

**Award**  
**NASD Regulation, Inc.**

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In the Matter of the Arbitration Between

Name of Claimant

Paul V. Ferraro

Case No. 99-00804

Names of Respondents

E\*TRADE Securities, Inc.  
Michael A. Schoenberger

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**REPRESENTATION OF PARTIES**

Claimant Paul V. Ferraro, hereinafter referred to as "Claimant", appeared pro se.

For Respondents E\*TRADE Securities, Inc. ("E\*TRADE") and Michael A. Schoenberger ("Schoenberger"), hereinafter collectively referred to as "Respondents": Mark T. Dooks, Esq. and Paul S. Chan, Esq. of the law firm of Bird, Marella, Boxer & Wolpert, P.C., Los Angeles, California.

**CASE INFORMATION**

Statement of Claim filed on or about: February 24, 1999.

Claimant signed the Uniform Submission Agreement: February 17, 1999.

Statement of Answer filed by Respondent E\*TRADE on or about: April 23, 1999.

Respondent E\*TRADE signed the Uniform Submission Agreement: June 23, 1999.

Respondent Schoenberger's Joinder in Statement of Answer of E\*TRADE and Motion to Dismiss filed on or about: May 27, 1999.

Respondent Schoenberger did not file an executed Uniform Submission Agreement.

**CASE SUMMARY**

Claimant asserted the following: E\*TRADE was negligent in its handling of Claimant's cancellation of orders and their negligence constituted unfair trade practices. Further, Respondents offered Claimant margin trading when sufficient funds were not available in his account. Respondents' actions resulted in a liquidation of Claimant's account. Claimant further alleged Respondents had a pattern of failing to provide reliable, efficient and convenient executions of stock trades and failed to follow NASD rules in that regard. Further, Respondents were not properly equipped to handle high volume trading days.

Respondents denied any wrongdoing in this matter and asserted the following: E\*TRADE's

Customer Agreement warned customers that when placing a request to cancel an order, the cancellation of that order was not guaranteed. In the instant case, Claimant placed multiple orders before receiving confirmations that his requests to cancel certain trades had been accepted. By so doing, Claimant ran the risk that more than one order would execute, and that is what occurred. Respondents further contended that Claimant remained responsible for the multiple trades even though they exceeded his buying power. E\*TRADE's Customer Agreement provides that a customer is responsible for his orders, including any orders which exceed available funds in his account. Further, Respondents contended that Claimant failed to mitigate his damages by holding his positions for six days, until he was liquidated.

### **RELIEF REQUESTED**

Claimant requested compensatory damages in the sum of \$10,000.00.

Respondents requested that the Statement of Claim be dismissed in its entirety; that they be awarded their costs and forum fees in this matter; and, that they be awarded such other and further relief as the Arbitrator deemed just and proper.

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

Respondent Schoenberger 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 ("Code") and having answered the claim, is bound by the determination of the Arbitrator on all issues submitted.

On August 9, 1999, Claimant informed NASD Regulation, Inc. that he was dismissing Respondent Michael A. Schoenberger from this matter.

### **FINDINGS OF FACT**

The Claimant in this case had been investing with the Respondent E\*TRADE since 1994. In 1996 he opened a margin account and received a copy of Respondent E\*TRADE's Customer Agreement in effect at that time. As of January 20, 1999, Claimant had approximately \$10,000.00 equity in his margin account. On the morning of January 20, 1999, Claimant issued several electronic orders, which ultimately resulted in purchases in excess of his margin buying power. Joint Exhibit 1 reflects the several orders, executions and confirmations of the date in question.<sup>1</sup> When Claimant failed to fund his account in an amount sufficient to cover the aforesaid purchases, Respondent E\*TRADE liquidated his account on January 26, 1999.

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<sup>1</sup>The evidence submitted at the hearing raised a question as to the accuracy of the specific times reflected in Joint Ex. 1. However, the evidence was insufficient for the Arbitrator to conclude that any other times reflected in other documentation was likely to be more accurate.

The evidence submitted at the hearing revealed that the Claimant initiated four separate orders: Order Nos. 237-241. Order No. 237 was a "Buy" order (immediately followed one minute later with a Request to Cancel). Order No. 238 was a "Buy" order for an identical number of the same company. Order No. 239 was a "Change" order, requesting a change in Order No. 238. Order No. 240 was another "Buy" order for an identical number of the same company (shortly thereafter followed by a Request to Cancel). Order No. 241 was a "Buy" order for a different number of shares of another company. Respondent placed and had executed Order Nos. 237, 238 and 241. Order No. 239 was automatically cancelled since the order sought to be changed had already executed. Order No. 240 was cancelled pursuant to Claimant's request before it executed.

It is uncontroverted that Claimant initiated the above orders without having received confirmation of any single order. Claimant did, however, check his "Portfolio View" a number of times throughout the morning and saw nothing to indicate that any of his orders had been executed. In the past it was Claimant's custom to look at his "Portfolio View" when Respondent's website failed to provide timely confirmation of his transactions. Since his "Portfolio View" was void of any information on the date in question, Claimant assumed that none of his orders had been executed. He did not intend to place multiple orders in excess of his margin account buying power.

Claimant insists that the unintended result of duplicate and numerous purchases in excess of his margin buying power was caused by Respondent E\*TRADE's negligence in the following particulars:

1. an inordinate delay in communicating confirmations back to him;
2. the execution of orders in excess of his margin buying power (50%);
3. previously conditioning him to rely upon order rejections where there was insufficient buying power in his account to cover purchases;
4. failure to adequately communicate the terms contained in the "updated" customer agreement; and,
5. failure to adequately communicate the "confirmation warning" contained in the new website, but not contained on the old website he normally used.

Respondent E\*TRADE presented uncontradicted evidence that it has limited control over the time required to send confirmations back to its customers. Respondent E\*TRADE cannot send a confirmation until it receives notice from the market maker that an order has been executed. In the present case there are some questions as to exactly when Respondent E\*TRADE received this information on the various orders (see footnote 1 above). However, no evidence was presented which enabled the Arbitrator to conclude that Respondent E\*TRADE was negligent in this respect. In fact, Respondent E\*TRADE did present evidence tending to show that confirmations were sent to Claimant as soon as possible after

the necessary information was received from the market maker.

Claimant asserts that Federal Regulation T (Title 12, Sec. 220.12) prohibits a broker from executing purchases for a customer in excess of the customer's margin purchasing power. Sec. 220.12 (a), as set out in Claimant's Exhibit #3, requires equity of at least 50% "of the current market value of the security" before purchasing on margin. While Regulation T does appear to require brokers to limit the extension of credit as asserted by Claimant, it clearly envisions "margin deficiencies." It does not appear to limit a broker from ever extending credit above the required equity level. The arbitrator, therefore, finds that Regulation T requires the broker to issue a "margin call" within the "payment period" when a customer's equity in a margin account falls below the 50% requirement. Since that is exactly what occurred in this case, the arbitrator does not find that Respondent E\*TRADE was in violation of Regulation T. Additional evidence in support of this conclusion came from Respondent E\*TRADE's representative, Rob Monteleone. Mr. Monteleone testified that most brokerage firms allow a customer with a margin account to place orders without any equity whatsoever in the account, but do require a deposit of the minimum amount of equity by the settlement date.

Claimant testified that he had been denied credit in the past when his proffered orders exceeded his margin buying power and had, therefore, come to rely upon Respondent E\*TRADE to refuse to place such orders. While it is possible for a brokerage firm to assume an obligation such as that asserted by Claimant, by past practices, those practices must be consistently and invariably repeated over a significant period of time. The evidence of prior order rejections presented in this case was insufficient to convince the arbitrator that the Claimant was reasonable in relying upon Respondent E\*TRADE to always reject orders in excess of his buying power.

Respondent E\*TRADE asserts that Claimant should have been aware of his obligation to pay for all orders due to the express verbiage contained in the "updated" Customer Agreement, effective in July 1998. Claimant denied seeing said agreement prior to the incidents that resulted in this dispute. Respondent E\*TRADE presented evidence of a mass mailing of the document which tends to support its position that Claimant should be bound by the express terms of the updated and modified agreement. However, the arbitrator is unconvinced that the Claimant received a copy of it and, therefore, finds that Claimant is not bound by any of the terms contained in said document. The Claimant did, admittedly, receive a copy of a Customer Agreement in 1996 and introduced that document as Claimant's Exhibit #2. That agreement clearly states that a margin call may result when a customer's equity falls below certain requirements. The agreement also warns that "market conditions or other circumstances" may preclude the giving of advance notice of a deficiency situation. The arbitrator finds that the Claimant should have been aware of the possibility that the placement of multiple orders (albeit unintentionally) in his margin account could result in a margin deficiency.

Respondent E\*TRADE presented evidence that Claimant should have been aware that no assumption should be made on the execution of an order until confirmation of the order is received. This information concerning the "confirmation warning" was available in E-Station on both the "old" and "new" websites. Claimant testified that the confirmation warning did not appear on the "old" website, the one he habitually used, and he did not see it until he logged on to the "new" website on January 20, 1999. The arbitrator has significant concern as to the confusion that may have resulted in having two separate websites up and running at the same time and whether the same information was contained on both sites.

Without deciding whether the Claimant should have had access to, and seen, the "confirmation warning", the pivotal question is whether Claimant acted reasonably in placing multiple orders on January 20, 1999, without receiving any confirmations and without actually knowing which, if any, of his orders had been executed. The arbitrator finds that it was not reasonable for the Claimant to have assumed that none of the previous orders had been executed and the loss sustained in this matter was caused by the negligence of the Claimant in placing multiple orders.

### **AWARD**

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

Claimant's claims against Respondent E\*TRADE are dismissed, with prejudice.

Pursuant to Claimant's dismissal as stated in "OTHER ISSUES" above, all claims against Respondent Schoenberger are dismissed, with prejudice.

### **FEEES**

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	= \$75.00
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#### **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
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#### **Adjournment Fees**

No adjournments were requested in this matter.

**Forum Fees and Assessments**

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

One Pre-hearing session with the Arbitrator x \$200.00 = \$200.00  
August 3, 1999 1 session

Two Hearing sessions x \$200.00 = \$400.00  
September 29, 1999 2 sessions

Total Forum Fees = \$600.00

The Arbitrator has assessed the total forum fees of \$600.00 to Claimant.

**Fee Summary**

Claimant be and hereby is solely liable for:

Initial Filing Fee	= \$75.00
Forum Fees	= \$600.00
Total Fees	= \$675.00
<u>Less payments</u>	<u>= \$675.00</u>
Balance Due NASD Regulation, Inc.	= \$0.00

Respondent E\*TRADE be and hereby is solely liable for:

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

All balances are due and payable to NASD Regulation, Inc.

**Arbitrator's Signature**

\_\_\_\_\_/s/\_\_\_\_\_  
Kenneth R. Starr  
Presiding Chair

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Signature Date

November 8, 1999  
Date of Service (For NASD office use only)

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Two Hearing sessions x \$200.00	= \$400.00
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Total Forum Fees	= \$600.00

The Arbitrator has assessed the total forum fees of \$600.00 to Claimant.

**Fee Summary**

Claimant be and hereby is solely liable for:

Initial Filing Fee	= \$75.00
Forum Fees	= \$600.00
Total Fees	= \$675.00
<u>Less payments</u>	<u>= \$675.00</u>
Balance Due NASD Regulation, Inc.	= \$0.00

Respondent E\*TRADE be and hereby is solely liable for:

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

All balances are due and payable to NASD Regulation, Inc.

**Arbitrator's Signature**

  
Kenneth R. Starr  
Presiding Chair

11/3/99  
Signature Date

Date of Service (For NASD office use only)