



BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

DEC 09 2003

MARC SPITZER, Chairman  
WILLIAM A. MUNDELL  
JEFF HATCH-MILLER  
MIKE GLEASON  
KRISTIN K. MAYES

DOCKETED BY *nr*

IN THE MATTER OF

DOCKET NO. S-03450A-02-0000

PHILIP WILLIAM MERRILL  
3788 N. 156<sup>th</sup> Drive  
Goodyear, AZ 85338  
CRD#2436444,

DECISION NO. 66614

Respondent.

OPINION AND ORDER

DATES OF HEARING: August 26, 27, 28, September 30, October 1, 2, 3, 2002, January 21, 22 and 23, 2003

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Philip J. Dion III

APPEARANCES: Anthony Bingham, Special Assistant Attorney General, on behalf of the Securities Division of the Arizona Corporation Commission; and

Frank Lewis, Begam, Lewis, Marks & Wolfe, on behalf of Respondent.

BY THE COMMISSION:

\* \* \* \* \*

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. On January 17, 2002, the Securities Division ("Division") of the Commission filed a Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist, for Restitution, for Administrative Penalties, and for Other Affirmative Action ("Notice") against Philip William Merrill ("Respondent") in which the Division alleged that Respondent has engaged in acts, practices, and transactions that constitute violations of the Arizona Securities Act ("Act").

1           2.     The Respondent was duly served with a copy of the Notice.

2           3.     On January 23, 2002, Respondent filed a request for a hearing.

3           4.     On August 26, 27, 28, September 30, October 1, 2, 3, 4, 2002, January 21, 22 and 23,  
4 2003, a full public hearing was conducted before a duly authorized Administrative Law Judge at the  
5 Commission's offices in Phoenix, Arizona. Respondent appeared and was represented by counsel.  
6 The Division also appeared and was represented by counsel. Testimony was taken, and more than 70  
7 exhibits were admitted into evidence.

8           5.     On April 14, 2003, the Division and Respondent submitted closing memoranda.

9           6.     Respondent was a registered securities salesman in Arizona with Morgan Stanley  
10 Dean Witter<sup>1</sup> ("MSDW") in Sun City, Arizona. Respondent was employed with MSDW from  
11 November, 1993 until April 2, 2001. Respondent was terminated from MSDW for allegedly making  
12 unauthorized transactions in a customer's account.

13          7.     After his termination from MSDW, Respondent was employed by the Acacia Group in  
14 Phoenix, Arizona for eight months. Respondent was terminated from the Acacia Group and  
15 thereafter, has not practiced in the securities industry.

16          8.     Since his termination with the Acacia group, Respondent has not been registered with  
17 any securities dealer. Pursuant to A.R.S. § 44-1947(B), Respondent's registration expired on  
18 December 31, 2001.<sup>2</sup>

19          9.     In the Notice, the Division alleged that Respondent made unauthorized transactions in  
20 the accounts of his clients, Lori Mayfield, Janet Mayfield, Sylvia Hays, Beatrice DuChene and Viola  
21 Brotherson. The Notice further alleged that Respondent made unsuitable transactions in the accounts  
22 of Viola Brotherson and Beatrice DuChene. The Division also alleged that Respondent made  
23 unauthorized and unsuitable transactions in his customers' accounts that constituted a fraud or deceit  
24 upon his clients in violation of A.R.S. §44-1991.

25  
26  
27 <sup>1</sup> Originally, Respondent was hired by Dean Witter. Subsequently, that firm and Morgan Stanley merged creating what is  
now know as Morgan Stanley Dean Witter.

28 <sup>2</sup> A.R.S. § 44-1943(D) and A.R.S. § 44-1947(D) allow the Commission to bring an action to suspend or revoke an  
individual's securities salesman license within two years after the termination or lapse of the individual's registration.

**UNAUTHORIZED TRANSACTIONS****Lori Mayfield**

10. Lori Mayfield is a 40 year-old advertising and travel writer who was introduced to Respondent through her mother, Janet Mayfield, during the Thanksgiving weekend of 2000.

11. Lori Mayfield testified that she relied on Respondent for advice because she did not have much experience or knowledge about investing in the stock market.

12. She further testified that she told Respondent that she wanted to work "in partnership"<sup>3</sup> with Respondent and research trades suggested by him before authorizing any transactions. She also stated that she never gave Respondent permission to make any trades in her account without her approval.

13. Lori Mayfield traveled to India from December 12, 2000 until January 12, 2001. She testified that she did not authorize Respondent to make any trades in her account while she was out of the country.

14. Lori Mayfield testified that her mother, Janet, contacted her when she returned from her trip to India. Lori Mayfield said her mother warned her to check her financial statements from MSDW.

15. Lori Mayfield testified that when she looked at her statements, she noticed that a number of unauthorized transactions had taken place in her account. She stated that some of those transactions were made while she was out of the country. Specifically, she stated that purchases made on December 11, 14, and 20, 2000 and February 5, 2001<sup>4</sup> were unauthorized. The purchases involved various funds and single stock purchases in excess of \$30,000.

16. Lori Mayfield testified that she filed a complaint with MSDW and since then has settled the matter with MSDW. The Division is not requesting any restitution in connection with Lori Mayfield's investments.

17. At the hearing, Respondent admitted that the trades in question were not authorized by Lori Mayfield. Respondent stated that he has admitted his indiscretions all along and stated that he

<sup>3</sup> Transcript at 1250.

<sup>4</sup> The funds or stocks were the MSDW Heath Sciences Fund, Van Kampen Emerging Growth Fund, General Electric, Cree Research, Inc. and Triquint Semiconductor, Inc.

1 told his supervisor, Charlie Cajero, that he had made unauthorized trades in Lori Mayfield's account.  
2 Respondent stated that the trades made in Lori Mayfield's account were an "oversight"<sup>5</sup> and not  
3 intentional. Respondent explained that his judgment was affected by personal problems he was  
4 having at the time and that it was the hectic time of year (year end) for the securities industry.

5 18. On October 17, 2001, the National Association of Securities Dealers ("NASD") issued  
6 a letter that concluded that Respondent had made unauthorized trades in Lori Mayfield's account in  
7 violation of NASD rule 2110.

8 **Janet Mayfield**

9 19. Janet Mayfield is a 66 year-old retired widow.

10 20. Janet Mayfield testified that she relied on Respondent for advice because she did not  
11 have much experience or knowledge about investing in the stock market.

12 21. Janet Mayfield testified that she did not have a discretionary account with Respondent,  
13 and that nothing in her account was to be changed without her approval.

14 22. Janet Mayfield admitted that she could not remember if Respondent talked to her  
15 about all of the transactions made in her account, but she was adamant that certain transactions were  
16 unauthorized.

17 23. She testified that she did not authorize Respondent to purchase the Unit VK Internet  
18 Series 24A, MSDW Information Fund, and MSDW Tech Fund B in November and December of  
19 2000. She further claimed that, during that same period of time, Respondent made unauthorized  
20 purchases of Triqint Semiconductor, Inc., Inktomi CRP, Redback Networks, MSDW Health  
21 Sciences Fund, Unit VK Biotech Pharmaceuticals and Van Kampen Emerging Growth B. Janet  
22 Mayfield testified that she had just "taken my money out of tech funds and, in my wildest dreams, I  
23 can't imagine that I would have approved"<sup>6</sup> re-investing the money in internet funds. Additionally,  
24 she stated that the purchase of Home Depot stock in January of 2001 was also unauthorized.

25 24. Janet Mayfield has settled her claims with MSDW and the Division is not requesting  
26 restitution in connection with Janet Mayfield.

27 \_\_\_\_\_  
28 <sup>5</sup> Transcript at 1790.

<sup>6</sup> Transcript at 1340.

1           25.    Respondent testified that all of the trades made in Janet Mayfield's account were  
2 authorized by her. He stated he had made various notes regarding his conversations with all of his  
3 clients, including Janet Mayfield. During his testimony, he explained his notes and stated he had  
4 talked with Janet Mayfield about the various transactions. Respondent argued that the notes should  
5 be given substantial weight as they were made contemporaneously with the transactions.

6           26.    Respondent testified that Janet Mayfield introduced Respondent and recommended  
7 him as a financial advisor to her daughter, Lori Mayfield, during the Thanksgiving weekend of 2000.  
8 At that meeting, Respondent stated he talked about the profits<sup>7</sup> made by Janet Mayfield from the short-term  
9 sale of Triquent Semiconductors, Inc., a stock Janet Mayfield claims was purchased in an  
10 unauthorized transaction.

11           27.    Respondent argued that Janet Mayfield never explained why she recommended  
12 Respondent to her daughter knowing that he allegedly engaged in unauthorized trading in Janet  
13 Mayfield's account.

14           28.    Janet Mayfield testified that Respondent did not consult with her about the purchase of  
15 Triquent Semiconductors, Inc. stock on November 16, 2000. It is clear from the record that on  
16 November 21, 2000, before the Thanksgiving weekend meeting with her daughter, Janet Mayfield  
17 sold that stock and made a profit of approximately 37 percent. When questioned about this  
18 transaction, Janet Mayfield testified that it "was my first red flag."<sup>8</sup> Based on the evidence, it appears  
19 that Janet Mayfield was willing to overlook Respondent's indiscretions and introduce her daughter to  
20 the Respondent because she made a quick and substantial profit.

21           29.    Although never explained by Janet Mayfield, it is clear from the evidence that she did  
22 not receive her November and December 2000 statements until December 2000 and January 2001,  
23 respectively. Therefore, with the exception of the Triquent Semiconductors, Inc. purchase, she was  
24 not put on notice of the alleged unauthorized trades until after she introduced her daughter to  
25 Respondent.

26           30.    Respondent also argued that Redback Networks and Inktomi CRP were present in her

27 <sup>7</sup> The evidence shows Janet Mayfield made approximately \$2,200 on an investment of approximately \$5,900 for a return  
28 of almost 37 percent in a matter of just five days.

<sup>8</sup> Transcript at 1341.

1 account before Respondent became Janet Mayfield's financial advisor.

2 31. In Exhibit S-37, it is clear that Janet Mayfield purchased shares of Redback Networks  
3 and Inktomi CRP in November and December of 2000, which was the period of time when Janet  
4 Mayfield was a client of Respondent.

5 **Sylvia Hays**

6 32. Sylvia Hays is an 82 year-old retired widow. Ms. Hays' primary occupation was a  
7 wife and mother to her family.

8 33. Ms. Hays testified that she relied on Respondent for advice because she did not have  
9 much experience or knowledge about investing in the stock market.

10 34. Ms. Hays stated she never signed a discretionary agreement with Respondent, and he  
11 was not to make trades on her account without her permission.

12 35. Ms. Hays stated that when she reviewed her September 2000 statement, she noticed  
13 she had sold her interest in MSDW Dividend Growth B Fund and re-invested that money in MSDW  
14 Information Fund B. She stated this caught her eye as the MSDW Information Fund B was  
15 "unfamiliar"<sup>9</sup> to her.

16 36. Ms. Hays testified that the sale and purchase were unauthorized. She stated she called  
17 Respondent and admonished him for making an unauthorized trade and told him that he was not to  
18 change any of the funds in her account without her approval.

19 37. Ms. Hays testified that Respondent remained her broker until he was terminated from  
20 MSDW. She stated that after Respondent left MSDW another broker took over her account and  
21 talked with Ms. Hays about selling the MSDW Information Fund. Ms. Hays said she did not sell the  
22 fund as it was her philosophy to "just let it ride."<sup>10</sup>

23 38. Ms. Hays testified that Respondent offered to reverse the trade, but she declined. She  
24 stated she erroneously thought there would be a charge to switch back, so she decided to keep the  
25 MSDW Information Fund B.

26 39. Respondent testified that all of the trades made in Ms. Hays' account were authorized  
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28 <sup>9</sup> Transcript at 1475.

<sup>10</sup> Transcript at 1500.

1 by her.

2 40. Respondent stated he specifically talked to Ms. Hays about selling the MSDW  
3 Dividend Growth B Fund. He testified that he made the recommendation to Ms. Hays, and many  
4 other clients, to sell the fund as it had announced in September 2000 that the dividends paid out by  
5 the fund were going to be cut by \$0.02 a share. He testified that he recommended a cost free switch  
6 to the MSDW Information Fund B. He testified he told Ms. Hays that if she was not happy with the  
7 change, she could switch back without incurring any charges. Respondent testified that Ms. Hays did  
8 not ask to be switched back to the MSDW Information Fund B.

9 41. Respondent also testified he did not earn a commission for the exchange made in Ms.  
10 Hays' account.

11 42. During the relevant period of time, Ms. Hays owned 188 shares of the MSDW  
12 Dividend Growth Fund B. Therefore, the economic impact of the dividend cut to Ms. Hays would  
13 have been a reduction in dividends of only \$3.76 per dividend payment on an investment of over  
14 \$10,000.

15 43. Respondent argued that ordering restitution for Ms. Hays would be improper.  
16 Respondent argued that Ms. Hays chose to continue holding onto the MSDW Information Fund B  
17 even after he was no longer in charge of her account. Respondent argued it was Ms. Hays' decision  
18 to "let it ride" and, further, that the Division had not met its burden in establishing the value of the  
19 MSDW Information Fund at the time Respondent ceased to be Ms. Hays' financial advisor.

20 44. Exhibit S-47 which contains Ms. Hays' financial statements from MSDW shows that  
21 from the time of purchase in September 2000 until March 31, 2001, two days prior to Respondent's  
22 termination with MSDW, the value of the MSDW Information Fund B in Ms. Hays' account fell  
23 from \$10,115.13 to \$4,332.45.

24 **Beatrice DuChene**

25 45. Beatrice DuChene is a 78 year-old retired medical secretary, as well as a former  
26 employee of General Electric ("GE"). While she was a client of Respondent, she testified that she  
27 had very little investment knowledge, and did not understand the financial statements, such as  
28 confirmation pages or monthly statements, that she received from MSDW. She testified that once she

1 received any financial documents, she filed them without looking at them.

2 46. Ms. DuChene's daughter, Mary DuChene, testified that in 1998, when she was helping  
3 her mother prepare her 1997 taxes, she noticed that her mother had sold her GE stock.

4 47. Beatrice DuChene testified that she did not authorize the sale of her GE stock, and did  
5 not have a discretionary agreement with Respondent.

6 48. Beatrice DuChene said the sale of the GE stock took her by surprise as she never  
7 considered selling the stock. Beatrice DuChene explained she wanted to keep the stock because she  
8 had worked for GE and it was "important to me."<sup>11</sup>

9 49. Mary DuChene testified that the sale of the GE stock really upset her mother and  
10 Beatrice DuChene talked about the sale "ad nauseam."<sup>12</sup> She testified that her mother believed that  
11 she should have GE stock in her portfolio because "it's an American thing to have."<sup>13</sup> She further  
12 testified that, based upon Beatrice DuChene's prior employment with GE, her mother had an  
13 "emotional attachment"<sup>14</sup> to the GE stock. Mary DuChene further testified that her mother was very  
14 upset with Respondent because the unauthorized sale of the GE stock had violated her trust in him.

15 50. Beatrice DuChene testified that she went to Respondent's office to reprimand him for  
16 the unauthorized trade. She testified that she was very upset with Respondent. She stated the  
17 Respondent apologized and stated he would not do anything like that again.

18 51. Respondent testified that he talked to Beatrice DuChene twice about the sale of the GE  
19 stock and that he received her permission to sell it.

20 52. Respondent argued that throughout the hearing Beatrice DuChene exhibited a faulty  
21 memory about transactions and conversations that took place. Respondent noted that the record was  
22 replete with documents bearing Beatrice DuChene's signature and that she received various financial  
23 statements, including confirmation pages and monthly statements. Respondent argued Beatrice  
24 DuChene was, therefore, cognizant of the changes made in her account.

25 53. Respondent further agreed that Mary DuChene admitted that her mother had shown  
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27 <sup>11</sup> Transcript at 44.

<sup>12</sup> Transcript at 284.

<sup>13</sup> Transcript at 456.

<sup>14</sup> Id.



1 "signs of confusion"<sup>15</sup> during the relevant period of time.

2 54. The sale of 131 shares of GE stock took place on December 15, 1997,<sup>16</sup> and  
3 Respondent made a commission of \$166.54.

4 55. Respondent purchased on Beatrice DuChene's behalf 60 shares of GE stock on  
5 December 14, 1998.<sup>17</sup> Respondent made a commission of \$96.30. This was the day before Beatrice  
6 DuChene walked into the MSDW office in Sun City with a letter that stated she no longer wanted  
7 Respondent to be her financial advisor.

8 56. Respondent denied that the purchase of the GE stock made in Beatrice DuChene's  
9 account was made as a remedial measure for the prior sale of GE stock.

10 57. In a matter unrelated to the GE stock,<sup>18</sup> Respondent received a cautionary letter from  
11 the NASD in May of 2000. The NASD concluded that there had been a misunderstanding between  
12 Respondent and Beatrice DuChene. Respondent had claimed that Beatrice DuChene had given him  
13 the authority to make transactions to "protect her account value"<sup>19</sup> when she was away on trips. The  
14 NASD concluded that, since Respondent had not obtained Beatrice DuChene's written approval to  
15 make such transactions, he had violated NASD Rule 2510.

16 58. On June 2, 2000, Respondent replied to the NASD letter and promised to "endeavor to  
17 prevent even an appearance of this type of conduct mentioned in your letter."<sup>20</sup> He also stated he  
18 "reviewed various rules and regulations of the NASD and NYSE, as well as our firm's compliance  
19 guide with respect to various provisions such as . . . Discretionary Trading and Unsuitability."<sup>21</sup>

20 59. Respondent admitted that, just six months after he wrote the June 2, 2000 letter to the  
21 NASD, he made unauthorized trades in Lori Mayfield's account.

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23 \_\_\_\_\_  
<sup>15</sup> Transcript at 356.

24 <sup>16</sup> Exhibit S-6.

25 <sup>17</sup> Exhibit S-15.

26 <sup>18</sup> After Beatrice DuChene terminated her relationship with Respondent, she filed a complaint with the NASD. Part of the  
27 complaint addressed her investment in a unit investment trust, which rolled over each year unless Beatrice DuChene  
28 requested her money back. The NASD concluded that there was a misunderstanding between Beatrice DuChene and  
Respondent about the fund and the automatic roll over provision. The Division did not allege that the transactions  
involving the unit investment trust were unauthorized or unsuitable in this case.

<sup>19</sup> Exhibit S-50.

<sup>20</sup> Id.

<sup>21</sup> Id.

**Viola Brotherson**

60. The Division stated in its closing brief that this count was not substantiated during Ms. Brotherson's testimony at the hearing.

61. From the record it is clear that Viola Brotherson consented to the various sales and purchases made in her account. Therefore, the transactions in her account were authorized, and this count should be dismissed.

**UNSUITABILITY**<sup>22</sup>

62. The Division alleged that certain transactions, primarily the presence of the MSDW High Income/Yield Fund<sup>23</sup> in the accounts of Beatrice DuChene and Viola Brotherson were unsuitable. At the hearing, the Division stated that the MSDW High Income/Yield Fund was a junk bond fund as disclosed in its prospectus. The Division stated that the prospectus for the fund disclosed that the bonds that constitute the funds are subject to greater risks than higher rated securities and are considered to be speculative as to payment of interest and return of principle. The Division further stated that the prospectus advised investors to consider their ability to assume the risk involved in the fund.

63. The Division argued that two retired elderly ladies living on Social Security and income from their investments should not be exposed to this type of investment vehicle and its inherent risks.

64. Respondent agreed that this was a "junk bond" fund, and a majority of the fund was comprised of Grade B securities. However, Respondent argued that the fund was comprised of over 200 various bond issues and, therefore, it was a well diversified mutual fund.

65. Respondent stated that he had frequent meetings with his manager and others at

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<sup>22</sup> Respondent argued that the only testimony offered by the Division on the issue of unsuitability was from the Division's employee, Michael Donovan. Respondent argued that Mr. Donovan's qualifications to render an expert opinion in this matter are suspect because he never served in a position where he was charged with the duty of reviewing transactions for suitability, such as a supervisor, a branch manager or a compliance officer for a registered broker/dealer. In its analysis, the Commission is not relying on the testimony or exhibits created by Michael Donovan. Rather, the Commission is determining suitability of transactions based upon the other exhibits entered in evidence and the testimony of Beatrice DuChene, Viola Brotherson and the Respondent.

<sup>23</sup> Two funds were consolidated and renamed the Dean Witter High Yield B fund because both funds had essentially the same investment objectives and invested in the same securities. Both Beatrice DuChene and Viola Brotherson had an original investment that was exchanged for the Dean Witter High Yield B Fund on November 11, 1997. Since Dean Witter merged with Morgan Stanley, this fund will be referred to as the MSDW High Income/Yield Fund.

1 MSDW concerning the MSDW High Income/Yield Fund. He stated that his manager used the  
2 MSDW High Income/Yield Fund extensively to provide income for seniors citizens. Respondent stated he  
3 was aware of the excellent returns the fund provided during the period 1995 to 1998. He further  
4 testified that he attended a seminar where high yield bonds were discussed extensively and no one  
5 suggested that a high yield bond was a speculative investment.

6 66. Respondent testified that the MSDW investment pyramid, a training tool provided to  
7 him during his training at MSDW, classifies high yield bond funds as only slightly riskier than  
8 investments in cash and cash equivalents. Therefore, Respondent argued that a high yield bond fund  
9 should not be categorized as a risky or speculative investment.

10 67. Further, Respondent stated that the MSDW High Income/Yield Fund had a high rating  
11 and that the defaults reported by bond market associations were running at 1 or 2 percent, during the  
12 relevant period of time. Respondent argued this bolstered his argument that investments in those  
13 vehicles were not risky or speculative.

14 68. Respondent stated that the MSDW High Income/Yield Fund was not speculative, but  
15 was well diversified and that he had a reasonable basis to recommend the MSDW High Income/Yield  
16 Fund to his clients, including the alleged victims in this case.

17 69. Respondent argued that the MSDW High Income/Yield Fund was a suitable product  
18 for the alleged victims in this case and that the Division made no attempt to rebut the testimony that  
19 those funds were widely used by Respondent's firm for senior citizens, were highly respected and  
20 praised by *Forbes*, *Business Week* and other trade journals.

21 70. Respondent offered Exhibit R-1, which is a *Business Week* article entitled "Junk  
22 Bonds are Looking a Lot Less Junky" in support of Respondent's contention that his  
23 recommendations to his clients regarding the MSDW High Income/Yield Fund were suitable.

24 71. The Division noted that the same article stated that, "these bonds are best used in  
25 moderation: Financial advisors suggest allocating no more than three to five percent [of a portfolio]  
26 to a high yield bond fund."<sup>24</sup>

27  
28 <sup>24</sup> Exhibit R-1.

**Viola Brotherson**

72. Viola Brotherson is an 84 year-old retired secretary.

73. Viola Brotherson testified that she relied on Respondent for advice because she did not have much experience or knowledge about investing in the stock market.

74. Viola Brotherson stated that when she first met with the Respondent, she told him she wanted more income. She also stated that she understood that in order to get more income there would be more risk associated with the investment. She further stated that she would be willing to invest in speculative investments if she were to obtain the appropriate income.

75. Viola Brotherson stated that the Respondent never discussed the risks of the particular investment she made and never discussed the charges for making various trades.

76. Respondent admitted that from January 1998 through July 2000, 72 percent to 88 percent of Viola Brotherson's total portfolio was invested in the MSDW High Income/Yield Fund.

77. On August 23, 2000, Viola Brotherson's interest in the MSDW High Income/Yield Fund was exchanged for the MSDW Information Fund B.

78. On December 18, 2000, the MSDW Information Fund B was exchanged for MSDW Health Sciences Funds B.

79. In each case, those investments, the MSDW Information Fund B or the MSDW Health Sciences Fund represented 72 to 81 percent of Ms. Brotherson's total portfolio.

80. When questioned about the concentration of her portfolio, Viola Brotherson stated she did not realize that "all of her eggs were in one basket."<sup>25</sup>

81. Viola Brotherson's son, Clark Brotherson, testified that once he learned about his mother's investments, he talked to Respondent's supervisor, Charlie Cajero, about his mother's investments, specifically about the concentration of her funds in one investment vehicle. Mr. Brotherson testified that Mr. Cajero agreed with him and Mr. Cajero stated that Viola Brotherson's money should have been moved to a money market fund. Clark Brotherson testified that he told Mr. Cajero that he thought his mother's money had been mishandled and that her money should be

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<sup>25</sup> Transcript at 522.

1 returned to her. Clark Brotherson stated that Mr. Cajero said that was "doable."<sup>26</sup>

2       82. The Division argued that the MSDW Health Sciences Fund and the MSDW  
3 Information Fund, though not junk bond funds, had material risks that should have been disclosed to  
4 Viola Brotherson. The Division stated that the funds, as their name implies, concentrate their  
5 investments in either the health Sciences industry or the information industry. The Division argued  
6 that, due to this concentration, the value of the shares in these funds can be more volatile than mutual  
7 funds that do not similarly concentrate their investments. Additionally, the Division argued that  
8 because the health Sciences and the information industries are subject to substantial regulation, those  
9 funds could be adversely affected by changes in government regulations.

10       83. The Division argued that the percentage concentration of the MSDW High  
11 Income/Yield Fund, the MSDW Health Sciences Fund, and the MSDW Information Fund in Viola  
12 Brotherson's portfolio was simply too high. Further, the Division argued that the MSDW Health  
13 Sciences and MSDW Information Funds were funds whose primary objective was capital  
14 appreciation, not income, which is in direct contrast to Viola Brotherson's investment goals.

15       84. The Division argued that Respondent knew that Viola Brotherson was retired and  
16 knew or should have known that as a retiree, she could not afford to lose her investment principal as  
17 it was a significant source of income to her. The Division noted that, in a form completed by Viola  
18 Brotherson at the time she opened her account, the words "client does not want to answer" were inserted in  
19 the area that normally would delineate a client's financial status. The Division argued that that  
20 crucial financial information regarding Viola Brotherson such as income, net worth, liquid assets and  
21 tax bracket were never updated by Respondent and that those critical pieces of information were  
22 necessary to him in order to make the appropriate recommendations for Viola Brotherson.

23       85. Respondent testified that he spoke to Viola Brotherson prior to each transaction and  
24 that each time she approved of the sales and purchases in her account.

25       86. Respondent admitted that in meeting a customer's objective, a broker should not put  
26 all of his client's "eggs in one "basket." However, Respondent argued that the MSDW High  
27

28 <sup>26</sup> Transcript at 650.

1 Income/Yield Fund was a well diversified mutual fund and, therefore, he did not consider Viola  
2 Brotherson's investment in that vehicle as "putting all of her eggs in one basket."<sup>27</sup> He further argued  
3 that the MSDW Health Sciences Fund and the MSDW Information Fund were similarly well  
4 diversified funds.

5 87. Respondent noted that Viola Brotherson testified she understood the term "aggressive  
6 income" to mean that her principal would be more at risk than simply an investment in income.  
7 Respondent argued that Viola Brotherson admitted that in order to obtain more income, she would  
8 have to take on more risk and stated that she was desperate enough for income that she would have  
9 invested in aggressive vehicles. Therefore, Respondent argued the transactions in Viola Brotherson's  
10 account were suitable based upon Viola Brotherson's investment goals.

11 **Beatrice DuChene**

12 88. Beatrice DuChene testified that she discussed her investment objectives with  
13 Respondent and stated that she was a conservative investor that wanted to use investments to  
14 supplement her income.

15 89. Mary DuChene, daughter of Beatrice DuChene, contradicted her mother's testimony.  
16 She testified that her mother is not a risk taker, but is not conservative investor either. She described  
17 her mother as a "middle of the road"<sup>28</sup> investor.

18 90. Beatrice DuChene testified that Respondent never explained risk to her or discussed  
19 her risk tolerance in relationship to her investments.

20 91. Beatrice DuChene testified that she relied on Respondent because she did not have  
21 much experience or knowledge about investing in the stock market.

22 92. Respondent conceded that Beatrice DuChene's expertise in investing was "not the  
23 greatest."<sup>29</sup>

24 93. The Respondent admitted that the MSDW High Income/Yield Fund constituted  
25 anywhere from 6 to 18 percent of Mrs. DuChene's entire portfolio from January 1996 to October  
26 1998.

27 <sup>27</sup> Transcript at 1929.

28 <sup>28</sup> Transcript at 279.

<sup>29</sup> Transcript at 1825.

1           94.     During his examination under oath, Respondent admitted that high yield bonds could  
2 be considered aggressive income.

3           95.     Beatrice DuChene had three separate accounts with Respondent. Those accounts  
4 involved investments in individual stocks, various funds and annuities.

5           96.     Respondent argued that based upon Beatrice DuChene's total portfolio, his  
6 recommendation to purchase the MSDW High Income/Yield Fund was suitable.

7           97.     Regarding the presence of the MSDW High Income/Yield Fund in Beatrice  
8 DuChene's account, Respondent noted that Mary DuChene admitted that her mother's risk tolerance  
9 was somewhere in the middle and that she was not a conservative investor as portrayed by the  
10 Division.

11           98.     Respondent stated that he talked to Beatrice DuChene about the MSDW High  
12 Income/Yield Fund in 1995. Respondent stated that he was "shocked"<sup>30</sup> to hear her say that he did  
13 not discuss that investment with her. In fact, Respondent said that he remembered the discussion  
14 with Ms. DuChene about the MSDW High Income/Yield Fund in 1995 as she was "very  
15 concerned"<sup>31</sup> about charges and costs.

16           **Respondent's General Defenses**

17           99.     Respondent stated that he had frequent meetings with his manager and others  
18 concerning the handling of his customers' accounts. He further testified that he talked to others about  
19 available products and went to seminars about those products.

20           100.    He further testified that the MSDW system had a great deal of information about  
21 products and that he had access to computer information about the products he recommended.  
22 Respondent stated that the products he sold to the five alleged victims in this case were researched  
23 using the computer system.

24           101.    He further testified that he talked with his branch manager and other senior brokers  
25 about his recommendations to clients and that his manager reviewed all of his orders.

26           102.    Respondent testified that his manager never told him that an order he placed was  
27

28 <sup>30</sup> Transcript at 1601.

<sup>31</sup> Transcript at 1604.

1 improper or disapproved of any of his transactions on behalf of his clients.

2 103. Respondent testified that he always talked to his clients about three things: risk,  
3 reward and cost.

4 104. Respondent also stated in discussing his recommendations, he always discussed the  
5 MSDW investment pyramid which described various vehicles of investment and their risk factors with all  
6 of the alleged victims.

7 105. He further testified that he believed the funds he recommended to his clients were  
8 suitable.

9 106. Respondent claimed that he made notes about the conversations he had with his clients  
10 regarding his recommendations to buy or sell securities. He said that when he left MSDW, MSDW  
11 kept his notes per company policy. Respondent stated he was only able to recover a portion of his  
12 notes from the Sun City, Arizona office. Respondent testified that his branch manager, Charlie  
13 Cajero, stated that some of his notes were sent to New York City and were stored at the World Trade  
14 Center. Respondent stated that those notes were unrecoverable because of the tragedy of September  
15 11, 2001.

16 107. Sarah Whitmore, the current branch manager of the Sun City office, stated that per  
17 company policy, Respondent's notes were kept off site in a storage facility located in Maricopa  
18 County. She stated that records of salesmen are not sent back to New York.

19 108. Respondent argued that, other than Lori Mayfield, the alleged victims waited a  
20 significant period of time until they complained about unauthorized or unsuitable trades. Respondent  
21 noticed that Beatrice DuChene in some instances waited almost two years after the event to place her  
22 complaint in writing. He further argued that Janet Mayfield waited until after Respondent left  
23 MSDW in April of 2001 to make a written complaint about trades that had taken place in October,  
24 November and December, 2000. Respondent argued that the doctrine of laches should apply in that  
25 the delay in advising Respondent of the various complaints prevented him from doing things to  
26 protect his position and placed him at an unfair disadvantage.

27 109. The Division argued that the defense of laches is not supported by case law. The  
28 Division stated that this defense is not applicable, especially since this is an administrative



1 proceeding by a regulatory agency.

## 2 ANALYSIS

### 3 **Unauthorized Trades**

4 110. We find that Respondent made unauthorized trades in Lori Mayfield's account.  
5 Additionally, we find that Respondent made unauthorized transactions in the account of Janet  
6 Mayfield, Sylvia Hays and Beatrice DuChene. Regarding Beatrice DuChene, although her memory  
7 regarding her relationship and conversations with Respondent is questionable, in this matter the  
8 Commission is convinced by her statements and actions that the sale of her GE stock was  
9 unauthorized. It is clear from the record that Beatrice DuChene had a significant emotional  
10 attachment to her stock in GE and would not have sold that stock even if Respondent had  
11 recommended selling it. Further, the testimony of Sylvia Hays and Janet Mayfield prove beyond a  
12 preponderance of evidence that Respondent engaged in a pattern and practice of unauthorized  
13 transactions in the fall and winter of 2000.

14 111. We further find that there were no unauthorized transactions made in the account of  
15 Viola Brotherson.

### 16 **Unsuitable Transactions**

17 112. The Commission has held in past Decisions that a respondent's omissions along with  
18 his failure to diversify his clients' investments were enough for the Commission to find that the  
19 respondent had made material omissions and misstatements. *See, Buchanan and Company, Inc., et*  
20 *al.*; Decision No. 57365 (May 2, 1991), and *Boucher, Oehmke and Co., et al.*; Decision No. 57979  
21 (August 7, 1992),

22 113. In Decision No. 57365,<sup>32</sup> the Commission held that some risky and speculative bonds  
23 in certain customers' securities portfolios may have been suitable at the time if the salesperson had  
24 diversified the customers' entire security portfolio into other investments. Further, the Commission  
25 held that even if the recommendation of the securities was suitable for some investors, the large  
26 concentration of the securities in the investors' portfolios made the recommendations unsuitable.

27  
28 <sup>32</sup> *Buchanan and Company, Inc., et al.* (May 2, 1991).

1 Finally, the Commission found that a securities salesperson that fails to adequately diversify a  
2 customer's portfolio or recommends to a customer purchases in a security which constitutes a large  
3 percentage of the customer's securities portfolio, is in violation of the antifraud provisions of the Act.

4 114. The article regarding junk bond funds as an acceptable income vehicle entered into  
5 evidence by Respondent says that such funds are best used in moderation. Further, the article states  
6 that financial advisors suggest allocation of no more than three to five percent of one's portfolio in  
7 junk bonds.

8 115. Respondent admitted that Viola Brotherson was heavily invested in the MSDW High  
9 Income/Yield Fund, MSDW Health Sciences Fund B and MSDW Information Fund B, but stated that  
10 it was at her request. However, Respondent admitted that there is some point at which a broker should tell  
11 a customer that he will not make the trades as they are unsuitable.

12 116. In this case, Viola Brotherson was clearly relying on Respondent's expertise regarding  
13 her investments.

14 117. It is apparent based upon the testimony, the exhibits and prior Commission Decisions,  
15 that the high concentration of a junk bond fund in Viola Brotherson's portfolio was unsuitable.  
16 Additionally, the high concentration in sector stock funds in Viola Brotherson's portfolio was  
17 unsuitable. The severe over concentration in the MSDW High Income/Yield Fund, the MSDW  
18 Health Sciences Fund B and the MSDW Information Fund B were not suitable for her; particularly  
19 based upon her age, income, the risk involved and the mismatch between Viola Brotherson's  
20 investment goal of income and the investment objectives of the Information and Health Sciences  
21 Funds of capital appreciation.

22 118. We find that Respondent failed to adequately diversify Viola Brotherson's portfolio  
23 and instead recommended to her investments in a security that constituted an unreasonably large  
24 percentage of her portfolio, in violation of the Act.

25 119. We further find that the aforementioned investments made in Viola Brotherson's  
26 account were unsuitable.

27 120. Regarding Beatrice DuChene, the record shows that she is confused as to the  
28 conversations and transactions that took place with Respondent regarding her account. The record

1 indicates Respondent testified on several occasions that he had specific conversations with Beatrice  
2 DuChene about transactions in her account. Based upon that, it cannot be said by the preponderance  
3 of the evidence that Respondent did not have those conversations with Beatrice DuChene.

4 121. We find that it has not been proven by a preponderance of the evidence that Beatrice  
5 DuChene's investment in the MSDW High Income/Yield Fund is unsuitable. While her total  
6 portfolio invested in the MSDW High Income/Yield Fund ranged from six percent to eighteen  
7 percent, it is unclear based upon her portfolio and her daughter's statement that her mother was a  
8 "middle of the road investor" whether or not her participation in the MSDW High Income/Yield Fund  
9 at the levels suggested were unsuitable. While it is true that the article relied upon by Respondent  
10 states that financial brokers should invest three to five percent of their customers' total portfolio in  
11 these type of funds, the Division did not show by a preponderance of evidence that a deviation of one  
12 to thirteen percent from that recommended ratio is inappropriate, especially in light of Beatrice  
13 DuChene's risk tolerance and her total portfolio.

14 122. The Commission cannot conclude that the transactions in Beatrice DuChene's account  
15 were unsuitable.

#### 16 **Administrative Penalties and Restitution**

17 123. Based upon the evidence, Respondent violated the trust and confidence of his  
18 customers and caused monetary damages to them. The evidence further shows that Respondent is  
19 lacking in integrity and has engaged in dishonest and unethical practices in the securities industry.  
20 Respondent, by his own admission, engaged in unauthorized transactions in the account of Lori  
21 Mayfield even after he wrote a letter to the NASD addressing similar allegations by Beatrice  
22 DuChene. That admission alone is sufficient to revoke Respondent's license as a registered securities  
23 salesman in Arizona. It is clear from the record that Respondent engaged in a pattern and practice of  
24 making unauthorized trades in his customers' accounts and that, in the case of Viola Brotherson, he  
25 made unsuitable transactions and exposed Viola Brotherson to unnecessary risk. Therefore,  
26 Respondent's registration as a securities salesman in Arizona should be revoked, he should be  
27 ordered to permanently cease and desist from violating A.R.S. § 44-1991, and he should be ordered  
28 to pay administrative penalties and make restitution.

1 124. The Division requested that the Respondent pay not less than \$30,000 in  
2 administrative penalties based on his conduct. Further, the Division requested that the Respondent be  
3 ordered to pay a total restitution figure of \$80,535.70. The Division stated that \$30,107.27 should be  
4 paid to Beatrice DuChene, \$43,625.43 should be paid to Viola Brotherson and \$6,803 should be paid  
5 to Sylvia Hays.

6 125. Based on the evidence, we find that an administrative penalty of \$5,000 is prudent in  
7 this matter.

8 126. Regarding restitution for the unauthorized transactions, as to Lori Mayfield and Janet  
9 Mayfield, the Division did not request any restitution. Lori Mayfield and Janet Mayfield settled their  
10 claims with MSDW. Ms. Hays testified that she decided not to reverse the unauthorized trade made  
11 in her account and preferred to "let it ride". Ms. Hays made the decision to remain in the fund even  
12 after Respondent offered to reverse the trade at no cost. Therefore, we are not ordering any  
13 restitution for Ms. Hays. Regarding the unauthorized transaction in Beatrice DuChene's account, the  
14 Respondent should be ordered to pay restitution to the State of Arizona in an amount to be  
15 determined at a later date.

16 127. Regarding the unsuitable transactions in Viola Brotherson's account, the Respondent  
17 should be ordered to pay restitution to the State of Arizona in an amount to be determined at a later  
18 date.

### 19 CONCLUSIONS OF LAW

20 1. The Commission has jurisdiction over this matter pursuant to Article XV of the  
21 Arizona Constitution and the Securities Act.

22 2. Respondent violated A.R.S. § 44-1991 by making untrue statements of fact by failing  
23 to disclose material facts, and engaging in transactions, practices or courses of business which  
24 operate or would operate as a fraud or deceit. Respondent's conduct includes, but is not limited to  
25 the following:

26 (a) failing to disclose to Lori Mayfield, Janet Mayfield, Sylvia Hays and Beatrice  
27 DuChene that he had conducted unauthorized transactions in their accounts;

28 (b) failing to disclose to Viola Brotherson that he had conducted unsuitable

1 transactions in her account; and

2 (c) engaging in transactions, practices or courses of business which operated as a  
3 fraud or deceit on his Lori Mayfield, Janet Mayfield, Sylvia Hays, Viola  
4 Brotherson and Beatrice DuChene by conducting unauthorized and unsuitable  
5 transactions in their accounts.

6 3. Respondent's registration as a securities salesman should be revoked pursuant to  
7 A.R.S. § 44-1962(A) (2), (4), (9) and (10) for the following reasons:

8 (a) he violated the Act;

9 (b) he is lacking in integrity or is not of good business reputation; and

10 (c) he has engaged in dishonest or unethical practices in the securities industry.

11 4. Respondent should be ordered to cease and desist from future violations of the Act.

12 5. Respondent should be ordered to pay restitution pursuant to A.R.S. § 44-2032.

13 6. Respondent should be ordered to pay an administrative penalty of \$5,000 pursuant to  
14 A.R.S. § 44-2036.

15 7. Respondent did not conduct unauthorized transactions in Viola Brotherson's account.

16 8. Respondent did not conduct unsuitable transactions in Beatrice DuChene's account.

17 9. The doctrine of laches is not applicable in this matter.

18 **ORDER**

19 IT IS THEREFORE ORDERED that pursuant to A.R.S. § 44-2032, Respondent shall cease  
20 and desist from his actions described hereinabove in violation of A.R.S. § 44-1991.

21 IT IS FURTHER ORDERED that, regarding Beatrice DuChene and Viola Brotherson, the  
22 Respondent shall make restitution payable to the State of Arizona in an amount to be subsequently  
23 determined.

24 IT IS FURTHER ORDERED that pursuant to A.R.S. § 44-2036, Respondent shall pay as an  
25 administrative penalty for the violations of A.R.S. § 44-1991, the sum of \$5,000 within sixty days of  
26 the effective date of this Order.

27 IT IS FURTHER ORDERED that administrative penalties shall be made payable to the "State  
28 of Arizona" for deposit into the general fund of the State of Arizona.

1 IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under  
2 A.R.S. § 44-1962, Philip William Merrill's registration as a securities salesman in Arizona is  
3 revoked.

4 IT IS FURTHER ORDERED that the allegation that Philip William Merrill made  
5 unauthorized transactions in Viola Brotherson's account is dismissed.

6 IT IS FURTHER ORDERED that the allegation that Philip William Merrill made unsuitable  
7 transactions in Beatrice DuChene's account is dismissed.

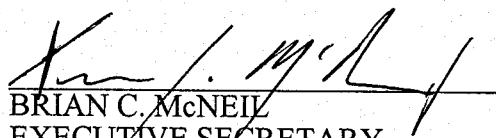
8 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

9 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

10  
11     
12 CHAIRMAN COMMISSIONER COMMISSIONER

13    
14 COMMISSIONER COMMISSIONER

15  
16 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
17 Secretary of the Arizona Corporation Commission, have  
18 hereunto set my hand and caused the official seal of the  
19 Commission to be affixed at the Capitol, in the City of Phoenix,  
20 this 9<sup>th</sup> day of December, 2003.

21   
22 BRIAN C. McNEIL  
23 EXECUTIVE SECRETARY

24 DISSENT \_\_\_\_\_

25 DISSENT \_\_\_\_\_

26 PJD:mj

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