

FINRA DISPUTE RESOLUTION ARBITRATION

IN THE MATTER OF THE
ARBITRATION BETWEEN:

SALLY G. DEFRAUDED

Claimant,

v.

BIG COMPANY

Respondent.

FINRA ARB NO. ____

STATEMENT OF CLAIM

The Claimant brings this action against Respondent, Big Company, because the company and its agent, John Doe, took advantage of Claimant and her family. Claimant was an elderly retiree who suffered from Alzheimer's for many years before her death in "Month, Year." Respondent was entrusted with Claimant's retirement savings, and its agent, John Doe, constructed a portfolio that was made up almost entirely of real estate investment trusts (REITs), the vast majority of which were risky, illiquid, non-exchange traded REITs (non-traded REITs). The portfolio that was sold to Claimant and her family would not have been suitable for any investor, but it was especially inappropriate here, given Claimant's advanced age and her health. Respondent and John Doe enriched themselves with high commissions and fees from these REITs. Meanwhile, Claimant's savings suffered large losses.

FACTUAL ALLEGATIONS

This is not the first time that a client has complained about John Doe. FINRA disclosures reveal a disturbing number of complaints over the years. Respondent entered into a consent agreement with the "State Securities Division" in "Year" to provide

restitution to investors who alleged that John Doe committed fraud and sold them unsuitable investments. Respondent settled three customer disputes in “Year, Year, and Year,” over allegations that John Doe sold clients unsuitable investments and engaged in fraud and churning. And in another case pending right now, an estate alleges that John Doe sold unsuitable investments to a now deceased investor. Despite decades of warnings, Respondent has ignored John Doe’s wrongdoing, has failed to supervise him adequately, and continues to employ him.

Had Claimant known as much about John Doe’s checkered past as the Respondent did, perhaps she would not have trusted John Doe. But she used John Doe as her broker for a long time, and she was not sophisticated financially, and so even before she was formally diagnosed with Alzheimer’s, she had to place her trust in John Doe to act in her best interests. As is common with Alzheimer’s patients, her symptoms developed over a period of several years. By “Year” things had gotten so bad that Claimant’s daughter, Susan G. Defrauded, encouraged her to get a formal diagnosis, and doctors confirmed that Claimant had developed Alzheimer’s.

Shortly thereafter, Susan G. Defrauded began to take care of her mother’s investments. Claimant’s husband (Susan G. Defrauded’s father) had died decades earlier, so Susan G. Defrauded and her husband were the only family left to care for her mother. Eventually, her mother moved from Iowa to the Kansas City area to be closer to Susan G. Defrauded and her family.

John Doe had already sold some risky REITs to Claimant. Once Susan G. Defrauded began to handle financial matters on behalf of her mother, John Doe convinced Susan G. Defrauded to continue to buy these types of investments for her mother. He told Susan G. Defrauded that the non-traded REITs were safe investments that would produce reliable, high returns for 2-3 years, after which the investor’s initial investment would be returned.

He told Susan G. Defrauded that her mother would never lose money in these investments. He convinced Susan G. Defrauded to move hundreds of thousands of dollars out of certificates of deposit and into risky non-traded REITs. Susan G. Defrauded is a pharmacist, not a sophisticated investor, and she believed John Doe's misrepresentations.

By "Month Date, Year," through sales to Claimant and her daughter, John Doe had constructed a portfolio that held more than \$\$\$\$\$\$ worth of REITs, about \$\$\$\$\$\$ worth of cash, and about \$\$\$\$\$\$ worth of assorted stocks and bonds. In other words, more than 86% of Claimant's savings was invested in REITs. Just as shocking, at least \$\$\$\$\$\$ of those REITs (about 66% of Claimant's savings) was invested in illiquid, non-traded REITs. The portfolio was so heavily titled towards real estate and non-traded REITs that there is no possible rationale for its construction other than the high commissions and fees that these investments generated for Respondent and John Doe.

Not surprisingly, this portfolio has performed disastrously. For example, Claimant owned \$\$\$\$\$\$ worth of REIT Company XYZ, a non-traded REIT that went into default in "Year." A class action was filed in "Month, Year" against Respondent in connection with its REIT Company XYZ program, alleging that Respondent promoted this REIT through material misrepresentations and omissions.

John Doe also recommended that Claimant buy \$\$\$\$\$ of Medium Company 1 REIT, \$\$\$\$\$ of the Medium Company 2 REIT, and almost \$\$\$\$\$ of the Medium Company 3 REIT. Respondent and John Doe made large commissions selling all these non-traded REITs. And all of them have suffered serious losses, with Medium Company 1 and Medium Company 2 losing more than half their value.

After Claimant's death in "Year", Susan G. Defrauded inherited the portfolio that John Doe had constructed. When Susan G. Defrauded's broker examined the portfolio she was alerted that something was amiss. Since then, Susan G. Defrauded has learned that

the REITs sold to her and her mother are not actually conservative, safe investments, and are not always a reliable source of income. Susan G. Defrauded has been advised to invest in a more appropriate portfolio, and has incurred substantial losses trying to rid herself of the risky, illiquid, unsuitable portfolio that John Doe sold to her mother.

Susan G. Defrauded is the executor of Claimant's estate and is Claimant's sole heir, legatee and devisee. She brings this action on behalf of the estate because she and her mother were misled about the safety of these REITs and the income they would generate, and were unaware of the fees and commissions that motivated Respondent and John Doe to sell them.

LEGAL ISSUES

Respondent is responsible for its agent's wrongful actions. It either knew John Doe was selling ridiculous amounts of risky REITs to his client or it failed to supervise him sufficiently to prevent him from doing so. As a FINRA-registered broker-dealer organization, Respondent and its agents owed its clients a fiduciary obligation to recommend suitable investments that were in line with their best interests and needs. In this case, Respondent and its agent should have recommended more secure investments for Claimant, such as municipal bonds or fixed income securities. And Respondent should have never allowed its broker to invest so heavily in REITs, in contravention of FINRA guidelines.

Claimant lived the final portion of her life in the Kansas City area, near her daughter, a Missouri resident, and John Doe convinced Susan G. Defrauded to invest hundreds of thousands of dollars of her mother's savings in REITs. Missouri law makes it clear that stockbrokers and their firms owe customers a fiduciary duty, which includes several obligations. "This fiduciary duty includes at least these obligations: to manage the account as dictated by the customer's needs and objectives, to inform of risks in particular

investments, to refrain from self-dealing, to follow order instructions, to disclose any self-interest, to stay abreast of market changes, and to explain strategies.”¹ In this case, Respondent and John Doe obviously failed to fulfill these obligations and thereby breached their fiduciary duty to Claimant.

CLAIMS FOR RELIEF

The following causes of action would be appropriate under the laws of Missouri:

1. Violations of the Missouri Uniform Securities Act

Respondent is jointly and severally liable with and to the same extent as its agent for violations of the Missouri Uniform Securities Act because it directly or indirectly controlled him and knew about or in the exercise of reasonable care would have known about the existence of his unlawful conduct. Respondent completely failed to supervise its broker and is liable as a control person for untrue statements of material fact and fraud perpetrated by its broker. Claimant should be awarded damages available under the Act, including interest at the rate of eight percent per year from the date of purchase, the costs of this arbitration, and attorneys’ fees.

2. Violations of the Missouri Merchandising Practices Act

Respondent and its agents were engaged in the sale of services to Claimant and Jane Doe, which would place them under the purview of the Missouri Merchandising Practices Act. In the sale of those services, Respondent and its agents used deception, fraud, false pretense, false promises, misrepresentations, unfair practices, and concealed, suppressed, and omitted material facts and thereby violated the Missouri Merchandising Practices Act. Claimant should be awarded of all damages available under the Act, including actual damages plus interest from the date of purchase, punitive damages, and

¹ *State ex rel. PaineWebber, Inc. v. Voorhees*, 891 S.W.2d 126, 129-30 (Mo. Banc 1995) (citing *Vogul v. A.G. Edwards & Sons, Inc.* 801 S.W.2d 746, 751-52 (Mo. App. 1990)).

attorneys' fees. Punitive damages are appropriate, given that Respondent has consistently failed to supervise John Doe with this client and many others, and given Respondent and John Doe's intentional efforts to enrich themselves by selling expensive, illiquid securities to vulnerable clients.

3. Breach of Fiduciary Duty

Respondent owed a fiduciary duty to Claimant. Respondent breached its fiduciary duty by failing to appropriately hire, train, and supervise its agent. Claimant was damaged due to Respondent's breach of duty. Therefore Respondent is liable to Claimant for its losses and for punitive damages sufficient to punish Respondent and deter other brokerage firms from allowing brokers to recommend that older clients use almost their entire savings to purchase speculative, expensive REITs.

4. Breach of Contract and Violation of FINRA Rules

Respondent received consideration for the services it offered Claimant. Respondent was obligated to provide her and her agents with competent and professional services in accordance with applicable industry rules, regulations, and practices. Respondent breached its implied and/or written contracts with Claimant by the wrongful acts described above. Claimant incurred damage as a result of Respondent's breach of contract, and should be awarded actual damages plus interest from the date of purchase.

5. Negligence

Respondent owed Claimant a duty to use reasonable care and diligence in hiring, training, and supervising John Doe to act as its actual or apparent agent. Respondent also owed Claimant a duty to use reasonable care and diligence in managing his account. Respondent breached these duties and Claimant sustained damages as a result. Claimant should be awarded compensatory damages, plus interest from the date of purchase.

6. Unjust enrichment

Claimant conferred a benefit upon Respondent, at the expense of Claimant, in the form of fees, commissions, and other monies paid to Respondent. Respondent accepted and retained those monies. Under the circumstances, it would be unjust for Respondent to retain the benefits conferred upon it by Claimant. Therefore the fees, commissions, and other monies paid by Claimant to Respondent should be returned to Claimant.

DAMAGES

Based on the foregoing, Claimant requests an award against Respondent as follows:

1. Recovery of all losses that Claimant suffered due to her investments in non-traded REITs;
2. Return of all amounts paid for financial plans, commissions, surrender fees, management fees, penalties, and other fees;
3. Interest on the funds invested, pursuant to Missouri law;
4. Fees and costs, including attorneys' fees, experts' fees and all arbitration-related costs;
5. Punitive damages in an amount to be determined in arbitration, because Respondent and John Doe took advantage of Claimant and her age, infirmity, and trust to enrich themselves at her expense in violation of their duties as her trusted fiduciaries;
6. Such other relief as is deemed just and proper.

HEARING LOCATION

Claimant requests a hearing in Kansas City, Missouri.

Dated: "Month, Date, Year"

Respectfully submitted,

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