

Award
NASD Dispute Resolution, Inc.

In the Matter of the Arbitration Between:

Dezso Ladanyi and Alice R. Ladanyi,
Claimants

Vs.

Case Number: 99-01914
Hearing Site: Cleveland, Ohio

Merrill Lynch Pierce Fenner & Smith, Inc., and
Ted W. Goble,
Respondents.

REPRESENTATION OF PARTIES

Gail E. Sindell, Esquire, of Kaufman & Cumberland, Cleveland, Ohio, represented Claimants Dezso Ladanyi and Alice R. Ladanyi ("Ladanyi"), hereinafter collectively referred to as Claimants.

Joshua R. Cohen, Esquire, of Kohrman, Jackson & Krantz, Cleveland, Ohio, represented Respondents Merrill Lynch Pierce Fenner & Smith, Inc. ("Merrill Lynch") and Ted W. Goble ("Goble"), hereinafter collectively referred to as Respondents.

CASE INFORMATION

The Statement of Claim was filed on or about April 26, 1999.

Both Claimants signed the Uniform Submission Agreement on April 8, 1999.

Respondents Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble filed their joint Statement of Answer on or about June 23, 1999.

Marianne Bretton-Granatoor, Vice President and Senior Counsel, signed the Uniform Submission Agreement on behalf of Respondent Merrill Lynch on January 18, 2000.

Respondent Ted W. Goble signed the Uniform Submission Agreement on June 17, 1999.

CASE SUMMARY

Claimants alleged the following in their Statement of Claim: churning of Claimants' accounts from 1997 through 1998; fraud with respect to a single account owned by Alice Ladanyi; negligence in failing to recommend and assist in the acquisitions/sale of suitable securities for the Claimants' accounts and in failing to know and understand the customers' needs and investment objectives; and breach of fiduciary duty as an investment advisor. These allegations involved transactions in the common stock of the following securities: Alco Standard, Unisource Worldwide and IKON Office Solutions, among others.

Respondents denied the allegations asserted by Claimants in the Statement of Claim and asserted the following affirmative defenses: failure to state a claim upon which relief may be granted, violations of the applicable statutes of limitation, laches, estoppel, ratification, contributory negligence and failure to mitigate.

RELIEF REQUESTED

Claimants requested:

Compensatory Damages	\$5,000,000.00
Interest	\$5,000,000.00
Attorney's Fees	unspecified
Other Costs	unspecified

Respondents requested that the Statement of Claim be dismissed in its entirety and that they be awarded costs. Additionally, Respondent Ted W. Goble requested that all reference to this arbitration be expunged from his record in the NASD Central Registration Depository ("CRD").

OTHER ISSUES CONSIDERED AND DECIDED

On September 22, 2000, the undersigned Panel Heard oral argument on Respondents' joint Motion to Dismiss and Claimants' Motion for Sanctions. The Panel issued a written Order on September 26, 2000, in which it denied both Motions.

At the conclusion of the hearing, the undersigned Panel made the following findings:

1. The facts presented at trial by both Claimants and Respondents reflect a long time business and occasional social relationship by and between Claimants and Respondents. Even as of the time of the hearings, Claimants maintained certain Accounts with Respondents. In

addition, for many years, including the present, several members of Claimants' family, as well as corporate entities in which Claimants and/or family members own(ed) interests, also maintain(ed) Accounts with Respondents. At issue in this cause of action however, were only the Accounts owned personally by one or both of the Claimants.

During the hearings, Claimants and Respondents submitted extensive documentation regarding activity in the Accounts at issue, as well as tax returns reflective of the investment activity for Claimants, including the years 1993 through 1998. Testimony showed Claimants engaged in margin and option trading in their Accounts on several occasions over the life of the Accounts. The Account Statements reflected a high concentration (in dollar value) of holdings in a single stock acquired by Claimants prior to their association with Respondents. There were no allegations by Claimants that Respondents engaged in unauthorized trading or that Respondent, Ted W. Goble, had discretionary trading authority over any of Claimants' Accounts. Claimants and Respondents each presented testimony through independent neurological experts regarding the nature and extent of Dr. Ladanyi's medical condition at the time of his injury in May 1996 through the date of the hearings. Each party also presented a financial expert. Both experts gave testimony regarding financial matters and damages relating to the activity in the Accounts from 1993 through 1998.

Churning occurs when a broker, exercising control over the volume and frequency of trading, abuses the customer's confidence for personal gain by initiating transactions that are excessive in view of the character of the account.

To prove the allegation of churning, Claimants are required to show, at a minimum, excessive trading and control. In addition, there must be intent on the part of the broker to defraud or to act with willful and reckless disregard of the customer's interest. Certain levels of trading activity in the Accounts can be indications of churning. Claimants' expert presented statistical information regarding cost maintenance equity ratios in the Accounts, which Claimants' expert testified constituted an appearance of churning. Respondents' expert presented statistical turnover calculations regarding the Account activities, which did not reflect excessive trading. Substantial testimony from Claimants and Respondent Goble, as well as written documentation, was received into evidence regarding various investment strategies that were adopted by the parties during the time period in question, including correspondence from Dr.

Dr. Ladanyi suffered injuries from a fall in Florida in April 1996. During recovery from this incident, he suffered a stroke in May 1996, leaving him (among other physical problems) unable to speak.

Ladanyi dated February 1996. It was conceded that Dr. Ladanyi had previously engaged in the purchase and sale of covered rights and acquisition of certain securities consistent with a strategy to reduce his income tax liability, including creating gains to offset carryover losses. Uncontroverted testimony presented by Respondents indicated that commissions charged by Respondents during this time period were often discounted.

The Panel finds that Claimants did not meet the requisite burden of proof with respect to control or Respondents' intent required to sustain a claim of churning the Accounts for the time period in question.

2. Claimants' allegation of fraud related to a separate Account maintained by Mrs. Ladanyi. She testified that in April 1998, she transferred funds into a new Account at Merrill Lynch that she intended to use for her children and/or their various business ventures. Mrs. Ladanyi testified she told Respondent, Ted W. Goble, that she wanted the money held in a "safe" account and intended to use it for her children. It was Claimants' position that monies in this Account were at risk for margin calls in other Accounts at Merrill Lynch owned by Claimants and that, had this been known, they would not have deposited the funds into a Merrill Lynch Account. In April and in May, 1998, Mrs. Ladanyi authorized (in writing) the transfer of funds from this Account into her husband's Account. It was her testimony that this was done in response to margin calls in her husband's Account. In addition, she periodically removed funds from the Account and transferred same to Accounts for the benefit of and/or directly to her children and/or their business ventures. She also testified that on occasion, when a margin call was made, Claimants used non-Merrill Lynch assets to meet their obligation.

The Panel finds no evidence of fraud or gross negligence with respect to the management and handling of this particular Account.

3. Claimants argued Respondents were liable for violation of the "suitability" and "Know-Your-Customer" Rules contained in customary Industry Regulations, as well as the Merrill Lynch Compliance Manual. By law, these claims are grounded in a legal cause of action for negligence. Claimants alleged that from the period 1993 through 1998, Respondents repeatedly violated these rules. The evidence reflected that prior to Dr. Ladanyi's stroke in May 1996, he was a highly intelligent, skilled and successful scientist who actively directed and managed his separate Accounts. Both prior and subsequent to his stroke, Dr. Ladanyi traded on margin and during these times, the debt-equity ratio in the Accounts sometimes neared maintenance levels. Neurological testimony and testimony of Claimants' witnesses, including Dr. Ladanyi, confirmed that

since his stroke, Dr. Ladanyi continues to process levels of understanding and knowledge of his assets, Account activity and business investments, despite being unable to speak. There was also testimony that, after his stroke, he participated in many phone calls and attended meetings with Respondent Goble and Mrs. Ladanyi where the nature and extent of the Ladanyi assets and stock portfolios were reviewed and discussed.

Prior to May 1996, Dr. Ladanyi incurred significant margin interest and engaged in very active trading in his various Accounts, which he directed. *Many holdings in the Accounts were the result of Dr. Ladanyi's desires and choices and not necessarily the result of Respondent Goble's recommendations.* Dr. Ladanyi and/or Mrs. Ladanyi also negotiated for decreased margin interest rates on the Accounts at one or more times during the history of the Accounts at Merrill Lynch. Prior and subsequent to May 1996, a number of recommendations were made to Claimants regarding the management and ordering of their stock portfolio, as well as their financial and personal affairs, including their estate plan, tax planning and tax return preparation. Respondents introduced Claimants to legal counsel in an effort to encourage them to seek advice and to prepare a formal estate plan consistent with the nature and extent of their extensive real estate and securities investments. Claimants had access to and utilized the services of a corporate attorney for affairs relating to their closely held corporate entities, as well as some personal matters. Although Claimants were generally unwilling to discuss their financial affairs with their children, two of their sons are lawyers. Dr. and Mrs. Ladanyi also engaged in expensive business ventures with their children, despite their practice of keeping their asset information away from their children. In addition, they had access to and on at least one occasion, utilized the services of a Certified Public Accountant to review their personal tax returns. Correspondence was exchanged with Claimants and Respondent Goble further recommending affirmative action on their part for purposes of organizing their substantial personal and financial affairs. Respondents also gave certain recommendations and advice to Claimants with respect to the management of their investment affairs, diversification of the securities investments, withdrawal of funds, gifts to children and reduction of margin, which Claimants admit they did not follow.

Claimants allege that subsequent to May 1996, the nature and extent of the activities in the Merrill Lynch Accounts and the duty of Respondents changed due to the change in Dr. Ladanyi's medical condition. Mrs. Ladanyi however, testified that she would not make any transactions in any of the Accounts without Dr. Ladanyi's prior approval and on all occasions she attempted to and generally obtained his consent to actions in the Accounts. She also testified that they received the

confirmation slips and the monthly Account Statements, which she relied upon Dr. Ladanyi to read both before and after his stroke. At no time did Mrs. Ladanyi, nor any members of her family, suggest to Respondents that Dr. Ladanyi was legally incapacitated or in need of a Guardian or Conservator. Testimony was presented reflecting that, subsequent to May 1996, Dr. Ladanyi prepared extremely complicated personal tax returns for years prior to and subsequent to 1996, and to this date, continues to drive an automobile. Evidence also reflected that Dr. and Mrs. Ladanyi engaged in business negotiations with their children and acted in active roles with respect to financing and funding various business ventures for their children with the specific consent and knowledge of Dr. Ladanyi subsequent to his stroke.

Evidence presented during the hearings is reflective of an effort on the part of Claimants and Respondents to reduce the margin debt in their Accounts and to diversify the portfolio. Repeatedly, during the lifetime of these Accounts, Claimants refused to liquidate certain securities in which they held a large percentage of their wealth. The Panel finds the subsequent decline in the market value of the highly concentrated stock, the substantial margin debt coupled with substantial and repeated withdrawals of funds from the Accounts for the benefit of Claimants' living expenses, as well as aiding and abetting their children, were the direct and proximate cause of the declining value and performance of Claimants' Accounts, and the subsequent margin calls. Respondents repeatedly recommended against this activity, which advice was admittedly ignored by both Dr. Ladanyi and Mrs. Ladanyi.

Claimants alleged that Respondent Goble acted as an investment advisor for them and in such capacity, carried a greater duty for management of Claimants' Accounts. It was admitted that no additional fee was charged by Respondent Goble for managing the investments other than commissions charged for trades in the Accounts. In addition, with permission of Claimants, certain financial foundation reports were prepared over the years, and on at least one occasion, were paid for by Respondent Goble, personally. There was no suggestion that Respondent Goble or Respondent Merrill Lynch collected commissions for trades, as well as management fees for maintaining and supervising the Accounts, which would be consistent with the position of a formal investment advisor. In addition, Respondent Goble testified that he is not licensed and has never been licensed as an investment advisor. Substantial testimony was given by Mrs. Ladanyi that, even after his stroke, she relied upon Dr. Ladanyi to give authority to Respondent Goble for activity in the Accounts. Mrs. Ladanyi also testified that she relied on Respondent Goble for advice however, she further testified that she often

did not follow the advice he gave with respect to the sale of securities and/or withdrawal of funds from the Accounts.

AWARD

After considering the pleadings and the evidence presented at the hearing, and having made the above findings, the undersigned arbitrators have decided in full and final resolution of the issues submitted for their determination as follows:

1. The Panel finds in favor of Respondents Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble. The Statement of Claim is dismissed, in its entirety, with prejudice.
2. Except as specified otherwise herein, each party shall bear its own costs and attorney's fees.
3. Any and all relief not specifically addressed herein is denied.

FEES

Pursuant to the Code, the following fees are assessed:

Filing Fees

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

Initial claim filing fee = \$ 600

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, the member firm is Merrill Lynch Pierce Fenner & Smith, Inc.

Member surcharge = \$3,000

Pre-hearing process fee = \$ 600

Hearing process fee = \$5,000

Adjournment Fees

Adjournments requested during these proceedings:

April 10-13, 2000, adjournment by Respondent Merrill Lynch = \$ 1,200.00

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:

Two (2) Pre-hearing conferences with Panel x \$1,200		= \$ 2,400.00
Pre-hearing conferences: November 17, 1999	1 session	
September 22, 2000	1 session	

Fourteen (14) Hearing sessions x \$1,200		= \$16,800.00
Hearing Dates: December 13, 2000	2 sessions	
December 14, 2000	2 sessions	
February 12, 2000	2 sessions	
February 13, 2000	2 sessions	
February 15, 2000	2 sessions	
April 10, 2000	2 sessions	
April 11, 2000	2 sessions	

Total Forum Fees		= \$19,200.00
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The Panel has assessed \$9,600.00 in Forum Fees to Claimants Dezso and Alice R. Ladanyi, jointly and severally, and the remaining \$9,600.00 in Forum Fees to Respondents Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble, jointly and severally.

Fee Summary

1. Claimants, Dezso Ladanyi and Alice R. Ladanyi, be and hereby are jointly and severally liable for:

Initial Filing Fee	= \$ 600.00
<u>Forum Fees</u>	<u>= \$ 9,600.00</u>
<u>Total Fees</u>	<u>= \$10,200.00</u>
<u>Less payments</u>	<u>= \$ 1,800.00</u>
Balance Due NASD Dispute Resolution, Inc.	= \$ 8,400.00

2. Respondent Merrill Lynch Pierce Fenner & Smith, Inc. be and hereby is solely liable for:

Member Fees	= \$ 8,600.00
<u>Adjournment Fees</u>	<u>= \$ 1,200.00</u>
<u>Total Fees</u>	<u>= \$ 9,800.00</u>
<u>Less payments</u>	<u>= \$ 9,800.00</u>
Balance Due NASD Dispute Resolution, Inc.	= \$ 0

NASD-DR Award

Dezso Ladanyi and Alice R. Ladanyi vs. Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble

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3. Respondents Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble be and hereby are jointly and severally liable for:

Forum Fees	= \$ 9,600.00
Total Fees	= \$ 9,600.00
Less payments	= \$ 0.00
Balance Due NASD Dispute Resolution, Inc.	= \$ 9,600.00

All balances are due to NASD Dispute Resolution, Inc.

Concurring Arbitrators' Signatures

Tracy L. Allen, Esq.
Public Arbitrator, Presiding Chair

5/21/01
Signature Date

Elmer G. Cowan, Esq.
Public Arbitrator

Signature Date

Bert Cliff
Non-Public Arbitrator

Signature Date

Date of Service (For NASD-DR office use only)

NASD-DR Award

Dezso Ladanyi and Alice R. Ladanyi vs. Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble

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3. Respondents Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble be and hereby are jointly and severally liable for:

Forum Fees	= \$ 9,600.00
Total Fees	= \$ 9,600.00
Less payments	= \$ 0.00
Balance Due NASD Dispute Resolution, Inc.	= \$ 9,600.00

All balances are due to NASD Dispute Resolution, Inc.

Concurring Arbitrators' Signatures

Tracy L. Allen, Esq.
Public Arbitrator, Presiding Chair



Elmer G. Cowan, Esq.
Public Arbitrator

Signature Date

MAY 22 2001

Signature Date

Bert Cliff
Non-Public Arbitrator

Signature Date

Date of Service (For NASD-DR office use only)

NASD-DR Award

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3. Respondents Merrill Lynch Pierce Fenner & Smith, Inc. and Ted W. Goble be and hereby are jointly and severally liable for:

Forum Fees	= \$ 9,600.00
Total Fees	= \$ 9,600.00
Less payments	= \$ 0.00
Balance Due NASD Dispute Resolution, Inc.	= \$ 9,600.00

All balances are due to NASD Dispute Resolution, Inc.

Concurring Arbitrators' Signatures

Tracy L. Allen, Esq.
Public Arbitrator, Presiding Chair

Signature Date

Elmer G. Cowan, Esq.
Public Arbitrator

Signature Date

Bert S. Cliff
Bert Cliff
Non-Public Arbitrator

5-22-01
Signature Date

Date of Service (For NASD-DR office use only)

Attn: Jeffrey Dean, Esq.

FAX 1-312-236-9239