Investor Bites Broker: NASD Restores Shares Lost in Margin Call

By David Dietz

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When the **Nasdaq** tumbled in April, the press was full of reports about hapless investors who had bought on margin and were unceremoniously sold out of their positions by their brokers when the value of their holdings fell. Some individual investors complained that they had no chance to avoid a sale by sending in more money or perhaps by choosing to sell something else.

Those complaints may have elicited sympathy from fellow investors, but it turns out that brokers were within their rights and the sales stuck. Now, margin buyers may be turning the tables.

California investor John Roth did and just scored a large stock award in an arbitration case filed with the **National Association of Securities Dealers** against his broker, **GKN Securities**. The decision, announced this week, restored more than $500,000 lost to Roth's account when GKN virtually sold him out in 1998.

Roth's attorney, Cary Lapidus of San Francisco, sees the victory as a warning shot across the bow of brokers who pull the trigger precipitously on clients with wilting portfolios.

"This case shatters the myth that customers cannot win margin liquidation cases," Lapidus said.

Brokers who loan money to customers to acquire stock, a process called margin buying, ordinarily have wide discretion to sell holdings if the value of an account drops. In many instances, though, brokers will give margin clients a chance to come up with cash or other collateral to compensate for the collapse.

Many margin investors were sold out during the technology wipeout in March and April, causing

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widespread protests. While many of the complaints were attributed to poor customer awareness of margin rules, some clients argued that positions were liquidated unfairly.

This was the crux of Roth's case: Roth was a veteran, well-heeled GKN margin customer who always made good whenever his broker called him to revive a sagging account. But in October 1998, he argued, GKN didn't give him an adequate chance when it sold at least $500,000 in stock -- most of Roth's holdings in four companies -- to meet a margin call.

Roth complained that GKN left only a brief message on his answering machine and by the time he called his broker the next day, it was too late.

"They panicked," Roth said. "They were so worried that they we're going to lose a buck that they let a client lose thousands."

Roth's case before the NASD was boosted by the testimony of his broker at GKN, who criticized the company's actions and said Roth had been too loyal to sell him out. The broker still handles Roth's account, but at another firm.

In its decision, the NASD restored the liquidation. GKN, a firm with a history of disciplinary problems, was ordered to give Roth 18,857 shares of what had been his principal holding, **Winstar Communications** (WCII:Nasdaq - news), in exchange for payment of $179,136. That gave Roth Winstar stock worth a net of about $575,000 at recent prices.

Peter Kent, GKN's chief operating officer, defended the company's handling of Roth's account.

"I'm somewhat befuddled by the board's award," he said. "I would do exactly what I did then today. I believe a broker has a right to sell out a customer when a customer goes to zero equity. His account was at zero equity and he was unavailable."

In the aftermath of the surge in margin calls last spring, the NASD is looking at possibly bolstering broker disclosure about margin buying.

"The requirements in this area are quite minimal," said Elisse Walter, chief operating officer of NASD Regulation.

In an effort to reach investors, the NASD has embarked on an education program about margin buying. It is sending flyers to brokers to be passed along to clients and posting more information on its Web site and also at this link.

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