

THE WALL STREET JOURNAL.

Investors Burned in Commodities Deals Sue Lenders That Supplied the Money

Tanouye, Elyse. **Wall Street Journal, Eastern edition** [New York, N.Y.] 24 Jan 1992: PAGE C1.

☐ Abstract (summary)

Evelyn Sedlacek, a 73-year-old retired secretary who lost \$26,000 in an investment scam, is trying to get her money back by going after SafraBank, the bank that made her the loan to buy \$27,000 worth of platinum. She is also suing the metals dealer, Morgan Whitney Trading Group of Venice CA.

☐ Full Text

Evelyn Sedlacek, a 73-year-old retired secretary in California, was initially skeptical when a telephone salesman called in 1987 to sell her an investment in precious metals. But his high-pressure pitch convinced her that platinum was about to take off and that she should take out a loan to buy as much as she could.

Ms. Sedlacek ended up losing \$26,000. And the dealer was later put into receivership at the request of the Federal Trade Commission.

Sadly, Ms. Sedlacek's experience isn't unusual. Thousands of investors, many elderly, have lost tens of millions of dollars in such investments. The twist to this tale, however, is how she plans to get her money back: going after the bank that made her the loan to buy \$27,000 worth of platinum.

In a federal court lawsuit filed in 1990, Ms. Sedlacek is suing SafraBank (California) of Encino, Calif., along with the precious metals dealer, Morgan Whitney Trading Group of Venice, Calif., and its principals. Also named as a defendant in the class-action suit, filed in federal district court in central California, is international financier Edmond Safra, who owns SafraBank and 29% of another defendant, Republic New York Corp., parent of Republic National Bank of New York, which participated in SafraBank precious metals loans through a Texas subsidiary.

Ms. Sedlacek's suit claims that SafraBank is as responsible for investor losses as the commodities salesmen who she alleges misled her into the precious metals investments. Ms. Sedlacek's attorneys, who are handling four other similar lawsuits naming as defendants SafraBank and different brokers, estimate that the five suits could involve as much as \$60 million lost by some 9,000 investors.

All told, SafraBank is facing 19 lawsuits from investors like Ms. Sedlacek who borrowed money to buy precious metals from brokers. One of those suits was filed by the state of Iowa, which is suing Morgan Whitney and SafraBank on behalf of 46 Iowa residents whom the state estimates lost \$500,000. In its suit, Iowa alleges that Morgan Whitney and SafraBank violated Iowa laws on consumer fraud, securities, commodities and consumer credit. The state claims that SafraBank acted in concert with Morgan Whitney to defraud consumers by misrepresenting or omitting facts about precious metals investments.

In a typical bank-financed precious metals deal, a commodities salesman persuades an investor to buy thousands of dollars worth of

gold, silver or platinum bullion or coins by putting down about 20% of the price in cash and financing the balance with a bank loan.

SafraBank isn't the only lender making bank-financed precious metals loans, but it considers itself a pioneer in the field and at one time was one of the largest lenders, a bank official says. Over the years, SafraBank has been involved in more than 10,000 bank-financed precious metals loans, a SafraBank attorney says.

Investors allege in lawsuits that the telemarketing salesmen who sold them precious metals didn't tell them that after paying high sales commissions, interest on the loans and other fees, investors had little chance of recouping their investment, much less making money on it. And, the suits allege, investors weren't told they were obligated by SafraBank to put up additional funds if precious metals prices fell below certain levels.

SafraBank, through a spokesman, says it believes the lawsuits are without merit.

The bank isn't privy to discussions between salesmen and borrowers, a SafraBank official says. Moreover, the bank's brochures and loan documents carry disclaimers to protect the bank from such claims, the SafraBank spokesman says. The bank's position is that it is the duty of the borrower to decide how to use the loan proceeds, and to be informed about the investment, says a SafraBank attorney. "The decision to enter a particular transaction has to be the borrower's and not the bank's," he says.

The potential liability and cost of litigation, however, prompted SafraBank to decide recently to get out of bank-financed precious metals lending within a year, the bank spokesman says.

State regulators applaud the investors' attempts to hold banks responsible. "The financial institutions like to tell you they're completely independent and not responsible for what salespeople say," says Lawrence Fuchs, Florida deputy comptroller. "We think that's nonsense." The commodities brokers don't give the customer a choice of financial institutions, he argues, and without the bank the sale wouldn't be made. "For the financial institution to claim they're not an integral part of the scheme is ludicrous," says Mr. Fuchs.

Experts on lender liability say that banks generally aren't required to protect borrowers from their buying or investment decisions, even if the bankers suspect shady dealings. "The general rule on banks and lending and fraud is that a bank is under no duty to disclose information it may have," says Thomas Greco, associate general counsel for the American Bankers Association.

The question comes down to whether the bank had a fiduciary responsibility to protect the borrower, says Kenneth Scott, Ralph M. Parsons professor of law and business at Stanford Law School. Granting a loan would not create a fiduciary responsibility because the bank and borrower are on opposite sides of a transaction, he says.

But investors are arguing that SafraBank was more than an indifferent lender. The lawsuits charge that SafraBank worked hand-in-hand with the salesmen to sell the precious metals investments. Besides lending money, SafraBank also lent credibility to the operators, they argue, by allowing them to use its name and its Federal Deposit Insurance Corp. protection in sales pitches. A SafraBank official denies the bank allowed brokers to use its name and FDIC insurance in sales pitches.

Moreover, SafraBank played a central role by aggressively promoting bank-financed precious metals to dealers and making recommendations on how to set up such programs, attorneys for Ms. Sedlacek claim. "We view the dealers as creatures of SafraBank," says Richard Heimann, Ms. Sedlacek's attorney in San Francisco. A SafraBank official denies the bank solicited business from brokers or worked actively in their businesses.

And there are practical reasons for angry investors to go after SafraBank and Republic Bank. At the first sign of trouble, boiler-room commodities operators typically disappear, taking investors' money with them, Mr. Heimann says, so there's little hope of recovering from them.

SafraBank officials aren't strangers to such suits. A bank attorney says it has faced similar claims in the past and they haven't held up: SafraBank was dismissed from the cases or the parties agreed to settle for nominal amounts. None ever made it to a jury, the attorney says.

But one case involving Ned Fenton, the head of SafraBank's precious metals operation, did go to a Los Angeles federal court jury, which found in 1986 that he had violated civil anti-racketeering laws when he ran the precious metals financing operation for West Coast Bank. That operation was acquired by Mr. Safra when he bought the assets of failed West Coast in 1984; however, the transactions at issue in the trial occurred before Mr. Safra acquired the bank operation.

The FDIC, as receiver for West Coast Bank, was also held in violation. The verdict was set aside and the suit dismissed after a settlement was reached, Mr. Fenton's lawyer points out.

In 1988, the FDIC itself raised warning flags in an examiner's report saying that SafraBank's precious metals lending practices made the bank potentially liable for losses by customers of the precious metals brokers.

SafraBank says it has responded satisfactorily to any issues raised by bank regulators. Federal and state regulators have conducted many examinations since 1988, a SafraBank official says, and found the bank's operations satisfactory.

But it still faces lawsuits by investors.

Ms. Sedlacek says that when she received her first telephone call from a Morgan Whitney salesman, she was unconvinced by his claims that platinum prices would soon rise to \$800 an ounce from \$539. She was won over, however, when the salesman spoke of SafraBank's affiliation with his firm.

"It made me feel a little secure about buying from these people because I felt they had the backing of this bank," says Ms. Sedlacek. "I thought they were regulated by some government agency, and with the backing of Safra, I had no reason to believe they weren't legitimate outfits."

Adding to that perception, the salesman instructed Ms. Sedlacek to make out the check for her down payment directly to SafraBank, she says. And all brochures, documentation, loan materials and receipts came from SafraBank, her lawyers say.

Feeling secure that she was investing through a federally insured bank, Ms. Sedlacek paid an initial \$10,233 to SafraBank to buy \$27,000 of platinum, according to documents she filed in the lawsuit. SafraBank sent her papers for a \$22,100 loan, bringing the total cost of the platinum, fees, interest, and commission to more than \$32,000. Platinum prices would have had to rise 18.5%, or an unlikely \$100 an ounce, over the six-month term of the loan before Ms. Sedlacek would break even.

She later incurred thousands of dollars in additional costs to renew the loan and to meet a surprise demand for additional capital when platinum prices fell, she says. She agreed to switch into silver at Morgan Whitney's urging, but when the salesman tried to push Norman Rockwell coins, she turned to a coin-dealer friend, who warned her against the investment. "That made me realize these people weren't professionals like they claimed to be," she says. "I was sick, and I was angry."

Ms. Sedlacek says she wrote a letter detailing her experience to the office of the California State Attorney General, which in turn notified the Federal Trade Commission. In response to a complaint filed by the FTC, the U.S. District Court for the Central District of California appointed a receiver for Morgan Whitney in 1990, alleging that the firm made false and misleading claims and failed to disclose material information in selling precious metals. Last August, Morgan Whitney and its principals, while denying any wrongdoing, settled the FTC complaint.

Morgan Whitney was just one of many operators of bank-financed precious metals programs that worked through SafraBank.

Last night, lawyers for SafraBank and precious metals investors were in settlement talks regarding the five lawsuits being handled by Ms. Sedlacek's lawyers. A spokesman for SafraBank and Republic New York Corp. said a settlement "will not be material for Republic New York Corp., Republic National Bank of New York, or Mr. Safra. It's also not going to be material to SafraBank (California) because Mr. Safra, its sole shareholder, stands fully behind the bank."

In one of the largest individual suits, 74-year-old Betty Moore Stowers of Topeka, Kan., through her conservator, Merchants National Bank of Topeka, sued SafraBank, American Financial Reserve Corp. and others in 1990 to recover \$1.4 million she allegedly lost in precious-metals investments made through American Financial, of Newport Beach, Calif.

SafraBank is also named as a defendant in lawsuits by investors who bought precious metals through Western Monetary Consultants. Western Monetary, formerly based in Denver but now in San Diego, filed for bankruptcy-law protection in 1988, according to William Kennedy, who headed the firm.

Between 1982 and 1988, Western Monetary sold \$400 million in precious metals to 3,000 clients, Mr. Kennedy says. About 600 investors with \$18 million in investments were caught in the bankruptcy proceedings, he says, adding that he plans full restitution within 10 years.