

About the Firm

Our sole focus is securities arbitration and litigation. We do not seek out personal injury cases, criminal appointments, domestic matters, or corporate defense work. All day, every day, our practice is devoted to representing investors. Because of that focus, we can provide superior advice in this specialized area.

Within the securities industry, we are strongly committed to raising the standard of conduct among financial professionals. We work closely with the Kansas and Missouri Securities Commissioners' Office in local and state government, and local, state, and national bar associations.

Our office, located in metropolitan Kansas City, represents investors ranging from young adults to elderly retirees; and from blue-collar workers to corporate executives. Every public citizen is entitled to the protection of state and federal securities laws, and every investor deserves to be protected from rogue brokers and unethical sales practices employed by brokerage firms across the nation.

Our office is committed to giving clients thoughtful advice about their investment situations. The office often joins forces with locally and nationally-recognized securities experts in order to provide the best representation for each client.

Jeff Kruske is currently a member of the Kansas Bar Association, Kansas Trial Lawyers Association, Johnson County Bar Association, the Public Investors Arbitration Bar Association, and is an NASD-licensed arbitrator.

IN Focus: Churning 101

Churning generally refers to the excessive buying and selling of securities in a customer's account by his or her broker, for the purpose of generating commissions and without regard to the customer's investment objectives. Many times he will sell the winners to show a small profit, and keep the losers. For churning to occur, a broker must exercise control over the investment decisions in the account, either through a formal written discretionary agreement or otherwise. Absent discretionary control, if the customer routinely relied on his broker's advice because he was unable to evaluate the recommendations on his own, the broker may have exercised control over the account.

The major securities industry self-regulatory organizations have rules prohibiting churning and excessive trading. Excessive trading is the same as churning, but without the requirement that the person engaging in the trading does so for the purpose of generating commissions. Churning and excessive trading can violate NASD Rule 2310, NYSE Rules 408 and 476, as well as state and federal securities law.

To establish that a broker has churned an account, the customer must demonstrate that the pattern of trading activity in the account was excessive. This can be done in a number of ways including calculations to determine the annualized rate of return that would be necessary to cover the commissions charged in the account, the number of times the equity in the account is turned over to purchase securities, and the purchase and sale trading activity that occurs in the account.

To determine whether the trading is excessive in light of the goals of the account, the most often used analysis is the calculation of a "turnover ratio." A turnover ratio is the total amount of purchases made in the account, divided by the average monthly equity in the account. That ratio is then annualized (by dividing the result by the number of months involved to get a per month ratio, and then multiplying that result by 12). An annualized turnover ratio of 6, which means that the equity in the account was invested 6 times in a year, can be indicative of excessive trading in the typical customer account.

Cost-to-equity ratios are another method (as compared to simple turnover ratios) of an indicator of churning because they directly measure the costliness of the trading. Properly interpreted, they provide sound guidance as to whether the trading could reasonably have been expected to benefit the customer. Cost ratios measure the fraction of an investment consumed by trading costs. Roughly speaking, annualized cost ratios yield the portfolio securities' breakeven rate of return; the account will show a profit if, and only if, the securities' gross returns exceed the cost ratio. For the purpose of calculating the cost-equity ratio, the only relevant commission is the cost to the customer. Commissions of about 5% to 6% annually in a brokerage account with a growth and income investment objective is probably about the limit the account can bear.

Excessive trading is measured not against a mythical yardstick, but rather against the investment

THE LOOKOUT

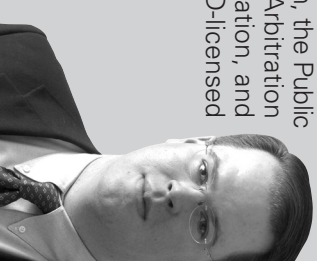
In this issue (page 3), we provide some tips for what you can look out for on a few of the more common investment abuses, including:

- Foreign Exchange Trading
- Internet Fraud
- Investment Seminars
- Private Securities Offerings

Want to be an Arbitrator?

The success of securities arbitration depends on the quality of the arbitrators who hear and decide the dispute presented by the parties. There is a need for new applicants in Kansas and Missouri to serve as NASD arbitrators.

Arbitrators are carefully selected from a broad cross-section of people, diverse in culture, profession, and background. If you have at least five years of business or professional experience, you may qualify to serve. Please contact the Law Office of Jeffrey S. Kruske if you are interested in applying to become an NASD arbitrator.



(continues next page)

Midwest  
Vol 5 Issue 1  
Securities Law Update

» In Focus: Churning 101

» The Lookout  
Common Investment Abuses to Look Out For

- » News
  - Lenexa Investment Adviser James A. Freese Pleads Guilty
  - Ex-Merrill Broker Wins \$1.6 Million in Arbitration Award
  - Kruske Law Firm Prevails in \$850,000+ NASD Arbitration
- » About the Firm

Visit the firm on-line at [www.kruskelaw.com](http://www.kruskelaw.com) to learn more about current securities industry news, the law firm, securities arbitration and litigation FAQs, download articles and reports, schedule a free consultation, and more.

MAF 14,016  
MMV 913  
LAW 652.6762  
JSK

913.652.6762

Devoted to Representing Investors in Securities Disputes

913.652.6762

Devoted to Representing Investors in Securities Disputes

*About The Firm*

Types of Claims Typically Handled

**Unsuitability**

Customer alleges that the broker recommended investments that were not appropriate for his or her investment goals, or even his age and investment objectives.

**Material Misrepresentations****or Omissions**

Customer alleges that the broker intentionally misled him or failed to disclose a material fact about an investment.

**Failure to Diversify**

Customer alleges that the broker over concentrated their portfolios in minimal sectors.

**Variable Annuities and****Equity-Indexed Annuities**

Carry very high expenses, and earn brokers very large commissions.

**Churning**

Customer alleges that the broker purchased and sold securities solely to generate commissions, without regard to the customer's investment objectives or goals.

**Unauthorized Trading**

Customer alleges that the broker entered transactions into the account without the customer's knowledge or approval.

**Breach of Fiduciary Duty**

Customer alleges that the broker breached his duty (position of trust and confidence) to a client.

**Negligence**

A claim for negligence is that the broker failed to use reasonable diligence in handling the affairs of the customer, and did not act as a reasonable and prudent broker would have acted.

**Selling Away**

This often occurs in situations where the broker is not reporting a particular transaction to his or her employer.

**Margin Violations**

Failure to fully inform the customer of margin risks can result in liability for any losses caused as a result.

**Life Insurance**

Not unlike securities, the sale of life insurance generally imposes a duty of determining suitability on the selling agent. Most state insurance codes require "fair dealing" with customers and a duty of determining an appropriate recommendation. If the product is variable, it may be considered a security and is subject to NASD rules in addition to any state codes and regulations.

**Commodities/Futures**

Litigation and arbitration involving futures contracts, derivatives, and over-the-counter (OTC) trading

objectives of the account. A broker, with discretion, handling a small account for a wealthy investor that is designed for heavy day trading, can have a turnover ratio of 20, and still not have churned the account, because the trading was not excessive in light of the customer's investment objectives. Alternatively, a turnover ratio of 4, or even 3, in an account that is designed for long term buy and hold can be excessive. In the real world, the analysis is not always so black and white, and most cases fall into the grays.

All of the above factors are relevant to control in suitability cases because they focus on the risks and expected returns of various investments. These factors have little to do, however, with the central issue in churning cases, e.g. the excessiveness of trading costs incurred given the likely financial benefits to the customer. At the root of this matter is the question that will be central to a claim: "Was there a reasonable probability that the securities trading would be profitable enough to cover the cost?"

**In the News****Lenexa Investment Adviser James A. Freese Pleads Guilty**

**Olathe, Kansas**—James A. Freese, 35, a Lenexa resident who formerly owned and operated AFG Capital Management, Inc. of Overland Park, pled guilty to ten felony crimes. The charges include one count of securities fraud for defrauding his church of \$513,800, three counts of investment adviser fraud for defrauding 116 advisory clients of more than \$7.2 million, one count of filing a false statement with the Office of the Securities Commissioner, and five counts of making false writings by sending false account statements to customers.

Freese was sentenced to 86 months in prison by Hon. James Franklin Davis in Johnson County District Court. Freese was also ordered to pay restitution of \$7,298,160.58.

On September 7, 2006, Securities Commissioner Biggs suspended the registration of Mr. Freese and AFG Capital Management after examiners from the Office of the Securities Commissioner conducted an audit of the firm. The suspension was not contested and the firm is no longer in business. On January 31, 2007, Biggs filed a civil lawsuit against Freese, AFG, and two other individuals. In the civil suit, the Office of the Securities Commissioner seized AFG assets in an effort to obtain restitution for former clients of AFG. As discovery in the case unfolded, however, only \$85,000 was identified as monies available to repay to the 116 defrauded victims.

**Ex-Merrill Broker Wins \$1.6 Million in Arbitration Award**

An NASD arbitration panel awarded a former Merrill Lynch broker \$1.6 million for wrongful termination and defamation, claims he had filed against his former employer in July 2007. The award included compensatory damages of \$400,000 plus interest and punitive damages of \$1.2 million. Awards of that size are a rarity in arbitration cases brought by employees against brokerage firms. Farbozr Zojaji, a \$325,000 producer who worked for Merrill for nine years, was fired in November 2004 for allegedly exercising discretion in one or more customer accounts without authorization and violating the company's privacy policy by using his wife as a translator on a call with a customer from Venezuela.

The panel sided with Zojaji's attorneys, who claim Merrill's conduct was inappropriate. The arbitration panel ruled that there were no written customer complaints, discretionary trades or violations of the company's privacy policy. Essentially, the panel found no evidence of wrongdoing on Zojaji's part. While most awards do not provide much insight on how a panel came to its decision, this award is a rare exception. The panel found that Zojaji's regional complex manager filed a false U-5 and ignored advice from Merrill's compliance officer to substantiate the allegations. The panel also suggested that the compliance officer exacted a personal vendetta against Zojaji for being an Iranian immigrant and went out of his way to make sure he did not succeed at Merrill, where he was being groomed for a management position. The panel found that Merrill's conduct was "without doubt, not merely grossly negligent, it was intentional."

According to the award, the director at Zojaji's branch office, and other Merrill employees, failed to follow up with the customers to vet the alleged complaints and did not review the telephone records that would have demonstrated that no discretion was used in trades in the customer's account.

**Featured in the Next Issue of MSLU...****Will the Sub-Prime Fallout Hit Retail Investors?**

Mortgage-backed securities in their simplest form are pools of actual home mortgages collected and "securitized" into certificates guaranteed by their quasi-government issuers. As such, they are among the safest investments behind treasury securities. Risks associated with mortgage-backed investments are directly related to interest rates. With falling interest rates, mortgage prepayment rates rise. Changes in interest rates, whether up or down, pose significant risk for securities whose value is derived from pools of mortgages.

Unlike traditional mortgage-backed securities such as Fannie Mae, Ginnie Mae, or Freddie Mac, CMOs (Collateralized Mortgage Obligations) collect the payments of principal and interest from the likes of Fannie Mae investments, and distribute these payments selectively on a priority basis among classes or "tranches" of the CMO investment. Because of their complexity, it is very difficult for investors to evaluate these investments. The next issue of MSLU will highlight these products, how NASD regulates them, and how many investors are being fraudulently sold these products as safe investments.

Zojaji, who couldn't get registered for six months after being fired from Merrill was then unable to hold down a job at A.G. Edwards because his entire book had been pillaged during that time.

Advocates for reforming the filing process for Form U-5 published after the award was issued condemning current industry practices. "Once an item is reported on a U-5, regardless of merit or accuracy, it is a permanent record, which can greatly impact [registered representative] employment in the industry going forward," writes Drew McCoy, chairman of the Wealth Advisor Institute's Advisor Council in a paper entitled "Recommendations for Reforming and Improving NASD Registered Representative Regulatory Filing Procedures."

"With legal immunity from defamation claims, there is little to stop an unscrupulous firm from, for example, filing derogatory information on a U-5 form in order to punish [a registered representative] for leaving for another firm," McCoy writes.

**Kruske Law Firm Prevails in \$950,000+ NASD Arbitration**

In March 2007, a Houston-based NASD arbitration panel awarded Byoung Im \$630,000 in compensatory damages, attorney fees and case expenses, and 8.25% interest starting in May 2004. The total value of the award exceeded \$850,000, one of the largest arbitration awards handed down so far this year.

In 2004, Byoung Im transferred \$680,000 to JPR Capital and their broker, Hong Joon Chun. Chun engaged in day-trading in the account without the authorization of Im, and manufactured account statements and faxed them to the customer from his apartment in New York, instructing him to ignore the firm account statements. Chun engaged in options trading over the course of four months, rapping commissions of over \$80,000. When Im requested a withdrawal of \$500,000 for a real estate investment, Chun sent a check for \$50,000, as the remainder of the account had been depleted by way of losses.

After the claim was filed, Chun voluntarily left JPR Capital, and before the award was entered, was barred from the securities industry for failing to respond to a request to be interviewed by NASD regarding the facts outlined in the claim.

Byoung Im was represented by the Kruske Law Firm. More information about the case can be obtained by contacting Jeffrey Kruske.

**THE LOOKOUT  
Common Investment  
Abuses to Watch Out For** **Foreign Exchange Trading**

Foreign exchange (forex) trading can be legitimate for governments and businesses concerned about fluctuations in international currencies, and it can even be appropriate for some individual investors. But the average investor should be wary when it comes to these complex markets. Forex scams attract customers with sophisticated-sounding offers placed in newspaper advertisements, radio promotions, or on Internet sites.

 **Internet Fraud**

Scammers continue to take advantage of technology to lure investors into "pump-and-dump" stock schemes. Be wary of investments being pitched through unsolicited e-mails, instant messages, and phony websites.

 **Investment Seminars**

Promoters of unsuitable investments are increasingly seeking potential investors, particularly seniors, by offering seminars, many of them promising a free meal along with "higher returns and little or no risk." Unfortunately, in many of the cases that securities regulators see, it is just the opposite: high risk and no returns, just disastrous losses.

 **Private Securities Offerings**

Con artists are turning increasingly to private securities offerings under Rule 506 Regulation D of the Securities Act of 1933 to attract investors without having to go through the full registration process. Although sometimes legitimate, these offerings are often associated with fraud.

**Did You Know?**

The Kruske Law Firm also represents individual securities brokers and other securities industry employees who have claims against brokerage firms. Many employees working in the financial services sector and securities industry can face legal situations requiring experienced attorneys who can best represent their situations. Jeffrey Kruske has helped many industry professionals facing a variety of legal circumstances including Form U-5 defamation and expungement, employment disputes concerning compensation, disciplinary proceedings and representation at NASD hearings.

Typical cases that an employee can bring are sexual harassment and employment discrimination (sex, age, race, disability) claims against their current and former employers. Securities rules allow these cases to be brought in a court as opposed to an arbitration forum. Former traders and brokers also bring cases against their former employers for failure to pay bonuses earned during the term of their employment. These cases include representing employees in claims for "fraudulent inducement" of their employment relationships. In these cases, the employees claim that their employers made false promises regarding the nature of the work which they were hired to do.

Other cases include lawsuits for Form U-5 defamation, which are claims against an employee's former securities brokerage firm for making false and defamatory statements on a Form U-5 filed by the firm with the NASD. A brokerage firm is required to file a Form U-5 whenever an employee leaves the firm which discloses the circumstances surrounding the departure. If false and defamatory statements are made on the Form U-5 regarding the employee, the employee may have a claim for defamation.