Newsday

Many Unhappy Returns / Ex-Stratton customers still fighting to recoup $130M

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STRATTON OAKMONT, a large penny stock “boiler room” operation formerly based in Lake Success, left a trail of wreckage behind when regulators closed it for fraud in December, 1996. That wreckage has just begun to surface in court documents and reports as regulators and a bankruptcy trustee work to untangle the mess. Newsday earlier this year chronicled two Stratton legacies - so-called “rogue” brokers who have jumped from Stratton to other brokerages to continue their fraudulent practices, and small companies struggling with severe financial problems because Stratton insiders allegedly pocketed most of the profits from their initial public offerings. This third and final story in this series tells what has happened to thousands of investors who claim that they lost money due to Stratton’s fraudulent practices, and are asking the brokerage industry’s “safety net” for compensation.

THERE ARE TIMES when the stress of trying to get his money back wakes Claude Stemp up at night, unable to breathe.

Stemp, 58, said he lost his life savings of $62,000, along with $60,000 of his parents’ money, in late 1996 when a salesman from Stratton Oakmont, a brokerage based in Lake Success, disobeyed Stemp’s orders to sell his stocks before they plunged in value.

The broker, Stemp said, sold him the risky, volatile stocks - a Stratton specialty - by making constant, aggressive sales calls when Stemp was distracted by his wife’s death from lung cancer. Once, the broker woke Stemp up with a call at 5:30 a.m.

But when Stemp decided to sell the stocks, the broker was “at lunch, at the chiropractor or at a staff meeting,” and never returned his calls, Stemp said.

After regulators closed Stratton for fraud on Dec. 5, 1996, Stemp turned for help to the Securities Investor Protection Corporation, a tax-exempt agency created by Congress in 1970 to recover investors’ assets when brokerages fail. SIPC’s purpose was to restore public confidence in the markets after a wave of broker failures.

Because SIPC’s symbol always appeared on his claim statements, and the broker “bragged” about Stratton’s SIPC membership, Stemp said: “I thought I was insured.”

But in October, 1997, the SIPC trustee for Stratton, Harvey Miller of the Manhattan law firm Weil, Gotshal & Manges, notified Stemp that losses due to "failure to sell," a practice regulators said was common at Stratton, don't qualify for SIPC's protection.

So at a time when he had planned to retire, Stemp, a former Air Force lieutenant colonel who flew bombers in Vietnam, has had to move from California to El Paso, Texas, to take a job in which he says he works 70 hours a week.

"I keep saying, `What did I do to deserve this? I raised five children and fought for my country,' " Stemp said. He is tired, worried about his widowed mother in California, and angry - not only at Stratton, but SIPC, which he calls "a fraud in itself."

Two years after the sinking of Stratton Oakmont, one of the most famous brokerages to have victimized investors during a recent national wave of small-stock fraud, its wreckage looks like a scene from "Titanic," with hundreds of victims still floating in the water waiting for help.

During its seven years of existence, Stratton spawned "rogue" brokers who spread its fraudulent methods to other firms, and siphoned off capital from many companies it brought public, earlier Newsday stories have revealed. Now, Stratton's death has exposed SIPC's limitations.

Brokerage ads and customer materials tout membership in SIPC, the closest thing the securities industry has to a safety net, the way banks brag about coverage by the Federal Deposit Insurance Corporation. But the reality is quite different: While bank customers are guaranteed their money back if the bank fails, investors in stocks must meet certain narrow requirements.

Although SIPC has assets of $1 billion, there's a good chance that it's not going to cover you if you're a victim of broker fraud, as many Stratton investors are discovering. By April, 1997 - the cut-off date for claims - more than 3,000 Stratton investors had filed for reimbursement by SIPC of an estimated $130 million in alleged damages, according to Adam Rogoff, an attorney for Weil, Gotshal & Manges.

SIPC has paid Weil Gotshal, which is acting as counsel to Miller in the Stratton liquidation, about $3 million in fees and expenses so far while payments to claimants have only totaled $400,000. Under the law that created SIPC, the final total to the law firm will be deducted from Stratton's general estate before it's divided up between investors whose claims aren't paid up front by SIPC, and Stratton's business creditors.

So far, Stratton's SIPC trustee has: - Made payments to nine Stratton investors, using $400,000 from SIPC's reserve fund. -Offered to pay four more investors who must still

decide whether to accept. - Denied 2,850 claims, mostly on grounds they didn't meet the legal definition of a "customer" entitled to SIPC protection. - ecovered about $1.3 million in Stratton assets, as well as another $250,000 worth of services from an investigative agency that the brokerage claimed owed it money. Weil, Gotshal is still reviewing about 97 claims.

Of those claims, between 40 and 50 will result in SIPC payment, Rogoff said. In an effort to recover assets for investors, SIPC also is suing Stratton's former owners and their wives to try and recover $50 million it says they took from the brokerage. One of the Stratton customers still waiting for his money is Louis Dequine, 86, a former Golden Gloves boxing champion who lives in Pensacola, Fla. According to an affidavit filed in the SIPC proceeding by their attorney, Dequine and his wife, Dorothy, 85, lost nearly $252,000 in 1994 when Stratton brokers sold the couple's stocks without authorization and used the proceeds to buy worthless securities. Since then, life has been tough.

Dequine said that the pressure of losing the money to Stratton contributed to a stroke he suffered in December, 1994. And SIPC's delay in making good their losses has thwarted the couple's plans to travel. "We were good savers, and we looked forward to doing things ever since we were married 65 years ago," Dequine said. "It makes me ashamed of this country that it could let things like this go on."

SIPC's general counsel, Stephen Harbeck, said the number of Stratton claims paid so far is small because after close examination, most of them don't meet the legal definition of a "customer" entitled to payment by the agency. "No one's claiming that they [the rejected claimants] didn't lose money.

They did," Harbeck said. "But Congress didn't give us the authority to satisfy their type of claims." Under the law that created SIPC, a customer is defined as an investor whose assets were held by a brokerage that is in liquidation, or are missing because they were "converted," or stolen. Harbeck said the Stratton Oakmont case has gone more slowly than most because claims in the case are "more complicated."

He said the legal fees in the case are justified because without a SIPC trustee, no Stratton claimants at all would have received reimbursement from the agency, and no coordinated effort would have been made to recover assets for other creditors. "There isn't a scandal here," Harbeck said.

"We're just doing our jobs." But attorneys for investors said that the Stratton case resembles others beginning to turn up as regulators crack down on firms that have copied Stratton's methods. It shows, they said, that SIPC's mandate needs to be broadened. "SIPC is close to useless," said Philip Aidikoff, a Beverly Hills, Calif.-based attorney who represents customers in claims against brokers. "They don't insure against

the kind of wrongdoing that steals money from people." Claimants' lawyers also say that even under its present mandate, SIPC could cover many more Stratton victims than it has.

The agency, they say, is deliberately making it hard for individuals to get their money back because it wants to protect its members, who are most of the nation's brokers.

"SIPC does what it does because it's owned by brokerage firms, not the government," said Steven Caruso, a Manhattan attorney who is a partner in Maddox Koeller Hargett & Caruso, an Indianapolis-based law firm representing a large number of claimants in Stratton's liquidation. Harbeck said the allegation isn't true. "The whole purpose of our systems is to return customer assets to them properly," he said.

"We will spend large sums to do it." SIPC's reserves, which now total more than $1 billion, come from assessments on brokerages. Currently, the member firms - including brokerage giants such as Merrill Lynch - pay $150 per year. (The agency, which can reimburse customers up to $500,000 for missing securities and cash, also has a $1-billion emergency line of credit with the U.S. Treasury.)

The Securities and Exchange Commission, which oversees SIPC, said through a spokesman, John Heine, that it has "no comment at this time" with regard to the Stratton liquidation or SIPC's overall performance. The National Association of Securities Dealers, a self-regulating trade group, said in June, 1997, that because of the large number of Stratton claims, it would set up a task force to explore ways to better protect investors.

It hasn't done so yet, although the issue is still on its agenda, according to Nancy Condon, a NASD spokeswoman. During its 28-year history, SIPC, which intervenes in about 1 percent of all brokerage closings, has satisfied nearly all claims made in cases it has closed, according to the agency's most recent report to the SEC. But the law that created SIPC reflects conditions when it was passed.

In 1970, brokerages were having trouble keeping up with paperwork, and for that reason, assets were sometimes mislaid or missing when a firm became insolvent, according to Mark Sargent, dean of the Villanova University School of Law in Pennsylvania and an expert on securities regulation. "The big misconception about SIPC is that it somehow protects you against unsuitable behavior by brokers," Sargent said. "That's what regulators are [for]. SIPC was never intended as a bulwark against fraud." SIPC, in decisions supported by courts, has taken the position that the word "conversion" in its mandate to restore assets covers only one type of fraud - unauthorized trading.

Allegations of that activity were the reason SIPC decided to intervene in Stratton's liquidation, court papers show. As an "introducing" broker - one that didn't settle its own trades, but had the work handled by another broker - Stratton didn't hold any customer securities and cash that would be covered by SIPC. Most brokerages did their own clearing in 1970, but according to the NASD, only about 25 percent of them do so now.

About 720 of the Stratton claimants for SIPC protection said their losses were due to unauthorized trading, probably the largest number of such claims SIPC has ever received, according to Harbeck. But under SIPC's procedures, those victims are only reimbursed if they can prove that they complained about the trade in writing in a "timely" fashion. The agency said that in Stratton's case, it is accepting as proof written protests of unauthorized trading that were made within 90 days.

It says the proof is necessary to show that someone is not trying to seize an opportunity to get their market losses back. But claimants' attorneys say that in the Stratton case, and others like it, when regulators have said there was a pattern of unauthorized trades, the burden of proof should be on the SIPC. "They [SIPC] are creating incredible barriers to investors getting their money back," said Mark Maddox, of Maddox Koeller, the law firm handling many Stratton complaints. "The FDIC isn't going to say, `if you don't have a complaint in writing, you don't get your money back.' "

The Dequines complained in writing immediately, documents show. But they may be disappointed. Under the law that established SIPC, people such as the Dequines whose stocks, rather than cash, were used to make the trades will be reimbursed with the original stock if the claim is honored, Rogoff said.

The Dequines' original shares, like many promoted by Stratton, are nearly worthless because the firm, according to regulators, artificially supported prices. SIPC has referred about 1,700 investors whose claims it denied to J.B. Oxford, Stratton's clearing broker, where it said they could pick up a total of $14 million in assets. Investors and their attorneys, however, say the assets at J.B. Oxford often amount to only a fraction of what was lost because of the drop in value of the investors' stock holdings.

For instance, Richard Eastburn, a Cleveland-area resident, told SIPC that his stock portfolio shrank by $12,510 due to an unauthorized transaction by Stratton brokers that left him holding stocks that plunged in value. When his claim was rejected because he couldn't prove he had complained in writing, the trustee told him he could pick up $1,817.67 at J.B. Oxford, the worth of his remaining assets.

"I don't feel the system has helped me at all," Eastburn said. Eventually, Eastburn and the other Stratton claimants denied by SIPC will line up with Stratton's general creditors for a share in Stratton's estate. If there is any estate, that is. Although Stratton said in its

bankruptcy filing that it had $5.5 million, only about $100,000 in property was found by SIPC when it first arrived at the brokerage. Even the office candy machine had been taken back by the owner, according to a court document.

Moreover, the Internal Revenue Service - along with SIPC - could possibly have first dibs on Stratton's estate before other claimants are paid, Rogoff said. The IRS has filed a $10 million claim against Stratton for back taxes. Calling SIPC outmoded, the Public Investors Arbitration Bar Association, whose members frequently represent investors trying to get money from the agency, plans to lobby Congress this year to change the 1970 law.

Joseph Borg, Alabama's security director and the head of a multi-state task force that investigated Stratton, said Stratton's methods are being spread by rogue brokers, and that many Americans don't understand that SIPC's coverage is limited.

But Villanova's Sargent said it doesn't make sense to provide FDIC-type coverage for brokerage accounts, which by definition, expose customers to risk in return for high returns.

"I don't know if anyone has devised a system of insurance that will protect everyone against fraud in the securities markets," he said. In Florida, Louis Dequine said he just wants his money back. "If I ever got it [the money]," Dequine said, "one of the first things I want to do is go to Alaska to go salmon-fishing."