

DJ COMPLIANCE WATCH: Lawsuit Accuses Firm of U-5 Fraud

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NEW YORK (Dow Jones)--Retired Nebraska road worker Lloyd Gerdes says that, unknown to him, his broker was fired from a previous employer, Kirkpatrick Pettis.

Had he known she was fired, Gerdes says, he wouldn't have signed on with her a few years later. And maybe then he wouldn't have lost at least \$40,000 - more than a quarter of his portfolio - in investments like an oil-drilling concern and a speculative stock traded on the pink sheets.

That's the argument Gerdes and his wife Marlene, joined by four other families, are making in a lawsuit filed last month against Mutual of Omaha, which owned Kirkpatrick Pettis at the time. Mutual of Omaha and the broker, Rebecca Engle, who isn't a defendant in the suit but is a defendant in related arbitration claims, deny the allegations.

The suit, filed in state court in Otoe County, Neb., points to the crucial role of full disclosure about broker job changes. In many industries, companies reveal as little as possible about workers' departures for fear of lawsuits brought by ex-employees.

But regulators require brokerage firms to fill out official forms, called U-5s, disclosing the reasons why brokers leave. The goal is to warn future employers and prospective clients about problem brokers. Investors can get information about a broker's history through the National Association of Securities Dealers, which makes part of the U-5 forms public.

Some brokers argue that this allows spiteful former employers to sabotage brokers' careers. But recently a U.S. District Court judge in Manhattan ruled that candor on the U-5 documents was so critical to investor protection that brokerages should be immune from defamation claims by ex-brokers.

Still, firms often walk a fine line between giving too much and too little information on U-5s.

Laid Off Or Fired?

According to her official record, Engle worked at Edward Jones for 14 years, leaving to join Kirkpatrick Pettis in 1998.

Soon after Engle's arrival, customer complaints about her started to trickle in, according to internal KP documents provided to Gerdes' lawyer, J.L. Spray, in arbitration claims

against Engle and her former employers. Engle has attributed some of the complaints to paperwork errors, and said one was the result of a disgruntled former employee's influence.

In November 2000, Engle left KP. The public part of her record, released by NASD, shows she left the firm voluntarily; her non-public record, available to regulators and potential employers, indicates that she was discharged due to a reduction in the firm's sales force.

Spray argues that internal documents show Engle wasn't laid off, but fired.

In a Dec. 18, 2000 letter from Kirkpatrick Pettis general counsel Brian McGinty to Engle's lawyer, McGinty wrote: "To characterize Mrs. Engle's termination as anything other than a discharge would be patently false.... While Mrs. Engle might prefer to say that she voluntarily terminated her employment because we decided to close our Nebraska City office, the closing of the office was the logical result of her termination."

A letter the same day from Engle's then-attorney to Engle described a conversation with McGinty, in which McGinty said the firm's executive committee had decided to terminate Engle because "they viewed you as requiring too much time and effort to manage."

Mutual of Omaha spokesman Jim Nolan said he could not confirm whether the documents provided by Spray were legitimate, and declined to comment on the substance of them. He said the lawsuit was "without merit."

Engle's current attorney, Martin Berliner, says she left KP because the firm wanted her to generate sales, instead of giving financial advice.

After leaving KP, Engle joined First Union Securities in November 2000. When First Union acquired Wachovia Corp. (WB) and took on its name in June 2002, Engle stayed on for another three months before leaving for Capital Growth Financial Securities.

Illiquid Investments

In 2003, Lloyd Gerdes, now 73, of Auburn, Neb., handed around \$180,000 in liquid assets to Capital Growth Financial Securities for Engle to manage. His final salary had been just under \$30,000 when he retired in 1997 after 35 years with the Nebraska Department of Roads.

Engle put about \$141,000 of Gerdes' money into variable annuities, he said. Such products can be unsuitable for older investors because they sometimes lock up money for long periods; investors can't get their funds out unless they pay penalties. Also, the products generally pay high commissions to the brokers who sell them.

In 2004, Gerdes said, Engle encouraged him to put \$25,000 into an oil-drilling operation that she told him would bring in at least a 10% profit.

Later that year, he said Engle had him invest another \$15,000 in a private holding company called Royal Palm Capital Group. Gerdes said she told him both moves were good one-year investments.

In November 2006, a pink sheets-traded company, PrimEdge Inc. (PEDG) - now run by Engle's former business partner at KP, Brian Schuster - announced it would acquire Royal Palm's assets. Schuster is a defendant in the arbitration claims.

By then Engle had changed firms again, moving to VSR Financial Services Inc. in May 2006, where her record shows her working until February 2007. Mutual of Omaha sold its KP retail brokerage division in 2005.

Since making the investments in Royal Palm and the oil-drilling operation, Gerdes said he's received \$1,500 and \$900 in dividends from the two, respectively.

He can't get his principal out of either one: The oil-drilling operation is a private company and the Royal Palm-PrimEdge merger hasn't been completed, making his investment illiquid, Spray said. Spray said Gerdes hasn't even received certificates for the PrimEdge stock.

Gerdes also can't get his money out of the variable annuities without incurring a penalty.

Engle's lawyer, Martin Berliner, said Engle herself invested more than \$500,000 in Royal Palm and affiliated companies. Berliner said Engle fully explained the risks of investing in Royal Palm and PrimEdge, and that a 168-page disclosure document included more than 20 pages of risks.

Schuster, who is now chief executive at PrimEdge, said, "As long as PrimEdge functions, you can make the point that nobody's lost anything. Have they been able to access the money? No," he said. But, "I refuse to believe at this point that anybody's lost anything."

Now, Spray has filed six arbitration claims against Engle and her former employers, on behalf of 52 account-holders. Most of the account holders are from Auburn or Nebraska City, Neb. - towns with populations of about 3,000 and 7,000, respectively. Engle denies the allegations made in the arbitration claims.

Gerdes and his wife hoped to visit Florida and California during their retirement years; those plans are on hold.

"Just have a little faith and we'll get by," he said, "but it's not going to be as good as it could have been."

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