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BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

Arizona Corporation Commission
DOCKETED

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AZ CORP COMMISSION
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IN THE MATTER OF

DOCKET NO. S-03450A-02-0000

Philip William Merrill)
3788 N. 156th Drive)
Goodyear, AZ 85338)
CRD#2436444) **RESPONDENTS' CLOSING BRIEF**
Respondent)

I-INTRODUCTION

The basic issues raised by the Notice of Opportunity to be Heard are whether or not there were unsuitable and/or unauthorized trades in the accounts of the five customers named in the notice. The presiding judge has also asked that we address the question "what amount of restitution would be appropriate if there should be a remedy".

Philip William Merrill (hereafter "Merrill" or "respondent") has **never** denied that there were unauthorized trades in the Lori Mayfield account (customer four in the notice). Lori (and Janet) Mayfield received compensation for losses incurred and released Merrill from any further monetary liability. Restitution in respect to either of the Mayfields is not an issue. What remedy should be enforced against Merrill for the unauthorized trades in the Lori Mayfield account will be discussed below.

We will first address the suitability question and show that the Division has not proven that there were unsuitable trades in any of the accounts. We will then address the unauthorized trading issue and show that the Division has not proven that there was unauthorized trading in any account other than the Lori Mayfield account which has never been contested. Finally, although we do not believe any restitution should be ordered we will address that issue.

II-UNSUITABILITY

The only testimony offered by the Division on this issue was that of the Division's employee, Michael Donovan. (Donovan). Donovan's qualification to render expert opinions on suitability are suspect. While employed in the securities industry he was never in a position where he was charged with the duty of reviewing transactions for suitability -- he never was a supervisor (transcript of proceedings 1021 -- hereafter TR___). It is the branch manager who must review transactions for suitability and he was never in that position (TR 1022). The compliance department of a broker/dealer also deals with issues of suitability and he was never involved with a compliance department (TR 1023).

Further adding to the suspicion about his opinions is the way Donovan arrived at his opinions. He came to the conclusion that Beatrice DuChene was a conservative investor simply by reading her new account form at Dean Witter from 1990 (TR 1013) although nowhere in her papers does it say that she is a conservative investor (TR 1036; and 1078). The new account form was the only thing he looked at (TR 1036). Absent from his testimony is that as a basis for his opinions he talked to Beatrice Duchene (he certainly was not

prevented from doing so prior to the hearing and it is difficult to understand why he did not talk to her), or was aware of the testimony given by Beatrice DuChene at the hearing. He reluctantly admitted that in the course of dealing with a customer a registered representative would obtain information other than that in the new account form that would impact what the customer was willing and interested in investing in (TR 1041 to 1045).

Donovan agreed that the NASD rule on suitability (Rule 2310) and Arizona Corporation Commission rule on suitability (R14-4-130) are essentially the same (TR 1032-33) and the essential element of those rules is that the person recommending has to have reasonable grounds to believe the recommendation is suitable (1036). The only thing he looked at to determine if Merrill had reasonable grounds to recommend in relation to DuChene and Brotherson was the new account forms (TR 1036).

The basis for Donovan's opinions on suitability is totally inadequate. Although he agreed that reasonable people could differ as to what is suitable (TR 1046) and that Merrill's manager, looking at the same things Donovan looked, had the job of rejecting unsuitable trades and did not (TR 1047) and that it is certainly possible that the manager charged with the duty to reject Merrill's trading if it was unsuitable would disagree with him (TR 1051).

Donovan's testimony concerning the suitability of the Dean Witter Hi-Income (later Hi-Yield) fund demonstrates the inadequacies of his opinions. The things he did not know about this investment are surprising:

- he did not calculate the comparison between the return on the hi-yield fund with the return on higher rated bond funds (TR 1120);

- he did not pay any attention to how the fund performed because it was "irrelevant to his review" (TR 1120);

- he was not interested in how many different issues were in the hi-yield fund even though one of the purposes of a mutual fund and an objective of the hi-yield fund is to spread the risk of loss among many issues (TR 1121);

- he had no idea what the percentage of defaults was in hi-yield bonds at the time Merrill was recommending them to his customers even though this would be a factor in determining the lever of risk in the hi-yield fund (TR 1122);

- he did not know how much money was in the hi-yield fund for investments (TR 1122);

- although he acknowledged that it is prudent to look at recommendations of his firms analysts and that Dean Witter had analysts Merrill could rely on, he was not aware that the Dean Witter manager in the hi-yield fund would rely on his own knowledge and expertise in determining what to invest in (TR 1156 and 1161 reading from exhibit S-31 page 10 of 134).

Donovan's problematic testimony concerning suitability was not confined to the Hi-Yield fund. He had used a Merrill Lynch publication entitled Global Research Review in his work but could not find in the document his interpretation of what is risky (TR 1059). Additionally, securities that he had pronounced speculative, such as

Microsoft, Oracle, Cisco and AOL were rated by Merrill Lynch as "Strong buys". (TR 1059)

Contrasted with Donovan's inadequate factual investigation is testimony in the record on the issue of the investment objectives and risk tolerance concerning Beatrice Duchene and by Viola Brotherson.

Catherine DuChene, Beatrice DuChene's daughter testified:

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12 Q. So you think you have the ability or the -- do
13 you think you have a feel for your mother's risk
14 tolerance and/or her investment strategies?

15 A. Correct.

16 Q. Okay. And would you explain -- would you
17 describe, rather, your mother to be a risk-taker, risk
18 adverse, or somewhere in the middle?

19 A. I really feel she's in the middle.

20 Q. Okay.

21 A. Once it's explained to her and she understands
22 it, that's what I do. Like, this is what it is mom.
23 This is what you're going to have, or this is what
24 you're going to have. This is where you'll be. And
25 then it's up to her to make that choice.

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1 Q. And so based on those decisions, she doesn't
2 necessarily go with the things -- the lowest risk and
3 the lowest payout. Is that fair to say?

4 A. She has recently.

5 Q. Okay. But during the period of time from 1997
6 up until recently, is it fair to say that she didn't
7 always go for the least return and the least risk?

8 A. That is correct.

9 Q. Okay. Not necessarily that she went for the
10 highest return and the highest risk, but that she's
11 just somewhere in the middle; is that correct?

12 A. That's correct.

This is not the definition of the conservator investor that Michael Donovan portrayed in his testimony.

Viola Brotherson testified:

3 Q. Okay. In 1990, did you know what aggressive
4 income was?¹

5 A. Yes.

6 Q. Do you know what just income is as opposed to
7 aggressive income?

8 A. Yes.

9 Q. Do you know what the difference is between
10 income and aggressive income?

11 A. Yes.

12 Q. What is the difference, in your words?

13 A. In my words, I would say it's income
14 accepted, shall I say, or something that's -- and
15 it -- if it's aggressive it's that you want to
16 improve. That isn't probably the answer I should
17 give. That's what it sort of means to me, that if I'm
18 wanting more income than I'm getting.

19 Q. Would you consider income to be more or less
20 risky than aggressive income?

21 A. Aggressive --

22 Q. Aggressive.

23 A. -- would be more, wouldn't it.

24 Q. More what, more risky or not?

25 A. More risky.

And later on in her testimony she said:

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25 Q. Now, there's also a discussion -- there was

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1 some testimony by you about this conversation, or
2 conversations you had with Mr. Merrill about more
3 income, and you testified, I believe, that Mr. Merrill
4 told you that he could get you more income; is that
5 correct?

6 A. Well, yes. I don't know how it was worded,
7 but he understood that I needed more.

8 Q. If I recollect correctly, you also mentioned
9 on cross-examination that you had some idea that more
10 income meant a little more risk; is that correct? Or

¹ Her new account form has listed her investment objectives as "aggressive income".

11 did you testify to something differently?

12 A. Well, I don't know if I considered that. Did
13 I indicate that?

14 Q. Well, I'm not the one testifying, you are, so
15 I can't tell you.

16 A. I didn't know that I indicated that, and
17 there's no -- I don't know if I considered it.

18 Q. Do you not remember, then, on
19 cross-examination, when Mr. Lewis, the gentleman here,
20 asked you a question about you understanding that more
21 income meant more risk, that you said something like
22 you understood or you thought you understood. Is that
23 what you meant to say? Did you understand the
24 question by Mr. Lewis?

25 A. I don't know. I didn't really know I

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1 indicated that. But maybe that's what he asked. I
2 can't say yes or no.

3 Q. Let's talk a little bit about that. Do you
4 really understand the principle that -- and this is a
5 principle in investing, it's a general principle --
6 that more risk is related to -- let me rephrase that.

7 Typically, more income comes with more risk
8 for any investment. Do you understand that principle
9 at all?

10 A. Yes, I do.

11 Q. Did Mr. Merrill ever discuss that principle
12 with you?

13 A. No, there wasn't any discussion about it.

14 Q. Did Mr. Merrill ever tell you that if you
15 wanted more income, you would need to take more risk
16 with your principal?

17 A. No, we didn't discuss it.

18 Q. Had you known that in order to get more
19 income or, as you called it, interest, which is the
20 same thing; correct?

21 A. Yes.

22 Q. You needed to take more risk, would you have
23 done it?

24 A. Yes, if I was, you know, kind of desperate
25 enough for more income I probably would. If I

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1 couldn't see my way clear to getting along without, I

2 would have done it, I guess.

3 Q. Were you desperate enough for more income?

4 A. Yes.

Since Michael Donovan did not take the time to learn what these ladies had said under oath rather than just look at the new account forms to arrive at his opinions that are at the heart of a main issue in this case, it is appropriate to argue that he would have come to a very different conclusion about their investment objectives if he had made the effort, and if he did not change his opinion he would have looked foolish and out of touch with reality.

It is appropriate to reject all of Donovan's opinion testimony offered in this matter. If Donovan does not have time to do more than just look at new account forms he should not be offered as an expert.

In contrast to Donovan's superficial analysis is Merrill's uncontradicted testimony about the what he did to determine suitability. We will catalog some of the applicable testimony in chronological order as it appears in the transcript:

1553 had frequent meetings with manager and others concerning the handling of customer accounts;

1553 talked to others about available products and went to seminars about products;

1554 early in his career at Dean Witter went to seminars in Dallas every other month for training in products;

1554 he had computer information on products he recommended which he used;

1554 Dean Witter system had a great deal of information about products and economics;

1555 everything he sold to customers, including 5 complaining

witnesses were researched in the system;

1556 in addition he talked to his branch manager and other
senior brokers at Dean Witter about what he recommended;

1558 his manager reviewed all order tickets;

1559 manager never told him an order he placed was improper;

1660 manager never disapproved any of his orders;

1562-4 discussed investment pyramid with all 5 complaining
witnesses;

1564 Dean Witter investment pyramid placed hi-yield bond funds
just above cash and equivalents as to risk;

1564 manager used hi-yield bond fund extensively to provide
income for senior citizens;

1658 explained details of why hi-yield fund not unsuitable-
consulted knowledgeable individuals; talked to branch
office

manager; used computer research; the manager of the fund
was highly regarded; Forbes magazine supportive article;

1660 was aware of the excellent hi-yield bond returns during the
period 1995-98;

1660 attended seminar where hi-yield was discussed extensively-
see our exhibits starting at 1007A;

1665 no one at seminar suggested hi-yield a speculative
investment;

1666-7 the bond fund had a high rating;

1667 defaults reported by Bond Market Association were 1-2%;

1668 hi-yield fund not speculative but diversified -- see
Business Week article;

1669 he believed he had a reasonable basis to recommend the bond
fund to his customers including those who testified;
16879 recommend change from Hi-yield to Brotherson because fund
had announced it would lower its dividend;
1690-1 research Information Fund and it had a good track record-
he had a reasonable basis for recommending the switch;
1701-7 talked to Sylvia Hays about switching from Dividend
Growth -- they announced in early September, 1999 that
they were going to cut dividend -- he recommended cost free
switch to Information Fund -- ACC 4248 shows there was no
charge for switch -- he told her she could switch back if
she wanted but she said no.

The Division chose not to attempt to rebut any of this testimony. The Division in rebuttal did call two witnesses from the Sun City office of Morgan Stanley Dean Witter, including the branch manager Sarah Whitmore. No questions of the branch office manager were asked about the testimony of Merrill concerning the high yield fund and the fact that it was a favorite of many in her office. Keith Guilfoyle, an attorney in the Morgan Stanley Dean Witter law department testified in rebuttal by telephone. Mr. Guilfoyle testified he was familiar with the duties of an office manager (TR 2007) and that one of the manager's duties is to review trade orders for suitability. Guilfoyle further testified that the firm has a supervisory duty not to allow a registered representative to engage in unsuitable trades and that is why manager reviews order tickets every day (TR 2008). In doing this work Guilfoyle said, the manager has information on his computer screen concerning customers to see

that all compliance issues are complied with (TR 2009). Guilfoyle also agreed that branch managers give guidance to their registered representatives as to what type of products to recommend to customers (TR 2010).

Duchene and Brotherson were not the conservative investors Donovan's superficial inquiry led him to conclude. There was substantial evidence, uncontradicted, that Merrill used many and varied approaches to make sure his recommendations were not unsuitable. The Hi-income, hi-yield fund, was not speculative. The Division made no attempt to rebut the testimony that those funds were widely used for senior citizens, highly respected, and praised by Forbes, Business Week and Lipper.

III-UNAUTHORIZED TRADING

There is one area of testimony by Michael Donovan that we do agree with. He testified that a customer has the obligation to pay attention to the handling of his/her account (TR 1029) and that if a customer is going to say that a trade is unauthorized he/she should come forward shortly after the trade and say that (TR 1030). This is a common sense rule of conduct. If something has happened with your investments that you do not agree with and did not authorize, it would be commonly expected that you would complain about it as soon as you learn of the unauthorized trading. It is abundantly clear in the record that other than Lori Mayfield, none of the complaining witness complained about unauthorized trading, if they did complain, close to the time of the event. Beatrice DuChene waited, in some instances almost two years after the event, to place her complaint in writing. Viola Brotherson never put an unauthorized trading complaint

in writing -- most likely, as discussed below, because she was advised of all trades. The Division offered no writing of Sylvia Hays complaining of unauthorized trading. Hays' testimony admitted that she waited a long time to make a verbal complaint because it was not "one of my first priorities" (TR 1483). Janet Mayfield waited until after Merrill left Morgan Stanley Dean Witter in April, 2001 to make any written complaint about trades that had taken place in October, November and December, 2000. The vice of this course of conduct, not making a complaint near the time of the event, is that it did not provide Merrill with an opportunity to respond and to collect data showing that he did not engage in unauthorized transactions. By the time Merrill was advised of the complaints of unauthorized trading he was gone from Morgan Stanley and did not have access to his records. The doctrine of laches should apply -- the delay in advising Merrill of the various complaints prevented him from doing things to protect his position and places him at an unfair disadvantage.

A. Beatrice DuChene

Beatrice DuChene was led into giving grossly inaccurate testimony. Her inaccurate testimony may be the result of agreeing with Mr. Bingham whenever she thought that was what he wanted, or the result of a very faulty memory or the result of her believing she might benefit financially by the answers given. As a prime example, being questioned by Mr. Bingham she testified:

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10 Q. Have you ever heard of Dean Witter high yield
11 bond fund?
12 A. No.
13 Q. Have you ever heard of Dean Witter dividend
14 growth fund?

15 A. No.
16 Q. What about Microsoft?
17 A. No.
18 Q. Dell Computer?
19 A. No.
20 Q. Cisco?
21 A. No.
22 Q. What about America Online?
23 A. No.
24 Q. Did you ever talk to Mr. Merrill about buying
25 or selling any of these securities or mutual funds

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1 before they were bought or sold?
2 A. No.
3 Q. Did Mr. Merrill ever notify you, perhaps
4 subsequent to the trades, that something had been
5 bought or sold?
6 A. No.

At the least, Mr. Bingham knew the answers given about Dean Witter Hi-yield fund and Dividend Growth were incorrect. Numerous documents that were in his file before the commencement of the hearing clearly demonstrated that these answers to his leading question were wrong.²

Merrill outlined for the court the numerous occasions when DuChene was provided with information concerning Dean Witter hi-yield and Dean Witter dividend growth. This testimony starts at page 1573 and goes through page 1585 of the transcript. The various documents, many bearing Beatrice DuChene's signature, advising her of one or more aspects of these investments were pointed out by Merrill. On the hi-yield she bought it 3 or 4 times, she got confirmations of the

² We suggest that this conduct by Mr. Bingham should result in the testimony resulting from all of his leading questions be rejected. An attorney has an obligation not to mislead the tribunal. His leading questions which result in answers that he knows are incorrect results in the tribunal being misled. Since he never made an effort to correct the mistaken testimony we can assume that he never made an effort to correct mistaken testimony resulting from his other, many, leading questions.

purchases, received prospectuses, it showed on her monthly statements, it showed on her year end statements, she received quarterly reports and monthly checks all of which had the hi-yield name on them. On the dividend growth, there were numerous documents that she signed and numerous documents that she received all with the Dividend Growth name on them. All of these documents were in Mr. Bingham's possession before he suggested by his leading questions that Beatrice DuChene deny knowledge of these investments. Even after all of this was pointed out to Mr. Bingham, document by document, he made no effort to correct the erroneous testimony. If Beatrice DuChene believed that these quoted answers were true then all of her testimony should be rejected because of her faulty memory and inability to correctly report what happened in the past. If she can testify that she never heard of Dean Witter hi yield or Dean Witter dividend growth in the face of the overwhelming documentary evidence that exists and that she received, many items bearing her signature, how can any of her testimony be accepted?

Although no sanctions or action is suggested by the notice against Merrill in connection with her highly profitable annuities, her testimony concerning them is instructive since it also demonstrates that her testimony cannot be relied upon, for whatever reason:

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24 Q. Did he discuss the fact that you were buying
25 annuities, investing in annuities with you?

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1 A. Not to my knowledge, no.

2 Q. Not at all?

3 A. No.
4 Q. At no time?
5 A. Not the annuity, no.
6 Q. At no time?
7 A. Not to my knowledge, no.
8 Q. Didn't you have to sign papers to buy the
9 annuity?
10 A. I signed a lot of papers with Phil that I
11 never knew what I was signing.
12 Q. You didn't sign papers that indicated they
13 were annuities purchases, and you were purchasing
14 annuities?
15 A. Phil stopped over and gave me papers to sign
16 and I signed them and gave them to him. He would stop
17 into my home and gave me these papers to sign, which I
18 did.
19 Q. And he wouldn't discuss them with you?
20 A. No. He'd just breeze in and say I need your
21 signature, and I gave it to him.

Starting at page 1601 through 1612 of the transcript Merrill explains why this testimony is incorrect. In addition to his testimony about his discussions with DuChene he points out that a number of the documents in evidence were not signed by her in her home but she had to travel to Merrill's office to get her signature guaranteed. Merrill also points out that the value of the annuities showed up on each of her monthly statements.

B. Viola Brotherson

Despite the claim in the notice that the purchases of the Dean Witter Hi income fund were unauthorized, the witness specifically testified that Merrill discussed with her selling Eaton Vance and buying something else (TR 519 to 522) "(Q) he suggested you purchase the Dean Witter high income fund? (A) Yes." Also the witness testified that when Merrill first started helping her they talked

about what to do to increase her income (TR 562) and things were done to increase her income (TR 563). Later she discussed with Merrill doing more of the same (TR 563). She knows it happened she just does not recall the details (TR 564). She knew she had purchased something new and that something else had to be sold to make the purchase (TR 569). Merrill made suggestions and she followed them (TR 570-571).

C. Sylvia Hays

Hays testified that Merrill started helping her in 1999 (TR 1486). He may have advised her on some trades (TR 1487). She does remember him talking to her about the EMC stock and telling her it was at a new high (TR 1487). and he talked to her about what her strategy should be in connection with the EMC stock (TR 1487-8). She talked to him about the sale of half of the EMC stock and gave him an order to that effect (TR 1488). She may have called him to talk about things in her account (TR 1489). She is not testifying that Merrill did not call her about a problem with the Dividend Growth (TR 1490) and (TR 1491) he may have (TR 1491-4).

Merrill's testimony starting at page 1702 and to 1707 sets forth his explanation of what happened. The Dividend Growth fund announced in early September (ACC 4298 is the monthly statement he is questioned about at this point) and he talked to her about it and recommend exchange to Information Fund. When he discussed the exchange with her he told her she could switch back but she declined. She erroneously thought there were charges for the switch and that is why she declined and she now understands there was no valid basis for her belief that there would be a charge (TR 1501 to 1504).

An aspect of the Hays situation, which also applies to exchanges made in the Brotherson account, is that Merrill earned no commissions for the exchanges within the Dean Witter family of funds. The Division has not been able to develop any explanation as to how Merrill benefited from the alleged unauthorized transactions when he received no commissions or other compensation for the exchanges. In the absence of any proof of motivation or benefit on Merrill's part, how can it be assumed that he engaged in wrongful conduct.

D. Janet Mayfield

There is no writing from Janet Mayfield complaining about unauthorized transactions until months after Merrill left Morgan Stanley and at least 6 months after events complained of. Merrill did not find all of his Janet Mayfield records at the Sun City office when he visited there (TR 1715). He did find records from October 26, 2000 showing discussions with Janet Mayfield about what was in her account at Prudential being transferred to Morgan Stanley (TR 1112). The pages show the discussion and the action taken (TR 1715-6). His notes reflect the discussion of the purchase of Health Science (TR 1719). At page 1721 he refers to the notes made concerning buying technology fund. At page 1722 he discusses his notes that show he talked to her about what to sell and what to buy. At the time Janet Mayfield invited Merrill to meet her daughter Lori Mayfield to discuss handling her account she already had a profit in Triquent, a stock that she says was unauthorized trading (TR 1767). Janet Mayfield never explained how she recommended Merrill to her daughter knowing, as she now claims that he engaged in unauthorized trading in her account in October and November, 2000. Merrill notes should be

given considerable weight. They are contemporaneous with the event they report. These are documents that were taken from Merrill in April, 2001 and he would have had no opportunity to fabricate them. Although, unfortunately, all of his notes are not available, there is enough to show that he had substantial discussions with Janet Mayfield about trades in her account, what to sell, what to buy. Merrill had persuasive documentation that contradicts Janet Mayfield's questionable recollection of the same events.

E. Lori Mayfield

What is important about the Lori Mayfield situation is that Merrill has never denied unauthorized trading. He could have. It would have been a simple matter to cover up the truth by telling his manager that there had been a misunderstanding on the telephone as to whether or not he had authority to enter the trades. That the customer was now saying there were no orders placed. The trades would have been reversed, the losses returned and the matter handled through the branch errors account (TR 1778 to 1780). No sanctions would have been enforced against Merrill by Morgan Stanley.

Merrill was well aware that there would be dire consequences as a result of his actions and admissions. The Division wishes to paint Merrill as a liar and a thief without acknowledging that he stood up and told the truth when he knew it would have a devastating effect on his life. The Division uses the testimony of complaining witnesses whose memory and ability to recall (and motivation, in two instances, DuChene and Janet Mayfield) is suspect and undoubtedly will argue that their spotty testimony should be accepted where it conflicts with that of Merrill. The record shows that Merrill has some

documents that support his testimony where it conflicts with that of the complaining witnesses. It has also been shown that all of his customer records were taken from him and only some of them have been made available for use at this hearing. There is ample reason to accept Merrill's testimony where it conflicts with that of the complaining witnesses.

IV-RESTITUTION

Both Janet and Lori Mayfield have received compensation and have released Merrill from any further monetary responsibility. An order of restitution would be contrary to the evidence and improper.

The Division is improperly suggesting that restitution should be made to Sylvia Hays based upon the value of MSDW Information fund on October 26, 2001 (see exhibit S-48). Although any restitution would be improper the Division has not explained why Merrill would be responsible for decisions made by Sylvia Hays to continue holding the Information Fund for seven months after he was no longer her account executive. The Division has not proven what the value of the Information Fund was as of the time Merrill ceased to be involved. Without this evidence, which it is the burden of the Division to prove, what restitution might be appropriate cannot be calculated.

Additionally, the testimony of Sylvia Hays cannot be overlooked. She did not consider information concerning the reduction in the Dividend Growth payout important, she did not pay attention to it (TR 1494-5). Her philosophy which she applied to the Information Fund, was to let things ride even if they are going down (TR 1495). It was her decision to let it ride because it was not a priority

(TR 1496). It was Sylvia Hays' decision to hold on to the Information Fund as a result of an erroneous belief. Sylvia Hays and the market place are responsible for any decline in the value of her holding, not Merrill. An order of restitution to Sylvia Hays is not called for.

The only evidence presented concerning the standard applied in awarding restitution came from Donovan when he was asked on cross examination where do you get the idea that someone can make a profit and still be entitled to restitution and he answered "out of the position of dealing fairly with your clients (TR 1086)". This is hardly a standard by which to measure the amount of restitution. No where in the Arizona Revised Statutes or Arizona Administrative Code is there any standard or criteria provided for measuring how much restitution should be made when it is appropriate. No cases have been found setting forth any standard or criteria. This lack of statutory, regulatory or case precedent guidance leads the Division to seek ridiculous results: for example, in the case of Sylvia Hays, restitution for a substantial period of time when Merrill had no connection with the account and the owner of the account was not concerned about its performance and paid no attention to it; in the case of Beatrice DuChene restitution where the portfolio she entrusted to Merrill was substantially profitable and met her investment objectives of growth and income.

We suggest that persuasive statutory guidance can be found in Arizona's Prudent Investor Act, ARS § 14-7601 et. seq.

Merrill was not a trustee for his customers. He was not a fiduciary for his customers (see Guilfoyle testimony TR 2012). The

duties of a trustee (and fiduciary) far exceed the duties that Merrill undertook as a registered representative. Yet the Prudent Investor Act gives much more leeway than Donovan or the Division would allow Merrill.

14-7601 A provides:

a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule requirements of this article.

14-7602 B provides:

A trustee's investment and management decisions respecting individual assets shall not be evaluated in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

Thus if Merrill had been the trustee for his customers with more responsibility and restriction than a registered representative, the validity of his efforts would be evaluated not in isolation but in the context of the whole portfolio under his management. In the absence of any guidance from the securities laws it would not be appropriate to evaluate Merrill's efforts in a manner more restrictive than if he were a trustee requiring him to perform in excess of the requirements placed on a trustee by the Prudent Investor Act. Merrill needed only a reasonable basis for his recommendations not the more burdensome and restrictive requirements of a trustee.

Applying these concepts to this case, there would appear to be little doubt that restitution to Beatrice DuChene would be uncalled for. The uncontradicted evidence is that Beatrice DuChene's portfolio

was substantially profitable and she received substantial income based upon Merrill's recommendations. The Division did not even attempt to attack Merrill's exhibits showing the favorable overall results in her investments. Her investment objectives were income and growth and that is what she got. The Division says that there were investments in DuChene's portfolio that lost money and she should be reimbursed for those losses. Stock brokers do not insure the success of their recommendations. Yes, some of the purchases did not work out profitably -- a small minority of the recommendations. But Merrill's "investment and management decisions respecting individual assets [should] not be evaluated in isolation but in the context of the trust portfolio as a whole". To do otherwise would be to make Merrill more responsible than if he had been a trustee.

Viola Brotherson's testimony varies substantially from the notice and does not support the conclusion that there were unauthorized transactions. As we have demonstrated above, the hi-yield, hi-income bond funds were not speculative and were suitable for someone seeking increased income, such as Viola Brotherson. It should be remembered that it is uncontradicted that Merrill discussed all trades and exchanges with Ms. Brotherson's son, Gaylen (TR 1691-3).

If we assume, hypothetically, that there might be some basis for restitution to Viola Brotherson, the Division has not come close to carrying the burden of proving what the restitution should be. The only document that discusses the alleged amount of losses in alleged unsuitable Brotherson transactions is S-21. The deficiencies in the Divisions proof are as follows:

1. Erroneously included in the calculations is \$1,875.90 in charges. The charges were not unsuitable.
2. No credit has been given for the over \$24,000.00 in income Viola Brotherson received from the hi-yield, hi-income bond funds.
3. The document calculates losses through May 21, 2001, more than one year after Merrill ceased having anything to do with the Brotherson account. He cannot be held responsible for losses that occurred after he no longer was involved. The Division has not even attempted to prove what the proper damages are for the period of Merrill's responsibility.
4. No effort has been made to calculate what the losses to Brotherson would have been had Merrill not recommended the changes that were made to the account in January, 1998. In view of the overall market decline starting in the spring of 2000, the Division must be aware that if Merrill had not recommended the sale of the Aim Charter, Pioneer Cap and Aim Value (which took place in January, 2000) the market value of those funds would be substantially less as of the date they wish to use for calculating restitution. What would the value of the account have been but for Merrill's recommendations? In other words, the Division has not shown that there was a causal connection between Merrill's recommendations and losses in the Brotherson account.

The Division must prove all of the elements that form a predicate for restitution. Even if it is assumed that the Division has shown unsuitable recommendations, which we deny, it has not proven the losses suffered as a result of that alleged conduct. Even under the Division's theory of this matter, Merrill would only be

liable for restitution for the losses that occurred as a result of unsuitable recommendations, not for losses that would have occurred even if he had not made the recommendations. It is the Divisions burden to prove these elements of the case, and it has not. The notice in this matter was filed January 17, 2002. The hearing in this matter started in August, 2002 and did not end until January, 2003. Viola Brotherson and her son testified on August 28, 2002. The Division presented rebuttal testimony on January 23, 2003, more than a year after the filing. The Division has had ample time to prove a case for restitution and it has not. There is no basis for awarding restitution to Viola Brotherson.³

The last item we will address is the appropriate sanction for the admitted unauthorized trading in the Lori Mayfield account.

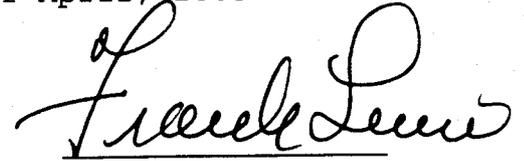
Consideration should be given to the fact that respondent has never denied the unauthorized trading and that he could have easily covered up the problem.

Consideration should also be given to the fact that respondent has already suffered financial and personal hardship as a fallout from what happened in the Lori Mayfield account. He was discharged by Morgan Stanley Dean Witter and lost accrued benefits (TR 1786) and has been barred from working in the securities industry since late 2001. Lori Mayfield received satisfactory reimbursement for what happened and released Merrill from any further liability.

³ If the presiding judge had felt that oral final argument in this matter was appropriate, respondent was prepared to make this argument before the filing of the briefs. This is the first opportunity the respondent has had to point out these substantial deficiencies in the Division's case.

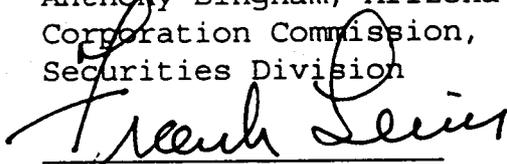
Philip Merrill has already been severely punished and sanctioned for what he did. No further sanctions are appropriate or needed.

Respectfully submitted this 14th day of April, 2003



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Attorney for Respondent

Copy of the foregoing
mailed/~~delivered~~ this
14th day of April, 2003
Anthony Bingham, Arizona
Corporation Commission,
Securities Division



Frank Lewis