

Award
NASD Dispute Resolution

In the Matter of the Arbitration Between:

Name of the Claimant

Laurena Poole

Case Number: 04-03447

Name of the Respondent

PFS Investments, Inc.

Hearing Site: Charlotte, North Carolina

Nature of the Dispute: Customer vs. Member.

REPRESENTATION OF PARTIES

Claimant, Laurena Poole, hereinafter referred to as "Claimant", was represented by Charles Wuest, Esq., Woska & Hayes, LLP, Kingwood, Texas.

Respondent, PFS Investments, Inc. ("PFS") hereinafter referred to as "Respondent", was represented by D. Larry Kristinik, Esq., Nelson Mullins Riley & Scarborough, LLP, Columbia, South Carolina.

CASE INFORMATION

Statement of Claim filed on May 10, 2004.

First Amended Statement of Claim filed on August 26, 2004.

Second Amended Statement of Claim filed on October 4, 2004.

Claimant signed the Uniform Submission Agreement on August 20, 2004.

Statement of Answer filed by Respondent on October 22, 2004.

A representative of Respondent PFS filed an undated Uniform Submission Agreement with NASD Dispute Resolution.

CASE SUMMARY

In the Statement of Claim, First Amended Statement of Claim and Second Amended Statement of Claim, Claimant asserted the following causes of action, among others: control person liability pursuant to Section 20(A) of the Securities and Exchange Act, breach of fiduciary duty, breach of contract, violation of know your customer rule, suitability, failure to diversify, failure to supervise, violation of securities laws, and failure to hedge. The causes of action relate to the purchase and sale of various mutual funds, including but not limited to Smith Barney Value Class A, Smith Barney Appreciation Class A and Smith Barney Aggressive Growth Class A.

Unless specifically admitted in its Statement of Answer, Respondent denied the allegations made in the Statement of Claim and asserted the following defenses, among others: approval; authorization; ratification; failure to state a claim upon which relief may be granted; assumption of the risk; contributory negligence; Claimant's claims are barred by the doctrines of waiver, estoppel and ratification; failure to exercise due diligence; failure to mitigate damages; and

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Claimant's claims are barred by the statute of limitations.

RELIEF REQUESTED

Claimant in the Statement of Claim requested:

Compensatory Damages	\$ 42,000.00
Punitive Damages	amount unspecified
Attorneys' Fees	amount unspecified
Interest	amount unspecified
Other Costs	amount unspecified

Respondent requested that Claimant's Statements of Claim be dismissed and that it be awarded costs and expenses in defending the claims.

OTHER ISSUES CONSIDERED AND DECIDED

At the hearing, Claimant amended the amount of relief requested to a total amount of \$205,132.00 in damages through expert testimony and documentation, as well as through a post-hearing brief. The Arbitrator accepted the amendment.

The parties 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, the Arbitrator has decided in full and final resolution of the issues submitted for determination as follows and submits the following reasoned award:

In 1999, Claimant, a senior woman resident of South Carolina with a high school education, found herself facing changed financial circumstances six years before she was eligible to collect Social Security retirement benefits. She had worked at BellSouth for approximately 26 years and her job was being eliminated. Any new opportunities at BellSouth would be out-of-state. Since she recently remarried and her other close relational ties were in South Carolina, applying for a new position and relocating were not attractive options. Claimant would soon lose her livelihood. She needed \$1200/month to cover her share of the household expenses. She could retire without penalty from BellSouth after her 56th birthday in January 2000. She had

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choices regarding her pension benefits: the two main choices being 1.) receiving a monthly payment of \$962 until age 99; or 2.) receiving a lump sum payment of \$158,000. If Claimant opted for the monthly payment she would have a shortfall of approximately \$250/month. She also wanted her two adult children to receive benefits from her long tenure at BellSouth if she died soon after retirement. If she took the monthly payment, the benefits ceased at her death.

Except for an ordinary account at a local credit union, a few shares of stock she inherited from her late husband, and a few U.S. Savings Bonds she purchased through payroll deduction, Mrs. Poole had no financial or investment experience. She did not have an Individual Retirement Account. She had never placed her money in an interest bearing money market account or in certificates of deposit. She had no understanding of the securities markets and had never purchased stocks, bonds, or mutual funds. Since Claimant had important financial decisions to make and lacked experience in these matters, she sought professional advice.

At the urging of a close family member, Claimant met with Carolyn Mendelssohn, an investment advisor for PFS Investments, Inc., a marketing company of Citigroup. Mrs. Mendelssohn visited with Claimant at her home in the fall of 1999 and again in January and February 2000. During these meetings Mrs. Mendelssohn learned much about Claimant's background and circumstances. She knew Claimant was losing her job and depended upon her retirement benefits to pay her monthly expenses. She also knew Claimant had limited education, was unsophisticated in life experience, and had no investment experience. In the earlier meetings, Mrs. Mendelssohn brought Claimant literature describing the financial products PFS Investments offered. In the later meetings she brought hypothetical illustrations reflecting the historical performance of recommended mutual funds and a Financial Needs Analysis (the "FNA"). Claimant testified that Mrs. Mendelssohn explained things in technical language that

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she did not understand. The expert witness testified that from his conversations with Claimant it was clear that she understood very little of the concepts Mrs. Mendelsohn explained. Claimant took away from the conversations and the literature, an understanding that if she took the lump sum payment and invested it in the recommended products, her money would grow and enable her to withdraw \$1200/month income. In February 2000, Claimant retired from BellSouth, took her benefits as a lump sum payment and invested it with PFS Investments, Inc. in three mutual funds Mrs. Mendelsohn recommended.

The Arbitrator finds that the record supports the conclusion that Mrs. Mendelsohn did not have reasonable grounds to believe her investment recommendations were suitable for Claimant, in violation of NASD Rule 2310. The initial investments in February 2000 and the investments in November 2001 were unsuitable investments given Claimant's age, loss of livelihood, immediate need for income, and limited ability to recover from market losses. The Arbitrator also finds that Mrs. Mendelsohn tried to mask the unsuitability of the investments by intentionally distorting the FNA Investment Profile (the "FNA") and the Client Profiles in the Smith Barney Mutual Funds Retirement Plan Account Applications (the "Applications"). The testimony and the Arbitrator's review of these documents revealed inconsistencies between the answers Mrs. Mendelsohn recorded and the information she knew about Claimant. In answer to the question "What do you want from your investment?" Mrs. Mendelsohn marked "Achieve growth with an emphasis on capital appreciation not on income." Since Claimant was losing her livelihood and had immediate cash needs it is clear that she needed income. In answer to the question "When do you anticipate needing the funds?" Mrs. Mendelsohn marked 3-6 years on the FNA and one of the Applications, and 7-10 years on the other. Again, Claimant would soon no longer have a job and she had no savings or other liquid assets to replace that income. She

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depended solely on the retirement funds and any income it could gain to pay her living expenses until she was eligible to collect Social Security. She needed immediate access to the funds. In answer to the question "Which of the following statements best reflects your comfort level with negative returns and its possible impact on your investment?" Mrs. Mendelsohn marked "I can tolerate negative performance spanning a year or more, understanding that this is often the trade-off for the possibility of earning higher returns." Mrs. Mendelsohn knew that Claimant, due to her inexperience and lack of investment knowledge, had no context in which to understand market losses and no context in which to gauge her emotional response to losses in account value. Additionally, Claimant had no understanding of the difference between income and capital appreciation.

Despite Mrs. Mendelsohn's efforts to cover the distortions, a comparison of the two Applications (the second Application completed 10 days after the first) would have uncovered inconsistencies. One Application indicated Claimant had zero years of investment experience and the other Application indicated she had 10 years of experience. The net worth calculations on the applications were different by \$100,000 and the number of dependents was different. Furthermore, a close reading of the Client Profiles should have raised warning signs. The suitability section of the PFS Investments, Inc. Supervision Procedures manual has guidelines for considering age and net worth in determining the suitability of an investment. A review of Claimant's profile would have revealed that the investments were outside the guidelines. The manual exhorts an advisor to discourage a customer from making an unsuitable investment and if the customer insists, the advisor should put the cautions in writing and place a copy in the customer's account record. No such letter was offered as evidence that the guideline breach was truly Claimant's choice. The out-of-bounds investment and the absence of a warning letter

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should have raised a red flag. Given the above-referenced evidence and an absence of testimony concerning Respondent's implementation of its Supervision Procedures, the Arbitrator finds that Respondent failed to supervise Mrs. Mendelssohn in violation of NASD Rule 3010.

Upon review of the FNA and the other documents given to Claimant to persuade her to take the lump sum and invest with PFS Investments, Inc., the Arbitrator finds these documents confusing and misleading. The FNA coupled with Hypothetical Savings Deposit Schedules gives the impression that capital appreciation and income are the same. Claimant did not know the difference. She did not understand the greater volatility of equities as compared to other investments, the greater risk of substantial losses, or her handicaps in recovering from substantial losses. The record also shows that Claimant did not understand that PFS Investments, Inc. had a limited portfolio of financial products to offer. The misleading quality of the FNA and other documents, the Client Profile distortions, the lack of clarity concerning the difference between income and capital appreciation, and the omissions regarding the limited product offerings leads the Arbitrator to conclude that the February 2000 and November 2001 transactions were misleading in violation of the South Carolina Uniform Securities Act and the South Carolina Unfair Trade Practices Act. The Arbitrator did not find Respondent's arguments concerning the statute of limitations persuasive. The November 2001 transaction refreshes the ethical defects of the February 2000 transaction, therefore the May 2004 filing of the statement of claim is well within the respective statutes of limitations.

This case raised other ethical concerns. Mrs. Mendelssohn is a professional with specialized education, training, and experience that gives her power in relation to an inexperienced person like Claimant. The potency of this power was more pronounced because Claimant had an immediate problem to solve. She was worried, vulnerable and took the risk of

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trusting Mrs. Mendelsohn to help. As the professional entrusted (or potentially entrusted) with another's assets, Mrs. Mendelsohn had a duty to do no harm and to act in Claimant's best interest. The advice given should have fit Claimant's characteristics and life situation. Upon consideration of the record, the Arbitrator believes that Mrs. Mendelsohn allowed her ambitions to cloud her professional judgment whereby she failed to appropriately discern whether she was the right financial professional to help Claimant. Acting in Claimant's best interest may have meant encouraging her to seek coordinated advice from financial professionals with different concentrations or certifications. She needed a financial planner and retirement specialist who could develop various alternatives for dealing with her income needs and help her decide upon a sound strategy. She also needed guidance from a tax advisor who could explain the tax implications of her strategic alternatives. Although the Arbitrator finds that the conduct in this case overstepped ethical bounds, the Arbitrator does not embrace Claimant's negative characterizations of Mrs. Mendelsohn and PFS Investments, Inc.

The Arbitrator accepted the interest figure from the damage document which was calculated from the original investment amount less the amounts withdrawn at 6% per annum from the date of the original investment (February 2000) through the date of liquidation (March 2005). The reasonable attorney fees and costs awarded are intended to be full satisfaction of Claimant's attorney fee agreement. The Arbitrator did not consider reasonable the professional time expended on the multiple motions to compel discovery, the motions for sanctions, and the pre-hearing brief, and therefore discounted a substantial portion of the time indicated in counsel's affidavit. For all of the foregoing reasons, the Arbitrator awards the Claimant double the amount of her calculated losses, interest, reasonable attorney fees and costs as set forth below:

1. Respondent is liable to and shall pay to Claimant the sum of \$ 112,410.00 in compensatory

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damages;

2. Respondent is liable to and shall pay to Claimant the sum of \$ 36,517.00 in interest;
3. Respondent is liable to and shall pay to Claimant the sum of \$ 37,000.00 in attorneys' fees, pursuant to the SC Uniform Securities Act;
4. Respondent is liable to and shall pay to Claimant the sum of \$14,698.00 in costs, expert witness fees and damage award calculation fees;
5. The parties shall bear their respective costs, except as Fees are specifically addressed below, and
6. Any and all relief not specifically addressed herein, including punitive damages, is denied in its entirety.

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 = \$ 300.00

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. Accordingly, Respondent is a party.

Member surcharge	= \$ 1,700.00
Pre-hearing process fee	= \$ 750.00
Hearing process fee	= \$ 2,750.00

Adjournment Fees

Adjournments granted during these proceedings for which fees were assessed:

May 4-5, 2005, adjournment by Claimant = \$ 450.00

Three-Day Cancellation Fees

Fees apply when a hearing on the merits is postponed or settled within three business days before the start of a scheduled hearing session:

May 4-5, 2005, adjournment by Claimant = \$ 100.00

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Forum Fees and Assessments

The Panel has assessed forum fees for each session conducted. A 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 sessions with a single arbitrator @ \$ 450.00	= \$	900.00
Pre-hearing conferences:		
December 16, 2004	1 session	
August 3, 2005	1 session	
Five (5) Hearing sessions @ \$450.00	= \$	2,250.00
Hearing Dates:		
August 24, 2005	2 sessions	
August 25, 2005	3 sessions	
<u>Total Forum Fees</u>	= \$	<u>3,150.00</u>

1. The Panel has assessed \$ 1,575.00 of the forum fees to Claimant.
2. The Panel has assessed \$ 1,575.00 of the forum fees to Respondent.

Fee Summary

1. Claimant is assessed and shall pay:

Initial Filing Fee	= \$	300.00
Adjournment Fee	= \$	450.00
Three-Day Cancellation Fee	= \$	100.00
Forum Fees	= \$	1,575.00
<u>Total Fees</u>	= \$	<u>2,425.00</u>
<u>Less payments</u>	= \$	<u>625.00</u>
Balance Due NASD Dispute Resolution	= \$	1,800.00

2. Respondent PFS is assessed and shall pay:

Member Fees	= \$	5,200.00
Forum Fees	= \$	1,575.00
<u>Total Fees</u>	= \$	<u>6,775.00</u>
<u>Less payments</u>	= \$	<u>3,250.00</u>
Balance Due NASD Dispute Resolution	= \$	3,525.00

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

ARBITRATOR

Kimberly G.W. Day-Lewis, Esq.

- Public Arbitrator, Presiding Arbitrator

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Arbitrator's Signature

Kimberly Day-Lewis

Kimberly G. W. Day-Lewis, Esq.
Public Arbitrator, Presiding Arbitrator

10/10/2005

Signature Date

October 11, 2005

Date of Service (For NASD Dispute Resolution office use only)