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BEFORE THE ARIZONA CORPORATION COMMISSION

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1 WILLIAM A. MUNDELL  
2 Chairman  
3 JIM IRVIN  
4 Commissioner  
5 MARC SPITZER  
6 Commissioner

AZ CORP COMMISSION  
DOCUMENT CONTROL **NEW**

6 In the matter of: ) DOCKET NO. S-03450A-02-0000  
7 Philip William Merrill )  
3788 N. 156<sup>th</sup> Drive ) **NOTICE OF OPPORTUNITY FOR HEARING**  
8 Goodyear, Arizona 85338 ) **REGARDING PROPOSED ORDER TO**  
CRD #2436444, ) **CEASE AND DESIST, FOR RESTITUTION,**  
9 Respondent. ) **FOR ADMINISTRATIVE PENALTIES, FOR**  
10 ) **REVOCATION OR SUSPENSION, AND FOR**  
11 ) **OTHER AFFIRMATIVE ACTION**

12 **NOTICE: RESPONDENT HAS 10 DAYS TO REQUEST A HEARING**

13 The Securities Division ("Division") of the Arizona Corporation Commission ("Commission")  
14 alleges that respondent has engaged in acts, practices and transactions that constitute violations of the  
15 Securities Act of Arizona, A.R.S. § 44-1801 *et seq.* ("Securities Act").

16 **I.**

17 **JURISDICTION**

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

20 **II.**

21 **RESPONDENT**

22 2. Philip William Merrill's ("MERRILL") last known address is 3788 N. 156<sup>th</sup> Drive,  
23 Goodyear, Arizona 85338.

24 3. From on or about February 17, 1994, until April 6, 2001, MERRILL was registered as a  
25 securities salesman in Arizona with Morgan Stanley Dean Witter, Inc. ("MSDW"). While with  
26 MSDW, MERRILL worked at the branch office in the Sun City, Arizona area. In April 2001,

1 MERRILL was terminated for alleged unauthorized transactions in a client's account. All  
2 allegations contained in this Notice of Opportunity for Hearing occurred while MERRILL was  
3 registered with MSDW.

4 4. From on or about May 25, 2001, until November 19, 2001, MERRILL was registered as  
5 a securities salesman in Arizona with The Advisors Group, Inc. While with The Advisors Group,  
6 Inc., MERRILL worked at the branch office in Phoenix, Arizona. MERRILL was terminated from  
7 The Advisors Group, Inc. for failing to comply with heightened supervisory requirements.

8 5. Pursuant to A.R.S. § 44-1949, MERRILL'S registration as a securities salesman in  
9 Arizona was automatically suspended on the date of his termination by The Advisors Group, Inc.,  
10 on or about November 19, 2001. Since that date, MERRILL has not been registered with any  
11 securities dealer. Therefore, pursuant to A.R.S. § 44-1947(B), MERRILL'S registration expired on  
12 December 31, 2001. The Commission has the statutory authority pursuant to A.R.S. § 44-1963(D)  
13 and A.R.S. § 44-1947(D), to bring this action to suspend or revoke MERRILL'S registration as an  
14 Arizona securities salesman within two years after the termination or lapse of his registration.

15 6. Since on or about May 25, 1994, MERRILL has been licensed in Arizona to sell life and  
16 variable life insurance products. Both of these insurance licenses expire on February 28, 2002,  
17 unless renewed.

### 18 III.

### 19 FACTS

#### 20 Customer One

21 7. Customer One is a 78-year-old retired widow who lives in Sun City, Arizona.  
22 Customer One had three accounts with MSDW. The primary investment objectives listed with  
23 MSDW for Customer One were income and capital appreciation. Customer One's investment  
24 goals were conservative. Customer One's sole source of income, other than any investment  
25 income she received, was monthly social security payments. Customer One's financial  
26 information listed with MSDW was: income of \$7,000 per year, net worth of \$130,000, and

1 liquid assets of \$28,000. Customer One desired preservation of her investment principal due to  
2 her age and financial situation. Customer One never signed a discretionary agreement with  
3 MSDW and MERRILL.

4 8. From approximately January 1996 to January 1999, MERRILL was Customer One's  
5 stockbroker at MSDW. Customer One was not a sophisticated investor. Prior to becoming a  
6 customer of MERRILL'S, Customer One's investment experience consisted of investing in bank  
7 issued certificates of deposit. Customer One trusted MERRILL and relied upon his financial  
8 knowledge and advice. Customer One did not understand the securities statements and other  
9 securities-related documents she received from MSDW.

10 9. On a number of occasions, MERRILL requested Customer One sign a discretionary  
11 agreement. Despite Customer One's refusal to sign a discretionary agreement, MERRILL treated  
12 Customer One's accounts as discretionary accounts. MERRILL conducted several unauthorized  
13 trades in Customer One's accounts while he was her stockbroker.

14 10. In approximately January 1998, while having her 1997 taxes prepared, Customer One  
15 discovered that MERRILL had sold some of her General Electric stock without her authorization.  
16 Soon after discovering this unauthorized trade, Customer One told MERRILL, in his office, that  
17 he was not to make any more trades in her accounts without her prior approval. Customer One  
18 later found out that MERRILL had conducted other unauthorized trades in her accounts prior to  
19 selling her General Electric stock, and that he continued to conduct unauthorized trades in her  
20 accounts after this incident.

21 11. Short-term trading often occurred in Customer One's accounts. On a number of  
22 occasions, securities, predominantly mutual funds, were sold within two years after being  
23 purchased. Mutual funds are considered to be long-term investments.

24 12. During much of 1997 and 1998, the MSDW High-Yield Securities Fund, a mutual  
25 fund, represented approximately 40% of Customer One's securities portfolio. This mutual fund  
26 seeks a high level of current income with capital appreciation as a secondary objective. The fund

1 invests at least the majority of its assets in high-yield corporate bonds that are below investment  
2 grade quality. These are risky bonds with poor credit ratings or even no ratings. The fund  
3 maintains no minimum credit-quality restrictions for its investments. The fund is rated a high-  
4 risk fund and is otherwise known as a junk bond mutual fund. The share price of the MSDW  
5 High-Yield Securities Fund declined during the time period Customer One owned its shares. The  
6 MSDW High-Yield Securities Fund was previously called Dean Witter High-Yield Securities  
7 Fund.

8 13. Customer One's investment in the MSDW High-Yield Securities Fund was not  
9 suitable for her, given the risky nature of the bonds held in that fund, the high concentration of  
10 the fund in Customer One's securities portfolio, her investment objectives, her desire to preserve  
11 her investment principal, her financial situation and needs, her age, and other relevant factors. In  
12 addition, the short-term trading that often occurred in Customer One's accounts, predominantly  
13 in mutual funds, was not suitable for Customer One due to the fact that mutual funds are typically  
14 long-term investments, and due to Customer One's financial situation and needs, her age, and  
15 other relevant factors.

#### 16 Customer Two

17 14. Customer Two is an 83-year-old retired widow who lives in Scottsdale, Arizona.  
18 Customer Two had one account at MSDW. Customer Two moved to Arizona in the early 1990's  
19 and transferred her account to the Sun City area MSDW branch where MERRILL was assigned  
20 as her stockbroker. The investment objective listed on Customer Two's new account form is  
21 "aggressive income." Customer Two did not prepare that new account form nor did she  
22 understand what "aggressive income" was in relation to investments. Customer Two did not  
23 provide any financial information to MSDW such as her net worth and liquid assets. Customer  
24 Two never signed a discretionary agreement with MSDW and MERRILL.

25 15. Ever since Customer Two moved to Arizona her sole source of income has been  
26 monthly social security payments of approximately \$700. The assets in Customer Two's account

1 represented virtually all of her total net worth. Customer Two did not want to risk loss of her  
2 investment principal.

3 16. Customer Two was not a sophisticated investor. Customer Two had no investment  
4 training. Customer Two trusted MERRILL and relied upon his financial knowledge and advice.  
5 Customer Two did not completely understand the securities statements and other securities-  
6 related documents she received from MSDW.

7 17. MERRILL treated Customer Two's account as a discretionary account. MERRILL  
8 did not discuss his recommended trades and receive authorization from Customer Two before  
9 making the trades mentioned below in her account.

10 18. From approximately January 1998 to July 2000, the MSDW High-Yield Securities  
11 Fund represented a range of about 72% to 88% of Customer Two's securities portfolio. The  
12 investment objectives and a brief description of this fund are included above for "Customer  
13 One." The value of the MSDW High-Yield Securities Fund in Customer Two's account  
14 decreased about \$20,000 during this same time period. The only other securities in Customer  
15 Two's account during this time period were preferred stocks in one company.

16 19. In or about August 2000, the shares in the MSDW High-Yield Securities Fund were  
17 exchanged for shares in the MSDW Information Fund. The MSDW Information Fund seeks  
18 long-term capital appreciation. This fund is categorized as a Specialty-Technology fund and has  
19 a high-risk rating. The shares in MSDW Information Fund were only held from in or about  
20 August 2000 until December 2000 when they were exchanged for shares in another MSDW  
21 mutual fund. During this time period, the MSDW Information Fund represented a range of about  
22 73% to 81% of Customer Two's securities portfolio. The value of the Information Fund in  
23 Customer Two's account declined during the time it was held. The only other securities in  
24 Customer Two's account during this time period were preferred stocks in one company.

25 20. In or about December 2000, the shares in MSDW Information Fund were exchanged  
26 for shares in MSDW Health Sciences Fund, another mutual fund. These shares were held in

1 Customer Two's account until at least October 2001. The MSDW Health Sciences Fund seeks  
2 capital appreciation. The fund is categorized as a Specialty-Health fund and has an average-risk  
3 rating.

4 21. From in or about December 2000 to October 2001, the MSDW Health Sciences Fund  
5 represented a range of about 73% to 76% of Customer Two's securities portfolio. The value of  
6 the fund declined during this time period. The only other securities in Customer Two's account  
7 during this time period were preferred stocks in one company.

8 22. The mutual fund investments in Customer Two's securities portfolio were not suitable  
9 for her, given the lack of diversification of investments in her portfolio, the high-risk nature of  
10 two of the three mutual funds, particularly the MSDW High-Yield Securities Fund, her desire to  
11 preserve her investment principal, her age, her financial situation and needs, the lack of financial  
12 information about her known to MERRILL, and other relevant factors.

### 13 Customer Three

14 23. Customer Three is a 65-year-old retired widow who lives in Goodyear, Arizona.  
15 Customer Three is the mother of Customer Four. MERRILL became Customer Three's  
16 stockbroker in or about October 2000. When Customer Three met with MERRILL in or about  
17 October 2000, she specifically requested MERRILL explain each investment recommendation to  
18 her before she gave her approval for the trade. Customer Three also informed MERRILL that  
19 she was a new investor and wanted to be very conservative with her investments as she is a  
20 retired widow. While MERRILL was Customer Three's stockbroker he tried to persuade  
21 Customer Three to sign a discretionary agreement. Customer Three never signed a discretionary  
22 agreement with MSDW and MERRILL.

23 24. From in or about November 2000 until January 2001, MERRILL made at least six  
24 unauthorized trades in one or more accounts belonging to Customer Three. MERRILL made  
25 many of these trades when Customer Three was out of town in November and December 2000.  
26 MERRILL treated Customer Three's accounts as discretionary accounts.



1 fund to what appeared to be an information fund. Customer Five did not authorize MERRILL to  
2 make any trades in her account while she was away from home.

3 31. After discovering the unauthorized trades in her account, she contacted MERRILL.  
4 MERRILL did not provide any explanation as to why he made the unauthorized trades in her  
5 account. MERRILL did offer to reverse the trades in the dividend growth and information funds.  
6 Customer Five declined to have these trades reversed because she believed she would have to  
7 pay a fee. The value of the information fund declined during the time period Customer Five held  
8 it in her account.

9 32. In Spring 2001, Customer Five complained to MSDW about the unauthorized trades  
10 MERRILL conducted in her account. MSDW refused to remedy the situation because Customer  
11 Five waited too long to complain. About two months ago, Customer Five authorized an  
12 exchange of her shares in the information fund for shares in a mutual fund similar to her prior  
13 investment in a dividend growth fund.

#### 14 IV.

#### 15 VIOLATION OF A.R.S. § 44-1991

#### 16 (Fraud in Connection with the Sale or Purchase of Securities)

17 33. In connection with the offer to sell or buy securities, or the sale or purchase of securities,  
18 within or from Arizona, MERRILL directly or indirectly: (i) made untrue statements of material fact  
19 or omitted to state material facts which were necessary in order to make the statements made not  
20 misleading in light of the circumstances under which they were made; or (ii) engaged in  
21 transactions, practices or courses of business which operated or would operate as a fraud or deceit  
22 upon customers. MERRILL'S conduct includes, but is not limited to, the following:

23 a) failing to disclose to his Customers, when communicating to them about their  
24 accounts, that he had conducted unauthorized transactions in their accounts;

25 b) failing to disclose to his Customers, when communicating to them about their  
26 accounts, that he had conducted unsuitable transactions in their accounts; and,

1 c) engaging in transactions, practices or courses of business which operated as a fraud  
2 or deceit upon his Customers by conducting unauthorized and unsuitable transactions in their  
3 accounts.

4 34. This conduct violates A.R.S. § 44-1991.

5 **V.**

6 **REVOCATION OR SUSPENSION PURSUANT TO A.R.S. § 44-1962**

7 **(Revocation or Suspension of Registration of Salesman)**

8 35. MERRILL'S conduct is grounds to revoke or suspend his registration as a securities  
9 salesman with the Commission pursuant to A.R.S. § 44-1962. Specifically, MERRILL:

- 10 a) has violated the Securities Act;
- 11 b) is lacking in integrity or is not of good business reputation; and,
- 12 c) has engaged in dishonest or unethical practices in the securities industry by:
- 13 (1) executing transactions on behalf of customers without authority to do so; and,
- 14 (2) recommending, or without authorization, purchasing, selling, or exchanging
- 15 any security without reasonable grounds to believe the recommendation,
- 16 purchase, sale, or exchange is suitable for the customer considering the
- 17 customer's investment objectives, financial situation and needs, and other
- 18 relevant information that is known.

19 **VI.**

20 **REQUESTED RELIEF**

21 The Division requests that the Commission grant the following relief against MERRILL:

- 22 1. Order MERRILL to permanently cease and desist from violating the Securities Act,  
23 pursuant to A.R.S. § 44-2032;
- 24 2. Order MERRILL to take affirmative action to correct the conditions resulting from  
25 his acts, practices or transactions, including a requirement to make restitution pursuant to A.R.S. §  
26 44-2032;



