WHEN IS AN ORDER AN ORDER?
UNAUTHORIZED TRADING BY SECURITIES BROKERS

Securities Arbitration
Practicing Law Institute (PLI)
1994

Douglas J. Schulz
Invest Securities Consulting Inc.
Westcliffe, Colorado

I. INTRODUCTION

Unauthorized trading of securities in a customer's brokerage account is one of the top five causes of action in securities arbitration.

The securities rules on unauthorized trading can be broken into two sets of rules. The first set dictates that the brokerage firm must have a client's prior written permission before the broker can make a trade without first discussing it with the client. The second set of rules concern what the broker must say to the client in order to produce a valid order. A related set of rules, which will be touched upon in this article, govern generally a broker's communication with an investor when soliciting an order; a violation of these rules do not per se constitute grounds for a unauthorized trading claim.

I have participated start to finish in many arbitrations as an expert consultant and witness. I have heard stock brokers and brokerage managers spout all kinds of opinions on what the necessary communications are between the broker and the client according to the regulations and norms of the securities industry, when placing an order. It was these divergent, inconsistent, and often unsupportable opinions that served as a catalyst for me to research and write this article. In writing the article, I conducted a survey of brokers, brokerage managers, compliance and supervisory personnel for their opinions on the subject of when is an order an order. Additionally, I spoke with regulators concerning their interpretation of rules and regulations governing proper order entry and communications between a stockbroker and the client.

II. WHY THE RULES WERE WRITTEN

A broker wields a tremendous amount of power in the ability to make a securities transaction without first discussing the transaction in detail with the client. This power is magnified because the broker-client relationship is almost universally recognized as one of trust and because client approval, when given, is granted verbally on the telephone. Against this backdrop emerged the strict rules of Congress and the various exchanges governing proper communication between a broker and a customer.

When Congress wrote the 1934 Act, it likely realized that having a well educated investing public was an unrealistic dream. Congress knew that investors would both trust and rely on their brokers. It further recognized that it was much easier to educate, train, license and regulate brokers and brokerage firms than the investing public

Although the securities business is perceived as being extremely document intensive, there is actually but a few documents which must be executed by an investor to open an account. Indeed, investors can open an account over the phone and be trading thousands of dollars in minutes with no documents being signed nor money transferred.

The Customer Agreement is a document rarely read or fully understood by the investor wherein both the investor and the brokerage firm agree to abide by the rules of the industry. There is also a New Account Form, which is the only document the brokerage firm has which evidences, in a very limited and restricted manner, what the client's investment goals are. Even though some brokerage firms are now sending the New Account Form to the clients, it is often filled out by the broker and never seen by the client.

Today, the investing public is as uneducated about the rules and regulations of the industry as they have ever been. Other than the Customer Agreement, the regulators and brokerage firms have taken little action to inform investors of some of the more basic rules of the industry. What constitutes unauthorized trading, what a GTC order is, and what time and price discretion are remain "Greek" to the majority of investors. Therefore, the onus is on the brokers and brokerage firms to ensure that the rules are followed.

III. LEGAL, DISCRETIONARY TRADING

Many people confuse unauthorized trading with discretionary trading. Discretionary trading (perhaps undeservedly) has gotten a bad name, as it is often alleged alongside an unauthorized trading claim. Discretionary trading is <u>not</u> unauthorized if the investor has given written authority to a particular broker or brokers to make transactions without first talking with him or her. In other words, discretionary trading is legal if it is properly authorized.

The rules of both the NASD (Article III, Section *15)* and the NYSE (Rule 408) require that the authority to make discretionary trades must be in <u>writing</u> and signed by the client. The author has heard all too often the defense that because the client gave the broker <u>verbal</u>. as opposed to written authority to trade on discretion, that the brokerage firm has fulfilled his duty and thus can make discretionary trades. Before the brokerage firm can make <u>any</u> trade on a discretionary basis, written authority must be obtained, lest the broker and the brokerage firm be in violation of both of the above rules

Section 15 of the NASD Manual - Rules of Fair Practice is devoted to "Discretionary Accounts" and provides that (a) no trades made in a discretionary account shall be excessive; (b) discretionary authority must be obtained from the client <u>i n</u>

writing and prior to any trades being made and such authority must be reviewed and accepted by management; and (c) supervisory individuals will monitor each discretionary order entered to detect and prevent transactions which are excessive in size or frequency in view of the financial resources and character of the account. Subpart (d) provides an exception to Section 15 in situations where discretion is used as to "the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified security shall be executed."[1]

NYSE Rule 408 is similar to the NASD rule, however it requires that the order must be marked discretionary at the time the order is entered and that written procedures on supervising discretionary trading must be maintained.[2]

Even with legal, discretionary trading though, inherent conflicts of interest still exist. The brokerage industry has therefore seen fit to entirely prohibit the use of discretionary trading for the purchase of direct investments or limited partnerships. The same restriction applies to option or commodity trading, even where the brokerage firm has written discretionary papers on hand for the client.[3]

Some brokerage firms have enacted their own rules restricting the use of discretionary trading. "Discretionary accounts are open to serious abuse.. account executives are well advised to refuse discretionary accounts unless they thoroughly understand the client's objectives and financial capabilities."[4] Dean Witter will only allow discretionary accounts where the customer is difficult to reach and where the investments are very conservative in nature.[5] Other brokerage firms only allow discretionary trading to be utilized by their most senior brokers.

IV. UNAUTHORIZED TRADING

There is no one rule of the securities industry more sacrosanct than that of unauthorized trading. Even those not versed in securities can imagine what abuses might result if a stockbroker were able to buy and sell securities in a customer's account with little or no discussions between the broker and client taking place beforehand.[6]

Courts have held that unauthorized trading is a violation of l0b-5 of the 1934 Act.[7] Unauthorized trading is also a violation of Article III, Section 15 of the NASD Rules of Fair Practice. Beyond these "statutory" rules, unauthorized trading is also the basis of common law claims of breach of contract, breach of fiduciary duty, fraud, and negligence. Unauthorized trading, when unchecked by the brokerage firm and/or intentionally conducted by the stockbroker, can lead to findings of gross negligence and thus the imposition of punitive or treble damages.

Inasmuch as the authority to make a particular trade typically is given by the customer in a telephone conversation with the stockbroker, the potential for abuse and hence the necessity for proper communication is great.

A. Proper Communication

Claims of unauthorized trading or unauthorized, discretionary trading often fall within the parameters of the rules governing brokers' proper communication with the public. The origination of an unauthorized trading claim or an unauthorized discretionary trading claim is usually either an entire lack of communication between the broker and the investor or communication which, in some respects, is incomplete.

An investor can only consent or authorize a trade if he or she understands what the broker is saying when the broker calls to suggest or solicit a trade. It is the stockbroker's responsibility to determine the customer's level of understanding of the securities markets.[8] The broker's fulfillment of what is known as the "Know Your Customer" rule provides the foundation for obtaining a properly authorized order. The order taking process may take place in a single phone call or a series of phone calls regarding the same order.

Brokers must communicate certain information to clients in soliciting an order for a particular investment. Brokers are not allowed the luxury of placing orders based on general conversations with investors concerning an investment. Rather, conversations concerning the investment must be specific in nature.

The order ticket itself provides a starting point for the most basic of information that must be discussed and agreed upon during the order taking process. While not all inclusive, the order ticket provides guidelines for the following to constitute a valid order:

1) the type of trade, such as a buy, sell, sell short, etc.

2) the specific security to be purchased;[9]

3) exactly how many shares/units are to be purchased;

4) the exact price the order is to be entered (unless it is a specialty market order[10]);

5) the current price at which the security is trading; and

6) any special instructions[1] 1

Additionally, the broker must disclose to the client where or not the brokerage firm makes a market in the security, if the trade is on a principal basis, if the firm was a manager of an offering in the past three years, if the firm has any positions or options in the proposed investment company, and if the brokerage firm has an employee that is a director of the security in question.[12]

B. <u>The Gray Area</u>

There exists some gray area in determining when an order is an order and thus whether or not an unauthorized trading allegation is substantiated. Typically, the gray area arises when the broker and client have had communications relating to trading in the account, but the question is whether the communication was sufficient to have met the test of "when is an order an order".

There is no NASD or NYSE rule which specifically defines "unauthorized trading". However, a number of rules provide the framework for determining what a broker should say to a customer in soliciting an order. NYSE Rule 472 entitled "Communications with the Public" states that no communication shall <u>omit material facts.</u>[13] NYSE Rule 401 requires brokers to adhere to the principles of good business practice.[14] Rule lOb5 defines as fraudulent any statement that is misleading or an omission of relevant facts.[15]

What is relevant or material are those factors which may have influenced the investor to either allow or disallow the broker to enter the order. If the following additional factors are not discussed with the investor prior to the trade, then the foundation may be laid for an unauthorized trading claim.[16]

1) the total approximate dollars (including commissions) the trade will involve;

2) the total approximate commissions the trade will generate;

3) the various risks attendant to the

4) whether the broker is trading the or other accounts; and

5) significant, recent news concerning question.

The NASD has previously enumerated matter as necessary topics of discussion the client in soliciting an order:

(1) the nature and rationale of the trading strategy, including its expected tax consequences;

(2) the anticipated volume and frequency of trading;

(3) the degree of risk anticipated;

(4) the potential of net profit considering market risks, tax consequences and commissions costs; and

(5) the customer's understanding of these factors.[17]

Indeed, brokerage firms have memorialized their own topics of discussion necessary between a broker and client under certain scenarios. For example:

1) If the trade is an initial public offering (IPO), there is a two step process whereby first the broker obtains from the client an indication of interest and subsequently, confirms the availability of the shares with the client.

2) If the trade is a mutual fund order, the client must be advised of sales charges, letters of intention (LOI), and rights of accumulation (ROA).

3) If margin is to be utilized in the transaction, then the broker must give the client "a verbal explanation of the computation and terms of margin interest charges."[18]

Although the brokerage firms do not declare in writing that if the above items are not communicated to the client, then the trade is unauthorized, an argument can certainly be made that if knowledge of the above items would have influenced the investor to <u>not make the transaction</u>, then the trade may well be unauthorized.

C. <u>Timing</u>

The issue of when a broker discusses a trade with a client in relation to when he enters the trade is a crucial one in many unauthorized trading disputes.

The norm in the industry is that the broker fills out the order ticket while taking the order from the client.[19] Any additional latitude is measured in minutes, not hours. This standard exists as much to protect the brokerage firm, as well as the client, from errors or misunderstandings. The broker should also read the written ticket back to the client before entering the ticket, making sure all the information is correct and understood.[20] Lastly, the broker is to contact the investor after the trade in question has been executed in order to inform the investor that the trade was made and to confirm the price.[21] This last step is not only considered proper customer service, but it cuts down on order errors and misunderstandings and if there are mistakes or misunderstandings, they are quickly caught. Guidelines such as these are published by the brokerage firms in their manuals and training course material. The fact is that they are rarely followed or monitored. Many an unauthorized trading claim would be prevented if brokers adhered to and brokerage firms enforced the above guidelines.

V. GOOD TILL CANCELED "(GTC)"

A client may direct a ticket to be entered "good till canceled" (GTC). GTC is also known in the industry as an open ticket. It is industry practice to presume that a client's order to buy or sell is valid for that day only and is to be transacted as soon as is practical after its receipt. Either the broker or the client must take affirmative action to interfere with this presumption.

GTC orders are designed so that an investor can decide to enter an order/trade with a specific price limitation of some type, and if the trade is not executed by the end of that trading day, the order is carried over to the next trading day. The order remains in the system until it is canceled.

Many tickets that are entered GTC or "open" are either limit or stop loss orders. A limit order is an order to buy or sell a stated amount of a security at a specified price or at a better price, if obtainable, after the order is presented to the trading floor. A stop order is a suspended market order. Whether or not it becomes effective is contingent on the price movement in the marketplace. If there is a transaction at or through the stock price set by the client, it becomes a market order. Stop orders may also be entered with a limit price. A stop limit order to buy must be entered above the current market - it becomes a limit order to buy if a transaction occurs above the stock price. The American Stock Exchange permits stop limit orders in the round lot market, provided that the stop and limit price are the same. As the name implies, a stop limit order is a suspended limit order. Sell stop limit orders may also be entered and should be entered below the current market price.

The NYSE used to require that all GTC tickets be renewed every six months, but this is no longer a requirement. The brokerage firms themselves have different regulations about how long a GTC ticket is good. At firms like Merrill Lynch, Bear Stearns, and Rotan Mosle, any ticket that is entered GTC or open is automatically canceled at the end of thirty (30) days unless the broker and/or the client renews the ticket. At Dean Witter and Prudential Securities, there is no automatic cancellation. The GTC that is entered in the system is left in the system until canceled by the broker or his client through the broker.

All open and GTC tickets must be marked and entered accordingly. It is the general practice at all firms that if a GTC ticket is entered, a confirmation slip of the order is sent directly to the client. It is also a general practice that GTC tickets are written on the client's monthly statement of account, reflecting the GTC or open order.

VI. TIME AND PRICE DISCRETION

Time and price discretion is the single exception under the NYSE rule that permits a broker to take discretion without prior written permission by the client.[22] The broker must still discuss in detail all of the other facts surrounding the order, but the broker may accept discretion as to when he may enter the order (the time) and at what price he will enter the order (the price).

The time and price exception is often misused, not only in the practical world of brokerage transactions, but in arbitration where it has become a favorite defense to unauthorized trading claims. A number of brokerage firms recognize the potential for abuse; firms such as Dean Witter do not allow their brokers to use time and price discretion. Other firms, while allowing time and price discretion, discourage it. It is the author 5 opinion that the exception to section 15 of the NASD Rules should be disallowed altogether, because its abuse is rampant.

Two scenarios of abuse are seen more often than others. The first is when the broker simply takes time and price discretion without discussing it beforehand with the investor. This is a violation because the broker must inform the client that he wishes to take time and price discretion, explain what time and price discretion means and then ask the client if he can have discretion prior to each and every trade. Time and price discretion may not be obtained after the fact nor may it based on any assumptions. It is only applicable as to specific authority for specific trades.

The second area of abuse is in the timing of time and price discretion. The NYSE measures time and price discretion in hours or days, not in weeks. Therefore, a time and price discretion that lasts more than a day or two is questionable and most likely a violation. If a broker wishes to take longer to enter a trade for his client, he has two other options - call the client back or use a "Good Till Canceled" (GTC) order ticket.

It would not be difficult to imagine the chaos and problems which would result if the industry allowed brokers to have large numbers of orders not written down, not entered, and subject to being entered based on the whim of the brokers. Throw in large, upward spikes or significant drops in the markets to this scenario and picture the conflicts this leeway would create.

The survey I conducted revealed that most people felt that the order ticket should be written at the time the order is taken from the client, even though the order will be entered later. Although it appears there is no NASD or NYSE rule that requires the broker to write the ticket immediately after receiving the order from the client,[23] there are a number of rules clearly requiring written documentation of the order and requiring that such documentation be forwarded to the client.[24]

Time and price discretion and Good Till Canceled (GTC) orders are explained in this article because they often are used by the brokerage industry as defenses for unauthorized trading. These defenses many times have bordered on the ridiculous. In one case in which I was involved, the broker and the client initially had some general discussions concerning investments. Months went by and thereafter daily trading took place with no additional conversations with the client. The defense - a denial that unauthorized trading occurred and an assertion that the broker used GTC orders and time and price discretion.

VH. THE DE FACTO DISCRETIONARY ACCOUNT

Courts have used a term called the "de facto discretionary account"[25]. This term describes the situation where the relationship between the broker and the client is such that the broker is viewed as controlling the account and all of the trades. It often occurs where the client is naive, where the client is related to the broker, or simply where the client places unqualified trust and reliance on the broker.[26]

The de facto discretionary relationship is most often used to measure churning and suitability violations, as opposed to unauthorized trading, however it too raises the question of precisely what must be communicated to the client before taking an order. If the client receives little explanation or information on a specific trade, then the broker may be held to be operating a discretionary account on behalf of the client.

Often, when there is a claim of unauthorized trading, there is also a claim of churning or unsuitable trading. An interesting question in many unauthorized trading cases is, "If the broker was so sure that a full and fair disclosure of information to the client regarding a trade would result in the client approving the transaction, then why would the broker make unauthorized trades in the first place?" It can best be handled by the claimants attorney by asking the investor the following question: "Mr. Investor, if the broker had told you that this investment was illiquid and very risky, would you have allowed him to place the order?" Your client's answer should be, "No."

VIII. UNSOLICITED V. SOLICITED TRADES

It is surprising to hear the number of definitions given by brokers and experts of just what constitutes a solicited versus an unsolicited trade. The securities industry can only look inward for blame. Most compliance manuals are void of explanations of the difference.

Dean Witter is one firm that does an good job of spelling out the difference:

> "Whenever an A.E. recommends a transaction to a customer and the customer follows that suggestion, the resulting order is considered to be solicited, provided that the time that has elapsed between the suggestions and the actual order is not unreasonable and there has been no material change in the recommended security... .An order resulting from the mailing of any research report or written communication concerning a specific security is also considered solicited."[27]

There exists a perception that the fullness of the communication between the broker and the client is lessened if the trade is unsolicited. The rationale is that if the client is making the investment decisions totally independent of any input from the broker, then the responsibility for the trade rests on the shoulders of the client, as opposed to the broker and brokerage firm. However, be aware of the Peterzell v Charles Schwab arbitration case.[28] There, the panel determined that even though the trades were unsolicited, the "know your customer" rule was still applicable and the brokerage firm still had the responsibility to ensure that the trades were suitable for the client.

PaineWebber's Sales Practice Policy Manual poignantly states, "While the burden of suitability is somewhat less in instances of unsolicited transactions, brokers may not be totally relieved of this responsibility and they should consider discouraging a client from making transactions which the broker believes may be contrary to the client's best interest."[29]

IX. INDICATIONS OF UNAUTHORIZED TRADING

The brokerage firm's compliance personnel or managers have the benefit of a variety of "red flags" which should alert the firm that one of it's brokers may be conducting unauthorized trading. These "red flags" are many times the same "red flags" that are indications of churning or unsuitable trading.

Brokerage firms are required to have "screens" set up which monitor the trading in all accounts and which alert the firm to possible improper trading, including unauthorized trading. The following are some of the activities which are monitored and which may trigger internal alarms:

evidence of excessive activity

- numerous trades
- in and out trading (buying & selling the same or similar securities)
- high turnover of equity
- commissions large in relationship to equity of account possible trading beyond the client's resources
- unusual trading
- significant losses
- consistent losses
- consistent and similar trading patterns in most of the broker's accounts
- large and uneconomical margin balances
- one account's commissions are a large percentage of the broker's total production

Unauthorized trading claims are rare in legal, discretionary accounts because there, the customer has granted authority to the broker to make trades without prior discussion. It is in non-discretionary accounts where the bulk of unauthorized trading allegations occur. If a broker from the outset plans to make a series of unauthorized trades on behalf of a customer, he would have little incentive to create a legal, discretionary account for the client for two reasons. First, the broker may not be able to obtain the customer's written permission and the request may only serve to alert the client of the potential for such activity. Second, and most importantly, if the broker opens a legal, discretionary account, he will subject himself and the account to a much higher level of supervision. The regulations require not only more supervision but additional reporting requirements on accounts which have been designated discretionary. A broker who is planning on breaching the rules in this area cannot afford this extra supervision.

x. UNAUTHORIZED TRADING CLAIMS IN ARBITRATION

"Unauthorized trading" is a familiar term to the brokerage houses. Claimant's counsel in an arbitration case involving the allegation of unauthorized trading should always request the compliance and supervisory manuals from the brokerage firm in question. These manuals will go into some detail about the requirements, restrictions, regulations, and supervision of trading which may be unauthorized.[30]

A favorite defense of brokerage firms to unauthorized trading is that the clients received the confirmations and the brokerage statements and did not immediately complain. Therefore, they argue, the clients have "ratified" the trades.

The rebuttal is that a customer is unable to "ratify" something about which he knows not all of the relevant facts. Additionally, it has been held that unless the customer is aware and has been informed that he has the right to reject unauthorized trades, the brokerage firm will be deemed to have breached its fiduciary duty and cannot use ratification as a defense. "There could not have been ratification... ratification occurs only when the customer with full knowledge of the facts, manifests his intention to adopt the unauthorized transaction."[31] Again, the sufficiency and completeness of the communication between the broker and the client is the determining factor. The NASD has stated, "The details of discussions between the broker and customer as to trading strategy to be followed and the attendant risks are vitally important to a determination of whether the customer knowingly consented to the strategy."[32]

One of the more unique defenses to unauthorized trading which I witnessed was in the <u>Tottenham v Bear Stearns</u> arbitration.[33] The defense in that case argued that the "ironclad" policy of both Bear Stearns and the securities industry obviated the need to obtain <u>written</u> authority for discretionary trading where "apparent authority" existed. There is no "apparent authority" in the brokerage industry. The claimants were awarded $2.4 million dollars in actual damages and one million dollars in punitive damages.

Another interesting defense of brokerage firms is the, "We had discretion but did not use it" defense, which I have witnessed on a number of occasions. This rationale is not an acceptable way to conduct business. If the brokerage firm or the client decides to cancel or not use the discretionary feature once it is established, notification to all parties must be in writing.[34]

One hotbed of disputes in arbitrations is whether the broker owed fiduciary responsibilities to his clients.[35] When the brokerage firm has written, discretionary authority, fiduciary responsibility automatically attaches. Also the burden to prove the suitability of trading in the account shifts 100% to the brokerage firm once it is established that the brokerage firm not only selected all of the investments in the account, but placed the orders without discussing them with the client. The existence of fiduciary responsibilities in a non discretionary account will likely be determined by the governing state law.

It is very helpful if claimant's counsel can establish clear cut violations of the unauthorized trading rules by showing the impossibility of communication during the relevant period. For example, if a client can prove that he was out of the country during the time period that trades were made, this would be some evidence of unauthorized trading. During the discovery process, counsel for both sides should request phone records of long distance calls, where applicable. When the production of phone records of both the brokerage firm or the investor reveal little to no phone contact during the trading period, this is a strong indication of unauthorized trading.

XI. CONCLUSION

The solution to the problem of continuing unauthorized trading is much the same as with many of the other securities regulations that are consistently broken: education and enforcement by the brokerage firms, the SRO's and the SEC.

Many investors have no idea what unauthorized trading consists of. No rule books, guidelines, or information sheets are furnished to investors upon the opening of their accounts. Far too many individuals believe that stockbrokers can act as licensed professional money managers and make trades as they see fit. New titles sported by stockbrokers, such as "financial consultant and "financial advisor" do little to dispel this impression. Oftentimes, the customer's discovery that unauthorized trading has occurred is secondary to other complaints voiced against the broker.

The toughest battle may be getting brokerage firms to take serious steps to limit unauthorized trading. One would hope that the simple fact that the industry is paying out millions of dollars in awards would be enough incentive to initiate this process. Or better yet, the realization by the industry that it is eroding the confidence of the investing public by not beefing up compliance and supervision departments should be a catalyst.

Education of the arbitrators is another solution. We have decided to place the ability of thousands of investors to recover damages in the hands of a few individuals. The least we can do is properly educate them to know the rules and regulations of the industry. It is ridiculous that arbitrators are not provided a free copy of the manuals for the NASD or NYSE when they become arbitrators.

The final alternative is public education, a feat that is perhaps beyond reach. The onus and major responsibility for correcting violations remain on the shoulders of the broker and the brokerage firm. Hopefully, in your next arbitration you will be armed with a better understanding of when an order is truly an order.

1 NASD Manual-Rules of Fair Practice, Article III, Section *15.*

2 New York Stock Exchange, Constitution and Rules, 1993. Other similar exchange rules include CBOT 423, CBOE #9.10, CHI. MERC. 932, and NFA 2-8(a) & 2-20.

3 Rare exceptions are if the client provides separate, written permission for the discretionary trading of direct investments (NASD Manual-Rules of Fair Practice, Article III, Appendix F, section 3(d)) or options (NASD Manual-Rules of Fair Practice, Article III, Appendix E, Section 18(a)).

4 The Securities Industry, A Program of the Professional Account Executive, Merrill Lynch, 1980.

5 Dean Witter Account Executive Compliance Guide, Discretionary Accounts 2.15

6 The potential for abuse would be greatly minimized if stockbrokers were not compensated based on their level of production.

7 Corbey V. Grace, *605* F. Supp. 247, 252 (D. Minn. 1985); United States v. Pray 452 F. Supp. 788 (M.D. Pa. 1978); Nye v. Blyth Eastman Dillon, 588 F.2d 1189 (8th Cir. 1978); Mansbach v. Prescott. Ball & Turben, 598 F. 2d 1017 (6th Cir. 1979); Cruse v. Equitable Securities of New York. 678 F. Supp. 1023, 1028 (S.D.N.Y. 1987).

8 NYSE Rule 405, the "Know Your Customer Rule", requires that the broker "use due diligence to learn the essential facts relative to every customer...."

9 If there are a number of various classes of the same security, only one specific class must be specified. For example, General Motors Common, $5.00 Cumulative Preferred, $3.75 Cumulative Preferred, Class E.

10 This would include orders such as market orders, at the opening, not held, at the close.

11 This would include instructions such as limit orders, stop loss, fill or kill, all or nothing, all or none, immediate or cancel.

12 New York Stock Exchange Constitution and Rules, Rule 472.40, February, 1993.

13 New York Stock Exchange Constitution and Rules, Rule 472.30, February, 1993.

14 New York Stock Exchange Constitution and Rules, Rule 401, February, 1993.

15 Code of Federal Regulations 240. lOb-S

16 This of course assumes that the investor has met the other requisites of an unauthorized trading claim, including damages.

17 Undated NASD Memorandum from William R. Schief to District Directors.

18 PaineWebber's Branch Office Manager's Supervisory Manual #5.3.

19 Patterns of Supervision, New York Stock Exchange, Page 69.

20 Patterns of Supervision, New York Stock Exchange, Page 69.

21 Patterns of Supervision. New York Stock Exchange, Page 69.

22 NASD Manual-Rules of Fair Practice, Article III, Section *15.*

23 Specific guidelines do govern the purchase and sale of commodities.

24 Rules 10(b)(10) and 17(a)(3) of the 1934 Act and NYSE Rules 407 through 410.

25 Mihara V. Dean Witter 619 F.2nd 814 (9th Cir. 1980).

26 Dean Witter's Account Executive Compliance Guide, Investment Recommendations

27 Dean Witter's Account Executive Compliance Guide, Investment Recommendations 3.2 page 1, March, 1988.

28 Peterzell V. Charles Schwab. NASD Arbitration 88-02868.

29 PaineWebber's Sales Practices Policy Manual, Opening New Accounts 3.1

30 PaineWebber's Practices & Policy Manual calls these rules "know your customer... .know every order"

31 Merrill Lynch V. Cheng, 901 F.2d 1124 (Ct. Appeals D.C. 1990).

32 Undated NASD Memorandum from William R. Schief to District Directors.

33 NASD arbitration 90-02700. Securities Arbitration Commentator, SAC ID 9011039

34 PaineWebber's Policy Manual 4.2 requires written notification.

35 Many states recognize the a broker's fiduciary duty as a matter of state law. Joel Peterzell V. Dean Witter. American Arbitration Association #32-136-0416-88-iD