

Award
NASD Dispute Resolution

In the Matter of the Arbitration Between:

Phyllis K. Steinberg, as Executrix of the Estate of Esther Krivin, (Claimant) vs. Gary Goldberg and Gary Goldberg & Company, Inc., (Respondents)

Case Number: 99-00482

Hearing Site: New York, New York

REPRESENTATION OF PARTIES

Claimant, Phyllis K. Steinberg, as Executrix of the Estate of Esther Krivin, hereinafter collectively referred to as "Claimant": Abram Steinberg, Esq., Steinberg and Kennedy, Monsey, NY.

Respondents, Gary Goldberg ("Goldberg") and Gary Goldberg & Company, Inc. ("GG&C"), hereinafter collectively referred to as "Respondents": Frederic T. Spindel, Esq., Venable, Baetjer, Howard & Civiletti, LLP, Washington, DC. (Mr. Spindel was previously with the law firms of Pillsbury Winthrop LLP, McLean, VA and Reed Smith Shaw & McClay, Washington, DC, during the life of this case.)

CASE INFORMATION

Statement of Claim filed on or about: February 2, 1999.

Amended Statement of Claim filed on or about: March 29, 2002.

Claimant signed the Uniform Submission Agreement: January 25, 1999.

Joint Statement of Answer filed by Respondents on or about: April 26, 1999.

Joint Statement of Answer to Amended Statement of Claim filed by Respondents on or about: April 16, 2002.

Goldberg signed the Uniform Submission Agreement: April 26, 1999.

GG&C signed the Uniform Submission Agreement: April 26, 1999.

CASE SUMMARY

Claimant asserted the following causes of action: fraudulent investment; unsuitability; false and misleading statements; and charging of improper, devious, and fraudulent account service fees. Claimant's claim involved the limited partnerships of Montebello Land Investors, Portfolio 100 LP, and VIP 100 LP.

Unless specifically admitted in their Answers, Respondents denied the allegations made in the Statement of Claim and Amended Statement of Claim and asserted the following defenses: the Statement of Claim fails to state a claim upon which relief may be granted; the claims set forth in the Statement of Claim are based on investments made more than 9 and 11 years ago and are not eligible for arbitration pursuant to Rule 10304 of the NASD Code of Arbitration Procedure; in conjunction with Claimant's investment objectives, the investments in Claimant's account were suitable and for her benefit; the nature of Claimant's investments were fully disclosed to Claimant both orally and by way of formal disclosure documents; fees charged by Goldberg with respect to Claimant's investments were fully and completely disclosed to Claimant; Claimant's claims are barred by the applicable statute of limitations; Claimant's claims are barred on the grounds that there was a failure to mitigate damages; and Claimant's claims are barred by operation of waiver and estoppel.

RELIEF REQUESTED

In the Statement of Claim, Claimant requested compensatory damages in the amount of \$85,000.00.

In the Amended Statement of Claim, Claimant requested:

- a. Compensatory damages in the amount of \$115,000.00 with interest from 1993, less \$38,684.81 (the amount obtained by Claimant from the liquidation of VIP 100 LP);
- b. Punitive damages as the Panel shall determine;
- c. Claimant's reasonable attorneys' fees for prosecuting this claim; and
- d. The costs and disbursements of this proceeding.

Respondents requested that Claimant's claims be dismissed, with costs, including reasonable attorneys' fees, assessed against Claimant.

OTHER ISSUES CONSIDERED AND DECIDED

Respondents filed a Motion to Dismiss based on Claimant's failure to allege a cause of action with particularity. The Panel denied said Motion with leave to renew. Respondent subsequently filed a Motion to Reconsider, which was denied by the Panel.

Claimant made a Motion for Summary Judgement based on Respondents' failure to comply with discovery. The Panel denied said Motion with leave to renew. Claimant subsequently renewed the Motion for Summary Judgement, which was again denied by the Panel.

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.

AWARD

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

1. The evidence is insufficient to sustain a finding of fraud, material misrepresentation, or substantially undisclosed self-dealing.
2. With regard to the Montebello Land Investors investment, the Panel finds no Award is warranted. The Panel specifically makes no finding on the fairness of any proposed settlement or buyout pending among the partners.
3. With regard to the Portfolio 100 LP/VIP 100 LP investment, the Panel finds that at the time of the merger, on or about October 1995, Esther Krivin and/or her agent was not an accredited investor and said investment was unsuitable for her; that Goldberg had a duty as broker, regardless of his alleged status as "general partner" or any other capacity, to so advise Claimant and/or to assign or recommend a "purchaser representative", which he failed to do; and that it was unreasonable for Respondents to determine that Esther Krivin and/or her agent was an accredited investor. Therefore, Respondents are jointly and severally liable for and shall pay to Claimant the sum of \$36,495.89, computed as follows:

Approximate value of VIP 100 LP investment (\$55,000.00 plus fees deducted) at the time of the merger into Portfolio 100 LP (10/1/95)	\$60,000.00
plus compound interest @5.7% (2 year Treasury notes) from 10/31/95 to 3/31/97 (approximate date of redemption)	<u>\$ 5,342.47</u>
	\$65,342.47
minus redeemed value 3/31/97	<u>\$38,668.31</u>
	\$26,674.16
plus compound interest @6.45% (2 year Treasury notes) from 4/30/97 to 2/2/99 (date of filing claim)	<u>\$ 3,379.80</u>
	\$30,053.96
plus compound interest @5.19% (2 year Treasury notes) from 2/29/99 to date	<u>\$ 6,441.93</u>
	\$36,495.89

4. As to the Clark Capital Management Company fees, the Panel finds that Respondents failed to show that Esther Krivin and/or her agent knew the amount of referral fees being paid to Respondents, and that the actual percentage of said referral fee is contradictory and unclear. Therefore, Respondents are jointly and severally liable for and shall pay to Claimant the sum of \$2,931.74, which represents 45% (the percentage indicated on Clark's unsigned form titled "Solicitor's Disclosure Statement" as payable to Respondents) of the amounts contained on the Clark account statements in evidence.
5. Claimant's request for punitive damages is hereby denied.
6. All other requests for relief are hereby denied.

FEES

Pursuant to the Code, the following fees are assessed:

Filing Fees

NASD Dispute Resolution will retain or collect the non-refundable filing fees for each claim:

Initial claim filing fee = \$ 150.00

Member Fees

Member fees are assessed to each member firm that is a party in these proceedings or to the member firm that employed the associated person at the time of the events giving rise to the dispute. In this matter, Gary Goldman & Company, Inc. is a party.

Member surcharge	= \$1,000.00
Pre-hearing process fee	= \$ 600.00
Hearing process fee	= \$1,500.00

Adjournment Fees

Adjournments requested during these proceedings:

Jan. 3, 4 & 5, 2001, adjournment by Respondents = WAIVED

Forum Fees and Assessments

The Panel assesses forum fees for each hearing session conducted. A hearing session is any meeting between the parties and the arbitrators, including a pre-hearing conference with the arbitrators, that lasts four (4) hours or less. Fees associated with these proceedings are:

Ten (2) Pre-hearing sessions with Panel x \$500.00	= \$5,000.00
Pre-hearing conferences: October 6, 1999	1 session
December 1, 1999	2 sessions

February 8, 2000	1 session
December 13, 2000	1 session
December 29, 2000	1 session
January 5, 2001	1 session
October 2, 2001	1 session
November 8, 2001	1 session
September 30, 2002	1 session

Nine (9) Hearing sessions x \$500.00 = \$4,500.00

Hearing Dates:	June 24, 2002	2 sessions
	June 25, 2002	2 sessions
	July 11, 2002	3 sessions
	November 1, 2002	2 sessions

Total Forum Fees = \$9,500.00

1. The Panel has assessed \$4,750.00 of the forum fees against Claimant.
2. The Panel has assessed \$4,750.00 of the forum fees jointly and severally against Respondents.

Administrative Costs

Administrative costs are expenses incurred due to a request by a party for special services including, but not limited to, additional copies of arbitrator awards beyond those provided without charge, copies of audio transcripts, retrieval of documents from archives, interpreters, and security.

1. Respondents, requested tapes, \$15.00.

Fee Summary

1. Claimant is solely liable for:

Initial Filing Fee	= \$ 150.00
<u>Forum Fees</u>	= \$4,750.00
Total Fees	= \$4,900.00
<u>Less payments</u>	= \$ 650.00
Balance Due NASD Dispute Resolution	= \$4,250.00

2. GG&C is solely liable for:

<u>Member Fees</u>	= \$3,100.00
<u>Total Fees</u>	= \$3,100.00
<u>Less payments</u>	= \$3,100.00
Balance Due NASD Dispute Resolution	= \$ 0.00

3. Respondents are jointly and severally liable for:

Forum Fees	= \$4,750.00
<u>Administrative Costs</u>	= \$ 15.00
<u>Total Fees</u>	= \$4,765.00
<u>Less payments</u>	= \$ 15.00
Balance Due NASD Dispute Resolution	= \$4,750.00

All balances are payable to NASD Dispute Resolution, and are due upon receipt pursuant to Rule 10330(g) of the Code.

ARBITRATION PANEL

Anna M. Fanelli, Esq.	-	Public Arbitrator, Presiding Chair
Ronald Jay Litchman, Esq.	-	Public Arbitrator
Judith R. MacDonald, Esq.	-	Non-Public Arbitrator

Concurring Arbitrators' Signatures

I, the undersigned arbitrator, do hereby affirm, pursuant to Article 7507 of the Civil Practice Law and Rules, that I am the individual described herein and who executed this instrument which is my award.



Anna M. Fanelli, Esq.
Public Arbitrator, Presiding Chair

12/4/02
Signature Date

Judith R. MacDonald, Esq.
Non-Public Arbitrator

Signature Date

Dissenting Arbitrator's Signature

I, the undersigned arbitrator, do hereby affirm, pursuant to Article 7507 of the Civil Practice Law and Rules, that I am the individual described herein and who executed this instrument which is my award.

Ronald Jay Litchman, Esq.
Public Arbitrator

Signature Date

December 10, 2002

Date of Service (For NASD Dispute Resolution use only)

ARBITRATION PANEL

Anna M. Fanelli, Esq.	-	Public Arbitrator, Presiding Chair
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Judith R. MacDonald, Esq.
Non-Public Arbitrator

12/2/02
Signature Date

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Ronald Jay Litchman, Esq.
Public Arbitrator

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Anna M. Fanelli, Esq.
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Signature Date

Judith R. MacDonald, Esq.
Non-Public Arbitrator

Signature Date

Dissenting Arbitrator's Signature

I, the undersigned arbitrator, do hereby affirm, pursuant to Article 7507 of the Civil Practice Law and Rules, that I am the individual described herein and who executed this instrument which is my award.

Separate opinion attached.

Ronald Jay Litchman, Esq.
Public Arbitrator

Signature Date

December 10, 2002
Date of Service (For NASD Dispute Resolution use only)

NASD Dispute Resolution

Separate Opinion, concurring in part and dissenting in part.

In the Matter of the Arbitration Between:

Phyllis K. Steinberg, as Executrix of the Estate of Esther Krivin (Claimant)

vs.

Gary Goldberg and Gary Goldberg & Co., (Respondents)

Case Number 99-00482

Ronald Jay Litchman, Public Arbitrator:

The testimony and the documents presented to us persuades me that the majority of the panel does not go far enough.

The Estate's general theme throughout this protracted case has been that respondents were guilty of self-dealing, misrepresentations, omissions and half-truths with respect to two of the investments vehicles they handled for the Estate's decedent, Esther Krivin, the Montebello Land partnership and the stock portfolios structured as limited partnerships, known as Portfolio 100 and VIP 100. I do not agree that each of the particular acts by respondents which the Estate cited to us constituted misconduct; yet, on the whole, I find merit in the Estate's position that respondents overreached, served their own interests over and ahead of Esther Krivin's, lacked candor in their dealings with her and her granddaughter, took advantage of their quite apparent lack of understanding, and thereby breached the fundamental duty of fair dealing which they owed her.

In my judgment respondents' wrongful acts are not neutralized or justified by their "disclosures," which I find, in general, were crafted not genuinely to communicate the requisite warnings to Esther Krivin but to obfuscate them. The majority's finding the evidence insufficient to show a "material" misrepresentation or a "substantially undisclosed" self-dealing begs the issue. Self-dealing indeed there was, it was pervasive, and notwithstanding respondent's ability in retrospect to piece together various references to their conflicts of interest embedded in their voluminous and complex disclosure statements, respondents' behind-the-scenes machinations were largely veiled from the investor's view.

VIP 100 Limited Partnership

This was a portfolio of stocks structured as a limited partnership with Gary Goldberg as the general partner and the investors, including Esther Krivin, as limited partners. The Estate complains that this investment was "unsuitable" for Esther Krivin

and that respondents, Gary Goldberg particularly, engaged in "self-dealing, fraud and repeated conflict of interest activity." (Claimant's Issues B1 and B1.) The evidence adduced at the hearing on this issue was extensive and after the hearing we requested the parties to brief several points related to the issue of unsuitability. Because both parties' post-hearing briefs indicated that Leslie Sanderson had evidence material to this issue, we reopened the proceedings to hear her testimony.

The Estate invested in VIP 100 in September 1995, which is within the six year scope of this arbitration, by merging its holdings in a predecessor portfolio, "Portfolio 100," into the newly formed VIP 100.¹ Although respondents suggest that the merger was merely a matter of form without substance, their distribution of a full-blown offering memorandum, their solicitation of formal consents from the limited partners and Goldberg's testimony that any non-consenting limited partners could have liquidated their investments establishes, to the contrary, that it was a discrete investment and an "exchange" of one security for another within the purview of rule 10(b)(5) and NASD rule 2310.²

The parties agree that Esther Krivin's investment objective was "growth" and that this meant that she felt no need for current income but sought longterm capital appreciation for the benefit of her heirs. I do not agree with the Estate's argument that the VIP 100 portfolio was not a "growth" investment vehicle simply because it did not "grow." Respondents correctly rejoin that no investment is guaranteed to "grow" but only offers the investor an opportunity that it will "grow." Also, as respondents point out, VIP 100 did in fact "grow" when it is measured from the time of its inception to particular dates of respondents' choosing, to capture the days when the markets fluctuated to the upside.

Respondents point out that in exhibit H-1 Esther Krivin recited that "I authorize you to make longer term growth investments in my account . . . You [Gary Goldberg] have explained to me the risk of someone of my age investing in this manner . . ."³ But

¹In his post-hearing brief respondents now argue that the period of limitations should commence with Estate's signing of the consent to the merger in June 1995, and therefore the 6 year period lapsed some months before the complaint was filed. However, the merger was not consummated, and therefore the securities were not actually exchanged, until October 1995, and that is the operative "occurrence or event giving rise to the . . . dispute, claim or controversy," NASD Code §10304.

²It also appears that respondents received "selling commissions" of \$375,000 upon the 1995 merger (Exhibit 29, page 1), in addition to the quarter million dollars they received when Portfolio 100 was created (Exhibit 34, page 1). Manifestly, the merger was not inconsequential to them.

³Even taking this document at face value I still find that it does not establish, as Respondents contends, that Esther Krivin assumed the high-risk margin strategy utilized by VIP 100. But I am hardly convinced that the document deserves to be taken at face value. As Goldberg admitted, the document was handwritten by him and placed before under Esther

(continued...)

I am not persuaded that an investor who says she seeks "longer term growth" and "you have explained to me *the* [sic] risks" thereby gives her investment advisor *carte blanche* to subject her capital to whatever risks he might. An investor's desire for "growth" must be taken by her financial advisor to mean a "*risk adjusted*" growth and a tradeoff between upside potential and downside risk to capital. Respondents' arguments do not take risk adjustment into account.

As the VIP 100 offering memorandum states, it was to be a "speculative" investment vehicle. As Goldberg acknowledged in his oral testimony, "growth," without more, does not imply "speculation," which is a qualitatively higher level of risk. Goldberg testified that VIP 100 was "speculative" because it permitted him to use leverage in the form of buying stocks on margin.⁴ Leverage will magnify profits on the upside, but magnify losses on the downside. Just as a 10% gain in the market value of margined stocks will show a 20% profit on invested dollars (all other things being equal and reduced by the cost of margin interest), a 10% decrease in market value will produce a 20% loss (plus the cost of margin interest) and a 50% loss will wipe out the position altogether.

Not only were respondents permitted by the offering memorandum in the abstract to use margin leverage, they actually did use it, and extensively. As the VIP 100 financial statement shows (Claimant's Exhibit C-31), the technology stocks in the portfolio were margined to 189%, not too far shy of the maximum 200%. The volatile effect of this strategy appears to be evident from Respondent's exhibit Q-5, a summary of the quarterly results of the VIP 100 Limited Partnership in 1997 and 1998. In round numbers, in 1997, the fund enjoyed income of \$210,000 in the first quarter, \$1.66 million in the second and \$2.7 million in the third – and then lost \$3.8 million in the fourth, wiping out all but \$775,000 of income for the year – averaging out to about an 8.25% return on the \$9.351 million value of the portfolio at the beginning of the year (see Claimant exhibit C31, page 6, year end 1996 fair value). That is not a rate of return which was worth the roller-coaster ride. In 1998, the first quarter enjoyed a gain of \$167,000, losses of \$59,000 and \$594,000 in the second and third quarters, and then a \$4.2 million gain in the fourth, for a net income of \$3.8 million for the entire year. Indeed that produced a startling 30+ percent return in 1998 – and an average annual

³(...continued)

Kravin's pen for signature. There is no independent assurance that it represents her sentiment or understanding, rather than the words which Goldberg put in her mouth. Leslie Sanderson did not recall ever seeing this document contemporaneously, and did not recall or believe that Esther Krivin was ever alone with Gary Goldberg. She suggested, therefore, that the photocopy produced for the record (the original allegedly having been lost) was a fabrication.

⁴Respondents' post-hearing brief argues that VIP 100 was not all that risky because it did not hold "penny stocks" but "highly reputable large cap, listed companies . . ." First, that argument overlooks the past and recent history that even stocks in such "reputable large cap listed companies" as Chrysler, Intel, K-Mart and Compaq (which are among the stocks held in the limited partnership) have taken their dives. But, more important, it overlooks omits the margin-to-the-max factor, which can make even a stodgy investment a gamble.

return of about 19% over the two years. "Long term growth" is one thing, but such wide feast-or-famine swings of millions of dollars – a third or more of the value of the whole portfolio in a single quarter – is something else again.⁵ (Indeed, the actual average return over the two good years, somewhat less than 10% per annum compounded, does not vindicate the volatility of respondents's strategy.) And, too, Goldberg acknowledged that by the time of the hearing the portfolio was in negative territory again.

It being an acknowledged "speculative" investment, the VIP 100 offering memorandum contained extensive provisions for vetting prospective investors to ascertain whether the portfolio was suitable for them. Tracking the provisions of SEC Rule 501 of Regulation D pertaining to such private placements, the offering memorandum provided that it was suitable only for an investor qualified as either an "accredited" or an "non-accredited" investor. In his testimony, Goldberg conceded that Esther Krivin was not an "accredited" investor, but he contended that she qualified as an "non-accredited" investor.⁶

Goldberg conceded in his live, sworn testimony that Esther Krivin did not qualify under the experience criteria of clause (b)(i). To establish that VIP 100 was suitable for Esther Krivin, Goldberg relied on clause (b)(ii), that she was a suitable investor because she was represented by a "purchaser representative" as defined in rule 501 of Regulation

⁵The investors' ability to take advantage of the lucky, wild swings to the upside was itself limited by the restriction that they could only liquidate their positions at the end of the calendar quarter. Unless the upswings fortuitously coincided with a calendar quarter, the investors could watch their portfolio value rise sharply and then fall just as sharply, while they remain stuck with their relatively illiquid limited partnership shares. Furthermore, practically speaking, the limited partners were apparently dependent on respondents to report on the quarter-ended value of their share of the partnership, so that by the time respondents reported, it was already old news.

⁶ The offering memorandum, tracking SEC rule 501 of Regulation D, sets forth how an non-accredited investor must qualify (Exhibit C-29 at page 42):

In general, each person who is not an accredited investor must represent in writing that (a) he has adequate means for providing for his current needs and personal contingencies without liquidating his investment in the Units and has a personal net worth, exclusive of the value of home, furnishings, automobiles and the amount to be invested in the Units, of at least \$100,000, and (b) either (i) he has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of an investment in the Units or (ii) he is represented by a purchaser representative (as defined in Rule 501) who has knowledge of and experience in financial and business matters generally, is capable of evaluating the merits and risks of investment in the Units and has in the past invested in or advised others with respect to investments of this type and is familiar with the financial and tax position and plans of the potential offered. However, after reviewing a potential investor's financial circumstances the General Partner has the right, in the exercise of its sole discretion, to apply more stringent suitability requirements. Different suitability standards may also be imposed by the securities laws of the particular jurisdiction in which an investor resides.

D. Goldberg testified that such a "purchaser representative" was appointed for Esther Krivin, and that it was someone employed by him or one of his companies. Utilizing an employee of the issuer (or, here, where the issuer is technically the general partner of a limited partnership, an employee of the general partner or one of the general partner's companies) as a purchaser representative for a concededly unsophisticated investor would, on the common-sense level, contravene the aim of the regulation, which can only be to supply the unsophisticated investor, who cannot herself assess whether the risk of the investment is suitable to her goals, someone capable of doing so in her best interest. To fulfill that protective function, the purchaser representative must be independent of the issuer; otherwise, the fox guards the henhouse.⁷

In footnote 5 of their post-hearing memorandum, respondents recanted Goldberg's testimony (dismissing it as merely his "expression of a belief"), and argued instead that Esther Krivin was an accredited investor because Leslie Sanderson possessed sufficient knowledge and sophistication and that Ms. Sanderson's abilities should be "imputed" to Esther Krivin.⁸ We saw and heard Ms. Sanderson's testimony. As respondent points out, she is generally well-spoken and articulate and capable of comprehending concepts. But she is not well informed or comprehending of several of the very basic principles of securities and investments, such as the difference between stocks and bonds; the nature of a "limited partnership;" or the meaning of a "general partner." She did not know the meaning of "margin." She testified that she took virtually no role in managing her own substantial portfolio, leaving that to her husband, and scarcely knows what investments her retirement plan holds.

My skepticism that she might be play-acting was dispelled when the evidence came out on cross-examination, uncontroverted, that she still thought that she was a principal beneficiary of Esther Krivin's Will when Esther Krivin died in 1996 (not knowing that Esther Krivin's had more recently changed her Will in favor of Phyllis Steinberg, her daughter), but although she never received an inheritance four years after her grandmother died, she never inquired why. I am persuaded that Ms. Sanderson, notwithstanding her general abilities and education, has a "blind-spot" for finances.

I am also persuaded, from hearing and seeing Goldberg's testimony and his demeanor, that he perceived her limitations and also her dependence on him. Mr.

⁷One need not strain to forge new equitable principles to arrive at this conclusion, for Rule 501 of Regulation D itself provides the a "purchaser's representative" must be independent of the issuer.

⁸Respondents rely heavily on Exhibit H-2 (GG-0579-K), Esther Krivin's letter to respondents authorizing them "to allow my granddaughter, Leslie Sanderson, to sign documents on my behalf." Read literally, even this letter does not appoint Ms. Sanderson as Esther Krivin's plenary power of attorney, to make investment decisions for her – but only the more ministerial task of signing documents, presumably, when specifically directed by Esther Krivin herself. There was no direct evidence as to who drafted of this document – against whom such an ambiguity might be resolved – but the other evidence of respondents' practice of preparing documents for Esther Krivin only to sign, suggests that it was respondents.

Goldberg is an accomplished and skilled promoter. Between Esther Krivin and Ms. Sanderson on the one side of the table, and Mr. Goldberg on the other, their bargaining positions were glaringly unequal. Having appointed himself Esther Krivin's fiduciary, as general partner of the stock portfolios (and the Montebello land partnership as well), he should not have placed himself in the position where he could, and likely did, hold and exercise undue influence over her, directly and through Ms. Sanderson. This is especially so because respondents had at hand the perfect solution for avoiding both the appearance, as well as the fact, of overreaching – to have a genuinely independent “purchaser's representative” appointed to give Esther Krivin independent and unbiased advice.⁹

This equitable consideration would not be so compelling were the particular investment vehicles into which respondents put Esther Krivin's money not so self-serving in respondents' favor. The stock portfolios and the land partnership were structured to guarantee respondents substantial fees and control. The limited partners were allowed to sell their shares only at fixed intervals and for liquidation amounts calculated by respondents (particularly the land deal), there being no real market for the shares.

It has been argued that the risks inherent in respondent's deals and the built-in opportunities for self-dealing by respondents at the expense of the investors were all disclosed, freeing respondents to reap the benefits of self-dealing. But once the investor is recognized to be incapable of comprehending the disclosures, then there has been a disclosure only in form but not in effective substance. Moreover, even full and fair disclosure satisfies only the statutory scheme of securities regulation; it does not repeal the common law prohibiting fraud, self-dealing or breaches of fiduciary duty. Were it otherwise, in an extreme case, an offering memorandum might “disclose” that the promoter or issuer will (not only “could”) defraud the investors and will breach the fiduciary duty a general partner owes the limited partners. Such a promoter may have a good defense against a securities law violation – because he fully disclosed his unseemly intentions – but none to liability for actually committing the underlying substantive offenses, which are still offenses, disclosed or not. A disclosure that an investment vehicle is structured in such a way that presents a opportunity for self-dealing by the general partner, cannot immunize the general partner when he *actually* takes advantage of the structure he created and he *actually* benefits himself to the detriment of his beneficiaries, thereby violating his underlying fiduciary trust. Disclosures are supposed to be a shield for the protection of investors, not a sword in the hands of financial promoters with a penchant for operating close to the line. And they are not a license to steal.

This record thus establishes not only that Esther Krivin was not a suitable investor in the VIP 100 portfolio, and that the investment was unsuitable for Esther Krivin – on

⁹By contrast, where respondents thought (or contend) that Esther Krivin needed outside advice, they readily knew how to retain Clark Management.

which the majority and I agree – but also that respondents overreached, misled, dissembled and breached their duties to her.¹⁰

The parties clash vehemently over damages.¹¹ Respondents contend, with some factual support, that if the Estate had not liquidated its account at the precise time it did, but waited another few months, it would have seen the portfolio appreciate in the market and it would have realized a profit. But Goldberg also acknowledged that if the Estate had held the portfolio until our hearing last summer – coincidentally, just after the

¹⁰ Respondents stress a distinction between the qualification of a potential investor for buying an unregistered security versus the suitability of the recommended investment to a particular customer. At least in this case, these concepts merge: Esther Krivin was not an investor qualified to buy (or be sold, or merged into) VIP 100, because she (personally as vicariously through Ms. Sanderson) lacked the requisite knowledge and sophistication; and VIP 100 was unsuitable for her because its level of risk substantially exceeded that which can reasonably be implied from her expressed objective of “growth.”

Respondents also assert that the suitability doctrine reflected in NASD Rule 2310 is inapplicable to this exchange of securities. (Respondents’ Post-Hearing Memorandum at 1-2.) They argue that where the rule speaks to the duty owed to customers by its “member’s,” it means only “brokers;” and that Goldberg, in recommending the exchange was acting “in his role as a representative of the General Partner of Portfolio 100 [Goldberg Planning Services, Inc., of which Mr. Goldberg was president], not in his capacity his brokerage firm, Goldberg & Company, Inc.”

That is quite too facile. Not the most sophisticated of investors would likely have divined which of his wardrobe of hats Goldberg might (at a later arbitration) profess or deny wearing on any given occasion – and certainly not Esther Krivin or Leslie Sanderson.

¹¹ At this juncture respondents first contend that there are no damages. They argue that a failure to comply with the qualified investor provisions is “only” a violation of the registration process and does not create a right of action for damages in the unsuitable investor to whom the security was improperly sold. We need not reach that issue because the Estate does not rest its claim solely on respondents’ failure to comply with Regulation D, but rather points to that non-compliance as evidence that the portfolio was unsuitable for Esther Krivin and that respondents knew or should have known so.

“Unsuitability” is a claim separate from Regulation D, and flows from the industry’s own regulations. The cases analyzing this issue typically focus on whether an alleged violation of a stock exchange or a NASD rule creates a private right of action in the investor in the federal courts or can be the basis for federal court jurisdiction. It does not – but that is not our concern in this forum. Indeed, the federal courts have concluded that NASD rules are not enforceable in the federal court because they are enforceable in arbitrations like this. *Klock v. Lehman Bros. Kuhn Loeb Inc.*, 584 F. Supp. 210, 217 (S.D.N.Y. 1984), citing *Colman v. D.H. Blair & Co.*, 521 F. Supp. 646 (S.D.N.Y. 1981). NASD arbitrations have regularly adjudicated unsuitability claims and made monetary awards in appropriate cases.

Respondents argue next that liability here can only be based on fraud, either common law fraud or fraud of the §10(b)(5) variety, so that *scienter* is a necessary element of the Estate’s claim. If that be so, then I find that the evidence (including Goldberg’s conceded belief that Esther Krivin was “unaccredited” and should not have been sold portfolio shares without a purchaser representative appointed for her) sufficiently proves *scienter*, either actual fraudulent intent or, at least, a reckless disregard for whether she was or was not an accredited investor, and for whether the investment vehicle itself was or was not suitable for her objectives.

markets reached their lowest point in four years – she would have again have realized a loss. Fixing damages upon fluctuating market values on any one date is too speculative, arbitrary and fraught with second-guessing and hindsight. Moreover, a party who was aggrieved by a fiduciary's breach of trust is not required to continue allow that fiduciary to continue handling her money. And, furthermore, the wide and rapid swings in the portfolio's market values cited by respondents, which turned a 40% loss into a 25% profit¹² within a matter of months (a 100% gain from trough to peak) bears the telltale signs of the extensive use of margin leverage – the very same strategy that made the investment too risky and therefore an inappropriate investment for Krivin. To allow respondents a setoff in the amount of the appreciation resulting from this speculation would reward their own wrongdoing.

The Estate, on the other hand, seeks a return of Esther Krivin's initial \$60,000 investment plus statutory interest at 9% for the 15 years since she first invested in the VIP 100's predecessor which was merged into VIP 100 in 1995, reduced by the \$38,000 actually received on liquidation in 1997. However, there is no legal entitlement to pre-judgment statutory interest, and a significant part of this measure of damages is time-barred.

The appropriate measure of damage is rescission as of the time of the merger. It would put the Estate back (as closely as we can accomplish it) to where Esther Krivin would have been if Esther Krivin were not sold an unsuitable investment – that is, Esther Krivin would not have been accepted as an investor, in 1995, and her funds, I infer from the record before us, would have remained in one of her public mutual funds. Rescission also enables the respondents, who will acquire the Estate's interest in the partnership upon payment of the award, to enjoy the gains (or losses) of the investment strategies they have staunchly defended in this case, which accomplishes one additional stroke of equity.

Esther Krivin's 1989 \$60,000 investment bought her 1.2 units (equal to 1.2% of the capital) in Portfolio 100 (see Exhibits C29, page 1; C4); as a result of the merger, her investment was were rolled over into VIP 100. The redemption value of the investment when it was rolled over was less than \$60,000, but the evidence does not show how much of that reduction is attributable to market losses versus the substantial charges and fees taken out by respondents. A true "rescission" puts the parties back to where they would have been if the transaction never occurred; thus, respondents would not have received any charges or fees from Esther Krivin, and Esther Krivin would have her

¹²Esther Krivin's original investment of \$60,000 had dropped to \$38,668.31 at the May 15, 1997 liquidation, (36.6%) but, according to Goldberg it increased to about \$80,000 several months later (a 201% increase from \$38,000).

\$60,000.¹³ Accordingly, I take that amount as the starting point, and the majority does likewise.

For the 18½ months between October 1, 1995 (the time of the merger into VIP 100) and May 15, 1997 (the time of the redemption from VIP 100) the Dow Jones Industrial Average increased fairly steadily from about \$4,755 to about \$7,333, an annualized return of about 35%. During the same period the S&P 500 increased from about \$581 to about \$841, an annualized return of 29%. (During this same period, Esther Krivin's interest in VIP 100 declined from \$60,000 to \$38,000, an annualized loss of about 38%). Assuming that Esther Krivin had not been sold VIP 100 and that her \$60,000 remained in her mutual fund from whence it came (see Exhibit G-5, page GG/KRI 0062), it would have been worth about \$78,000 (\$60,000 x 130%) by May 1997.¹⁴ Then the Estate received \$38,668.31 in redemption, leaving an balance due of \$39,331.69 (compared to the majority's balance of \$26,674.16). After the May 1997 redemption, it is reasonable to assume that Esther Krivin's funds would have been retained in cash. Here I agree that the majority's interest rates are a fair approximation of compensation, and their result is \$9,821.73 of interest, or 36.8% of \$26,674.15. Applying that rate to the \$39,331.69 balance I would find due, the interest would be \$14,842.38 and the total award to the Estate would be \$53,814.07 for this branch of its claim.

The Montebello Land Partnership

The Estate challenges this investment principally on the grounds of self-dealing and their breaches of fiduciary duty. There seems to be little dispute, nor could there reasonably be, that this investment vehicle was structured to afford respondents various opportunities to collect fees from the investors and, more significantly, to enable respondents to leverage the limited partners' investments in this portfolio in order to develop nearby adjacent land for their own benefit. For the reasons discussed with respect to VIP 100, the fact that the self-dealing potential inherent in this investment was disclosed in the offering memorandum is not a defense to the actual breach of fiduciary duty.

The equitable resolution of this controversy has been greatly simplified by the fact that, by the time of the hearing, this investment was about to be wound up upon the sale

¹³According to the Portfolio 100 balance sheet in Exhibit C30 (page GG-0464-K), its assets were \$7.588 million, but its Total Equity was only \$3.050 million, on account of a liability of \$4.515 million – for than half the assets – said, not too informatively, to be “due to broker.”

Were the amount “due to broker” added back to equity, then total equity would be \$7.563 million, and Esther Krivin's .8% (the original 1.2% reduced by one-third to reflect the 50% enlargement of the portfolio) would be worth \$60,504 – substantially the same as the starting figure we use.

¹⁴For the same period, the majority awards only interest, at the 2-year treasury note rate, of 5.7%.

of the partnership's land. Respondents represent that they are making certain concessions to the limited partners that will reap them a profit on the deal, over its lifetime (see Exhibit C24), although the amount of the profits (and what deductions the respondents may take for "expenses" and "contingent" liabilities) is not spelled out. However, respondents have required the limited partners to release them from any potential claims before they will be allowed the benefit of these alleged concessions. With this controversy pending, the Estate has declined to give the release and apparently respondents are holding the concessions hostage.

Such "in terrorem" and self-dealing treatment by a general partner of a limited partner is itself a breach of fiduciary duties. The notion that the fiduciary is entitled to bargain at arm's length with his beneficiaries for a release of his own liability fundamentally derogates the nature of a fiduciary relationship. Particularly since the respondents do not actually state how much their concessions will be worth, the offer of a concession in exchange for a release has the flavor of selling a "pig in a poke." Accordingly, notwithstanding the absence of a release, I would direct respondents to make the same pro rata distribution to the Estate as it makes to all the other limited partners who have signed the release.

The majority, however, declines to pass on this issue, "mak[ing] no findings on the fairness of any proposed settlement or buyout pending among the partners" (see Award page 3, point 3.) Thus, the award does not have *res judicata* or collateral estoppel effect on this issue in the event that claimant seeks in a separate action elsewhere to obtain redress for this instance of respondents' self dealing and overreaching. But putting claimant to yet another litigation against these well-heeled and adamant respondents is, in its practical effect, a small and insufficient consolation. I would have resolved this issue here in order to resolve the whole of the controversy between these parties.

Clark Capital Management

The remaining subject of this controversy concerns certain management fees paid out of Esther Krivin's assets to Clark Capital Management, to provide "market timing" advice. The estate challenges this expenditure on the grounds that it accrued no benefit to Esther Krivin, that constituted self-dealing by respondents because they received back from Clark 45% of the fees Clark was paid, and that retaining Clark was never duly authorized.

I see merit in the Estate's contention that Clark provided no benefit to Esther Krivin because that part of her assets that were in Montebello Land and Portfolio 100/VIP 100 were illiquid and could not have benefitted from "market timing;" and the rest was already under the professional management of the public mutual funds which respondents chose. Had respondents felt market timing were so important, they ought to have chosen different funds, rather than subject Esther Krivin's assets to duplicative advisory fees.

There is also merit to the Estate's independent contention that the engagement of Clark and the authorization of the fees paid to Clark were not duly and knowledgeably authorized. Unable to produce an executed written authorization, respondents offered into evidence only a blank form, and contended that Ms. Sanderson signed such a form. In place of actual proof of authorization, respondents explain that the original document became lost at or about the time that respondents produced documents including Esther Krivin's files to the SEC. That may be a reason, but it is not an excuse, and it is not a substitute for evidence.¹⁵ Moreover, our doubts over Ms. Sanderson's understanding of the more sophisticated methods by which respondents handled these assets outweigh respondents' contention that Ms. Sanderson knowingly ratified the payments to Clark after the fact. Ratification must be based upon a full understanding of the transaction at issue, and the preponderance of the evidence does not support this necessary element of respondents' contention.

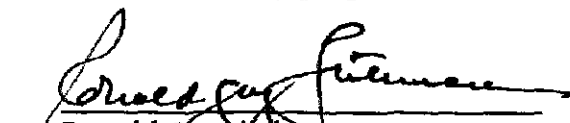
Both these factors take on greater importance because respondents were personally interested in the engagement of Clark, and because they received nearly half of the fees for themselves. Having placed themselves in a position of a conflict of interest, they should be held to a higher standard of proof.

The six year limitations period constrains us to reach only the fees paid to Clark Management after 1992, leaving only the last two years of fees. The majority's award returns to the Estate only that portion of the fees it paid to Clark that were rebated to respondents. This flows from the documents attached to Claimant's Exhibit C33, two Clark Management invoices stating erroneously that out of the fee charged by Clark, 3¾% of the value of Esther Krivin's accounts each year, respondents were receiving one-half of 1% of Esther Krivin's assets. In fact, respondents acknowledge that they received 45% of Clark's fees, or 1.6875% of Esther Krivin's assets. The majority refunds only this part to the Estate, on the grounds that "Respondents failed to show that Esther Krivin and/or her agent [Sanderson] knew the amount of referral fees begin paid to Respondents, and that the actual percentage of said referral fee is contradictory and unclear." I agree, as far as it goes, but I think the confusion over the percentage of the "referral fee" is the secondary issue here. This measure of damage fails to make the aggrieved Estate whole, but seems to be tailored to spare the wrongdoing respondents from suffering an out-of-pocket loss. Because I find that respondents also failed to show that Clark provided any benefit Esther Krivin or to show that either Esther Krivin or Sanderson understood what Clark was supposed to do, I would refund the entire fee.

¹⁵ The parties trade barbs as to which of them was responsible for obtaining a written authorization document, if one existed, directly from Clark. In fact, either party had the power to seek and serve a subpoena upon Clark for the production of the document, but neither did so. Inasmuch as respondents have the burden to prove due authorization for this expenditure, the absence of the document constitutes a failure of proof.

The Allocation of Arbitration Fees

Forum fees amount to \$9,500, which the majority splits evenly between the two sides. Reducing claimant's \$36,500 award by \$4,750 renders the award too close to a Pyrrhic victory. Claimant could have litigated this dispute in court at less expense, but was bound to arbitrate. Alternate dispute resolution best fulfills its promise to afford a more economical alternative to litigation when we exercise our authority to align the allocation of forum expenses to the outcome of the case on the merits. Allocating twenty percent of the forum fees to claimant would still exceed five percent of the award. Recognizing that claimant could have presented its case in a more efficient manner, I would go so far as to impose 25% of the fee on claimant, \$2,375, which I believe is a more reasonably proportionate.


Ronald Jay Litchman
Public Arbitrator

November 29, 2002