in full and final resolution of the issues submitted for determination as follows:

1. That Respondent, Addison Securities, Inc. is liable for and shall pay to Claimant, Lamar County Water Supply District Profit Sharing Plan and Trust, the sum of \$50,000.00 in compensatory damages and seven percent interest thereon from July 9, 1996 until the award is paid in full; and
2. That Respondent, Charles Schwab & Company is liable for and shall pay to Claimant, Lamar County Water Supply District Profit Sharing Plan and Trust, the sum of \$50,000.00 in compensatory damages and seven percent interest thereon from July 9, 1996 until the award is paid in full; and
3. That Respondent, Addison Securities, Inc. is liable for and shall pay to Claimant, Lamar County Water Supply District Profit Sharing Plan and Trust, the sum of \$14,000 in punitive damages pursuant to the parties post-hearing briefs outlining applicable state and federal law; and
4. That Respondent, and Charles Schwab & Company is liable for and shall pay to Claimant, Lamar County Water Supply District Profit Sharing Plan and

Trust, the sum of \$14,000 in punitive damages pursuant to the parties post-hearing briefs outlining applicable state and federal law; and

5. That 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 \$1,000.00 per hearing session and \$300.00 for each pre-hearing conference, if any. There was one (1) pre-hearing conferences and there were three (3) hearing sessions x \$1,000.00 = \$3,300.00 in forum fees. Pursuant to Rule 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 Rule 10332(c) of the Code, the NASD Regulation, Inc., Office of Dispute Resolution shall retain the non-refundable filing fee of \$250.00 and shall retain as forum fees the hearing session deposit of \$1,000.00 previously deposited with the NASD Regulation, Inc., Office of Dispute Resolution by Claimant, Lamar County Water Supply District Profit Sharing Plan and Trust. (The NASD Regulation, Inc. shall refund the \$250.00 overpayment by Claimant for its filing fee.)

Respondent, Addison Securities, Inc. is liable for and shall pay the forum fee sum of \$1,150.00 (total forum fees of \$3,300.00 minus the \$1,000.00 hearing session deposit already paid by Claimant divided in half) to NASD Regulation, Inc., Office of Dispute Resolution. Furthermore, the Respondent, Addison Securities, Inc. is liable for and shall reimburse the Claimant, Lamar County Water Supply District Profit Sharing Plan, \$500.00 (one half the \$1,000.00 hearing session deposit sum, previously paid by Claimant to NASD Regulation, Inc., Office of Dispute Resolution.)

Pursuant to Rule 10333 of the Code, Respondent Addison Securities, Inc. is liable for and shall pay the NASD Regulation, Inc., Office of Dispute Resolution its the non-refundable member surcharge of \$500.00.

Respondent, Charles Schwab & Company is liable for and shall pay the forum fee sum of \$1,150.00 (total forum fees of \$3,300.00 minus the \$1,000.00 hearing session deposit already paid by Claimant divided in half) to NASD Regulation, Inc., Office of Dispute Resolution. Furthermore, the Respondent, Charles Schwab & Company is liable for and shall reimburse the Claimant, Lamar County Water Supply District Profit Sharing Plan, \$500.00 (one half the \$1,000.00 hearing session deposit sum, previously paid by Claimant to NASD Regulation, Inc., Office of Dispute Resolution.)

Pursuant to Rule 10332 of the Code, Charles Schwab & Company, Inc. is liable for and shall pay to the NASD Regulation, Inc., Office of Dispute Resolution the sum of \$500.00 as a filing fee for the cross-claim for indemnification filed against Respondent, Addison Securities, Inc. for attorneys fees and other costs related to Claimant's Statement of Claim against Respondents. (The hearing session deposit in the amount of \$600.00 that was due upon the filing of Schwab's Cross-Claim is not added here, as the final forum fees due for the hearing is calculated above.)

Pursuant to Rule 10333 of the Code, the NASD Regulation, Inc., Office of Dispute Resolution shall retain the non-refundable member surcharge of \$500.00 previously deposited with the NASD Regulation, Inc., Office of Dispute Resolution by Respondent, Charles Schwab & Company, Inc.

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

Concurring Arbitrators' Signatures:

Ann Blaess Kimball, Esquire
Chairperson
Public Arbitrator

Date

Billy R. Daniel
Panelist
Public Arbitrator

Date

Peter J. Conlan
Panelist
Industry Arbitrator

Date