

**Award  
NASD Regulation, Inc.**

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In the Matter of the Arbitration Between:

Thomas Sherck and Tami White, Claimants vs. Lissa Searfoss and Royal Alliance Associates, Inc., Respondents.

Consolidated Case Numbers: 99-00645 & 99-00686      Hearing Site: San Francisco, California

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**REPRESENTATION OF PARTIES**

Claimants, Thomas Sherck ("Sherck") and Tami White ("White"), hereinafter collectively referred to as "Claimants": Linda Stoick, Esq., San Francisco, California

Respondent, Lissa Searfoss ("Searfoss"): Lissa Searfoss, San Francisco, California

Respondent, Royal Alliance Associates, Inc. ("Royal Alliance"): Louis H. Castoria, Esq., Wilson, Elser, Moskowitz, Edelman & Dicker LLP, San Francisco, California

**CASE INFORMATION**

Statement of Claim filed by Thomas Sherck, on or about: February 9, 1999

Statement of Claim filed by Tami White, on or about: February 9, 1999

Claimant, Thomas Sherck, signed the Uniform Submission Agreement: August 27, 1998

Claimant, Tami White, signed the Uniform Submission Agreement: February 4, 1999

Statement of Answer filed by Respondent, Royal Alliance Associates, Inc., on or about: June 24, 1999

**CASE SUMMARY**

Claimants Sherck and White alleged fraud, negligence, misappropriation, unauthorized removal of funds from their customer accounts, and refusal to tender liquidated securities upon request against Respondents Searfoss and Royal Alliance.

Respondent Royal Alliance denied the claims, denied Searfoss was its agent for these transactions, denied that Claimants were entitled to recover any damages, and asserted ten affirmative defenses. Respondent Searfoss failed to respond to the claims.

**RELIEF REQUESTED**

Claimant Sherck requested damages in the amount of \$3,800.00, plus interest and other appropriate damages.

Claimant White requested damages in the amount \$4,500.00, plus interest and other appropriate damages.

Respondent Royal Alliance requested that the Arbitration Panel dismiss this matter against Royal Alliance, with prejudice, and further requested that it be awarded its attorney's fees and costs incurred herein, and that the Arbitration Panel expunge this claim from its regulatory records. Royal Alliance further requested such other and further relief as the Arbitration Panel is empowered to award.

### **OTHER ISSUES CONSIDERED AND DECIDED**

Respondent Royal Alliance did not file with the NASD Regulation, Inc. Office of Dispute Resolution a properly executed submission to arbitration but is required to submit to arbitration pursuant to the NASD Code of Arbitration Procedure (the "Code") and, having answered the claim, appeared and testified at the hearing, is bound by the determination of the Panel on all issues submitted.

Respondent Searfoss did not file with the NASD Regulation, Inc. Office of Dispute Resolution a properly executed submission to arbitration but is required to submit to arbitration pursuant to the Code and is bound by the determination of the Panel on all issues submitted.

On or about January 12, 2000, Presiding Arbitrator, Charles E. Farnsworth reviewed and considered the positions of the parties relative to Respondent Royal Alliance's Motion to Dismiss. Mr. Farnsworth denied the Motion.

Respondent Searfoss did not appear at the hearing in this matter. Mr. Farnsworth ruled to proceed in Respondent Searfoss' absence in accordance with Rule 10318 of the Code.

### **FINDINGS**

1. **Jurisdiction.** Arbitration jurisdiction over Respondent Searfoss, a registered representative with the NASD, was obtained under NASD Code of Procedure section 9134(b)(1) by the mailing of the claims to her last known residence and to Respondent Royal Alliance, with whom she was still "affiliated".

2. **Admissibility of document.** Claimants' objection to the admissibility of Respondent Royal Alliance's exhibit C is overruled; the objection is deemed waived because the same attorney letter was attached to Claimant White's claim, filed with the NASD on February 9, 1999. Exhibit C is admitted.

3. **Liability.** The arbitrator finds Respondent Searfoss liable to both claimants for fraud and intentional misappropriation of the funds entrusted to her by Sherck (\$3,800) and by White

(\$4,500) for the "L.A. Account" during the period 1995-97. Respondent Royal Alliance is not liable to either claimant, however, for these acts of Searfoss as the alleged "ostensible agent" of Royal Alliance under Civil Code section 2338, because Royal Alliance did not cause claimants to rely on any such agency and claimants did not exercise due care in their reliance upon Searfoss as an alleged agent of Royal Alliance. Nor is Royal Alliance liable under the alternate theory as Searfoss' "controlling person." My reasons follow.

Royal Alliance authorized Searfoss to act as its registered representative beginning in August 1994, operating out of her home office and using New Account forms printed with both their names. Her status was that of an employee, not an independent contractor, for NASD purposes. Royal Alliance did not authorize Searfoss to sell a product known as the "L.A. Account." Searfoss solicited clients through her own network of contacts.

**Claimant Thomas Sherck** invested \$3,800 cash in the "L.A. Account" in June 1996 after discussing the matter with Searfoss on the street while en route to the bank without relying on any business card, certificate, account form, or marketing materials prepared by Royal Alliance. He got no Royal Alliance receipt or confirmation form, although he thought he was buying stocks. The periodic L.A. Account statements listed only Searfoss' name, not Royal Alliance's, while other investments he had bought through Searfoss listed both her name and the broker-dealer's. By the time he got Royal Alliance's New Account form in October 1997 (Exhibit A), he had already demanded that Searfoss return his money, and she had failed to do so. Thus, any reliance on Searfoss' use of Royal Alliance's forms (and the signature of Royal Alliance's managing executive Bruce McClain on a New Account form for an "existing client") at that late date did not proximately result in damage to Sherck; the money was already entrusted---and lost.

**Claimant Tami White** did visit Searfoss at her home office, and observed Searfoss' Royal Alliance registered representative certificate there. When she first entrusted cash to Searfoss in September 1996, she received a photocopy of a New Account form (front page only), however, which contained no mention of Royal Alliance or of any brokerage address, but listing the investment as "Mutual Funds L.S./ Retirement L.S./-L.A. Inv. Trust." (Exhibit 7.) And the form oddly listed "street" in lieu of White's social security number, all of which suggests that the investment was through Searfoss only and would not be processed further. Although the form is allegedly signed by a "managing executive," due care requires that White ask for the brokerage name and address. When White added funds to the account in March 1997, there again was no mention of Royal Alliance in the photocopied front sheet of the New Account Form (which served mainly as a receipt), and only obscure references to it on the back side, which I do not believe White could have relied on. By the time White got a New Account Form with Royal Alliance's logo and McClain's signature on it in July 1997, her investment of \$4,500 with Searfoss had been lost. Any reliance upon Royal Alliance at that time did not proximately cause damage to White.

In concluding that Royal Alliance had not made Searfoss its ostensible agent, I do not find either or the two leading cases cited by the parties as particularly persuasive. The court in Walsh v. Hooker & Fay 212 C.A.2d 450 (1963) found ostensible agency because the broker had sold the fraudulent stocks in the same manner as he had sold other stocks to the customer, and because the stocks were listed on the customer's monthly account with the broker-dealer---two important factors missing here. On the other hand, the court in Hauser v. Farrell 14 F.3d 1338 (9th Cir. 1994) found no ostensible agency where the broker expressly told the customers that he was selling them a stock that was unconnected with the broker-dealer and that he was quitting to go work for the company being created by the stock---two other important distinctions from this case.

Nor is Royal Alliance liable under the "controlling person" theory articulated in Hollinger v. Titan Capital Corp. 914 F.2d 1564 (9th Cir. 1990), cert. denied 499 U. S. 976 (1991). Royal Alliance did not aid or abet Searfoss in her scheme, and exercised good faith in its supervision of her. Although the local manager failed to conduct two annual audits of Searfoss' office, as required by its Compliance Manual, he did substantially comply with the NASD requirement of one inspection per year. The SEC's Order against Royal Alliance on January 15, 1997 concerning two east coast offices, in which the Commission doubted that Royal Alliance's annual compliance exams were adequate to supervise a one-representative office, was issued after the damage had occurred in this case, so any failure to increase exams after that date caused no consequential damage to these claimants.

**4. Damages.** Claimant Sherck suffered a loss of \$3,800 and Claimant White a loss of \$4,500 as a result of Respondent Searfoss' fraud and intentional misappropriation. They are entitled to recover those amounts from Searfoss, plus simple interest at 10% per year on those amounts from June 30, 1996 (Sherck) and from March 31, 1997 (White), in accordance with Civil Code section 3287(a).

### **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. Respondent Lissa Searfoss committed fraud and intentional misappropriation of the funds entrusted to her by Claimants Thomas Sherck and Tami White, and award is made against Searfoss in favor of Sherck in the amount of \$3,800 and in favor of White in the amount of \$4,500, plus simple annual 10% interest until paid, running from June 30, 1996 for Sherck and from March 31, 1997 for White.

2. Claimants' claims against Respondent Royal Alliance Associates, Inc. are denied and dismissed.

3. Royal Alliance's request that the Panel expunge Claimants' Claims from its regulatory records is denied.

4. The parties shall each bear their respective costs including attorney's fees.

### **FEES**

Pursuant to the Code, the following fees are assessed:

#### **Filing Fees**

NASD Regulation, Inc. will retain or collect the non-refundable filing fees for each claim:

Initial claim filing fee = \$50.00

#### **Member Fees**

Member fees are assessed to each member firm that is a party in these proceedings or to the member firm(s) that employed the associated person(s) at the time of the event(s) giving rise to the dispute. In this matter, the member firm is a party.

Member surcharge = \$300.00

#### **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 arbitrator(s), including a pre-hearing conference with the arbitrator(s), that lasts four (4) hours or less. Fees associated with these proceedings are:

One (1) Pre-hearing session with Panel x \$100.00 = \$100.00

Pre-hearing conference: September 28, 1999 1 session

Two (2) Hearing sessions x \$100.00 = \$200.00

Hearing Date: January 18, 2000 1 session

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Total Forum Fees = \$300.00

1. The Panel has assessed the \$300.00 in forum fees jointly and severally to Respondents Searfoss and Royal Alliance.

#### **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.

**Fee Summary**

1. Claimant, Sherck, be and hereby is solely liable for:

Initial Filing Fee	= \$ 50.00
Member Fees	= \$ 0.00
Adjournment Fee	= \$ 0.00
Forum Fees	= \$ 0.00
<u>Administrative Costs</u>	= \$ 0.00
Total Fees	= \$ 50.00
<u>Less payments</u>	= \$150.00
Balance (Refund)	= \$100.00

2. Claimant, White, be and hereby is solely liable for:

Initial Filing Fee	= \$ 50.00
Member Fees	= \$ 0.00
Adjournment Fee	= \$ 0.00
Forum Fees	= \$ 0.00
<u>Administrative Costs</u>	= \$ 0.00
Total Fees	= \$ 50.00
<u>Less payments</u>	= \$150.00
Balance (Refund)	= \$100.00

3. Respondent, Royal Alliance, be and hereby is solely liable for:

Filing Fee	= \$ 0.00
Member Fees	= \$300.00
Adjournment Fee	= \$ 0.00
<u>Administrative Costs</u>	= \$ 0.00
Total Fees	= \$300.00
<u>Less payments</u>	= \$300.00
Balance Due NASD Regulation, Inc.	= \$ 0.00

4. Respondents, Searfoss and Royal Alliance, be and hereby are jointly and severally liable for:

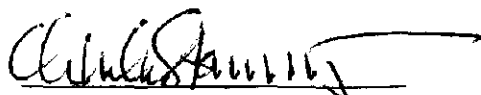
Forum Fees	= \$300.00
<u>Administrative Costs</u>	= \$ 0.00
Total Fees	= \$300.00
<u>Less payments</u>	= \$ 0.00
Balance Due NASD Regulation, Inc.	= \$300.00

All balances are due to NASD Regulation, Inc. and are payable within 30 days of the service date of this Award.

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**Presiding Arbitrator's Signature**



Charles E. Farnsworth, Esq.  
Public Arbitrator

2/18/02  
Signature Date

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Date of Service (For NASD office use only)