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NEW APPLICATION

ORIGINAL

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2003 APR -3 A 10: 30

AZ CORP COMMISSION
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Memorandum

DATE: 4/3/03

TO: Nancy Cole
Docket Control

FROM: Phillip Hofling
Securities Division

RE: In the Matter of Robert C. Frost/Robin Frost
Docket No. S-03493A-03-0000
Assigned Staff

CC: Mabel Aldridge

S-03493A-03-0000

This is to notify you that the following individuals have been assigned to the above-mentioned case.

- Mark Sendrow
- LeRoy Johnson
- Matthew Neubert

Phillip Hofling (Staff Attorney)

(Staff Investigator)

Note: The Assistant Attorney General assigned to this matter is: Not applicable.

NEW APPLICATION

ORIGINAL
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BEFORE THE ARIZONA CORPORATION COMMISSION

2003 APR -3 A 10: 29

COMMISSIONERS

AZ CORP COMMISSION
DOCUMENT CONTROL

MARC SPITZER, Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

In the matter of:

ROBERT C. FROST/ROBIN FROST,
husband and wife,
6062 E. Ludlow
Scottsdale, Arizona 85254

Respondents.

) DOCKET NO. S-03493A-03-0000
)
) **NOTICE OF OPPORTUNITY FOR HEARING**
) **REGARDING PROPOSED ORDER TO**
) **CEASE AND DESIST, FOR RESTITUTION,**
) **FOR ADMINISTRATIVE PENALTIES, OF**
) **SUSPENSION OR REVOCATION, AND FOR**
) **OTHER AFFIRMATIVE ACTION**

NOTICE: EACH RESPONDENT HAS 10 DAYS TO REQUEST A HEARING
EACH RESPONDENT HAS 30 DAYS TO FILE AN ANSWER

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") alleges that Respondent ROBERT C. FROST ("ROBERT FROST") engaged in acts, practices and transactions that constitute violations of the Securities Act of Arizona, A.R.S. §44-1801 *et seq.*, ("Securities Act").

I.

JURISDICTION

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

II.

RESPONDENT

2. ROBERT FROST is an individual whose last known address is 6062 E. Ludlow, Scottsdale, Arizona 85254.

1 corporate note, corporate income intermediate bond fund and equity income mutual fund holdings
2 represented low-to-moderate risk stable income producing investments. Their only investments that
3 presented greater risk were their high-yield bond fund and high income fund. However, these two
4 investments comprised only 13% of their entire portfolio and were consistent with their objectives as
5 income producing funds.

6 13. In late 1999, after friends suggested they could improve the performance of their
7 retirement funds and at the recommendation of those friends, the Devenney's contacted ROBERT
8 FROST. In or about November 1999 and again in or about early January 2000, the Devenneys met
9 with ROBERT FROST to discuss moving their retirement funds from California to Arizona. They
10 explained they were looking to increase their monthly income but not at the expense of their
11 principal. ROBERT FROST convinced them he and MSDW could accomplish this objective.

12 14. ROBERT FROST recommended the Devenneys place all of their retirement funds into
13 mutual funds maintaining it was a better strategy to invest in the stock market than CDs and bonds
14 because the market paid higher returns. ROBERT FROST mentioned he did not like bond
15 investments and assured the Devenneys his mutual fund recommendations would outperform their
16 existing bond portfolio. The Devenneys accepted his recommendations because they believed he
17 would structure a retirement plan that was in their best interest. The Devenneys viewed ROBERT
18 FROST as an experienced investment professional specializing in investing for retired persons.
19 They further believed ROBERT FROST understood it was essential that their retirement principal
20 be preserved and not subject to risk of loss.

21 15. Between late December 1999 and early January 2000, the Devenneys transferred their
22 entire A.G. Edwards' portfolio holdings plus cash to MSDW.

23 16. In concert with these transfers, on January 3, 2000, the Devenneys and ROBERT
24 FROST executed a form (the "Authorization Form") authorizing the liquidation of securities
25 transferred from A.G. Edwards to purchase shares in the MSDW American Opportunities Fund
26 ("Opportunities Fund"). The Opportunities Fund was mutual fund with a long-term growth

1 objective investing approximately 65% in common stock and 35% in foreign non-exchange traded
2 securities and other investments.

3 17. To justify the purchase, ROBERT FROST noted on the Authorization Form that the
4 purchase was based on the Devenneys' objectives having changed to "growth". This was
5 misleading. The Devenneys told ROBERT FROST that they were looking to increase their
6 monthly income but not at the expense of risking their principal. The Devenneys emphasized that
7 because their retirement funds represented the sum total of their retirement assets they could ill-
8 afford to subject these assets to increased risk of loss.

9 18. Contrary to the executed Authorization Form, ROBERT FROST did not limit his
10 purchases to the Opportunities Fund. Instead, he proceeded to purchase shares in four different
11 growth funds. He allocated the proceeds between the Opportunities Fund, the MSDW Information
12 Fund, the MSDW Mid-Cap Equity Trust Fund, and the MSDW S&P 500 Index Fund. Because the
13 Devenneys had specifically directed that some of their funds be retained as cash for extraordinary
14 unforeseen living expenses, ROBERT FROST allocated a portion of their A.G. Edwards
15 investment proceeds to a MSDW money market fund.

16 19. ROBERT FROST knew the Devenneys maintained approximately 50% or about
17 \$100,000 of their retirement funds in CDs. He further knew those CDs would mature in early 2000.
18 ROBERT FROST urged the Devenneys to use their CD proceeds to purchase additional MSDW
19 proprietary mutual fund shares. This recommendation was contrary to the Devenney's practice of
20 rolling over their CDs into new CDs. Once again, trusting ROBERT FROST's expertise, in late
21 March 2000, the Devenneys deposited approximately \$108,000 from three CDs to their MSDW
22 accounts. Of that amount, \$95,000 was used by ROBERT FROST to purchase shares in the Van
23 Kampen Technology B Fund, the MSDW Small-Cap Growth Fund and additional shares in all of
24 the mutual funds they now held except the S&P 500 Index Fund. The balance of CD proceeds,
25 approximately \$13,000, was added to their MSDW money market account. Thus, just prior to the
26

1 close of March 2000, the Devenneys had transferred all \$237,000 of their retirement funds into
2 MSDW investments.

3 20. From the time they completed transferring all of their retirement funds to MSDW, their
4 investments began to lose money. In fact, they lost money in fifteen of the eighteen months from
5 March 2000 through September 2001.

6 21. Even though they experienced continuing losses, the Devenneys sought ROBERT
7 FROST's and MSDW's advice and counsel on several occasions expressing their concerns.
8 Unfortunately, because their lack of investment experience led them to believe that ROBERT
9 FROST was a trusted professional working for a reputable firm, they continued to rely to their
10 detriment on ROBERT FROST's and MSDW's advice.

11 22. For example, in May 2000, they placed a telephone call to ROBERT FROST to express
12 their concern about their account's continuing decline. While ROBERT FROST was unavailable to
13 take their call, another unnamed MSDW representative assured them that their investments were
14 "very good and not to worry."

15 23. In July 2000 they transferred \$25,000 from their money market to a traditional savings
16 account because they were extremely worried about the safety of their funds.

17 24. In or about October 2000, the Devenneys visited with ROBERT FROST who, while
18 telling them he could not predict how the market would perform, offered no advice as to whether
19 they should make any changes to their account. Though the Devenneys were very concerned about
20 the losses in their accounts, they did not understand the risks and continued to trust ROBERT
21 FROST.

22 25. The Devenneys again met with ROBERT FROST in April 2001. At this meeting they
23 received assurances that the market would recover.

24 26. Finally, on September 17, 2001, the Devenneys formally complained in writing to
25 ROBERT FROST's branch manager, Charles Cajera. Cajera advised that in order to stop any
26 further losses, they could move their funds into MSDW money market accounts. Cajera cautioned,

1 however, that should they attempt to move their funds from MSDW they would incur financial
 2 penalties. The Devenney's did not understand why they would incur such penalties. Nevertheless,
 3 because they had already suffered substantial losses, they felt they could ill-afford to lose more
 4 money, let alone pay penalties. Thus, shortly after the "9-11" event when the market had taken a
 5 substantial beating, at Cajera's suggestion, the Devenneys liquidated most of their mutual fund
 6 holdings, thereby locking-in their losses, by transferring their funds into a MSDW money market
 7 where they remain to this date. Because they have lost such a substantial sum coupled with the fear
 8 of losing more money by incurring a withdrawal penalty, they feel trapped and have been unable to
 9 remove these funds from MSDW despite their desire to do so.

10 27. A review of the Devenneys' MSDW accounts shows their account lost more than 51%
 11 of its value or \$123,906.71 through September 30, 2001, when they transferred their mutual fund
 12 investments into their MSDW money market account. Their loss is illustrated as follows:

13	a)	Total invested by Devenneys:	\$236,673.04.
14	b)	Dividends and capital gains credited to the accounts:	<u>\$5,822.96.</u>
15		Subtotal Investment and Earnings:	\$242,496.00
16	c)	Fees charged against the accounts:	<\$140.00>
17	d)	Funds withdrawn and/or paid to the Devenneys:	<\$30,360.63>
18	e)	Balance of funds as of 9/30/01 in money market account:	<u><\$88,088.66></u>
19	e)	Net Profit/<loss>:	<\$123,906.71>

20 28. ROBERT FROST's recommendations were unsuitable for the Devenneys. In fact, his
 21 recommendations were completely at odds with their past investment practices and expressed
 22 investment objectives. Comparing the Devenney's portfolio before and after associating with
 23 ROBERT FROST illustrates the significant change from an income producing portfolio with low
 24 risk to a growth oriented portfolio with considerably more risk. This change is illustrated by as
 25 follows:

	<u>Combined Devenney Retirement Funds</u>	<u>Pre-MSDW</u>	<u>MSDW</u>	<u>Type</u>
1	CDs	45.5%	\$107,780	Income
2	Cash	6.8%	\$ 16,000	Income
	Money Market	.01%	\$ 294	13.0% \$31,267 Income
3	Bankers Trust NY Corp. Sub Note	9.7%	\$ 23,032	Income
	UTS Corporate Income Fund	21.7%	\$ 51,395	Income
4	MFS Series Trust High-Income A	3.0%	\$ 7,193	Income
	Mainstay High-Yield Corp Bond Fund	9.8%	\$ 23,049	Income
5	Federated Equity Income Fund B	3.5%	\$ 8124	Income
	MSDW Small Cap Growth		9.6% \$ 23,247	Growth
	MSDW Information Fund B		12.5% \$ 30,034	Growth
6	MSDW Mid-Cap Equity Trust B		9.0% \$ 21,667	Growth
	MSDW S&P 500 Index B		2.8% \$ 6,731	Growth
7	MSDW American Opportunities B		46.1% \$110,904	Growth
	Van Kampen Technology B		3.8% \$ 9,243	Growth
8	MSDW Div Growth		3.2% \$ 7,613	Growth
		<u>100%</u>	<u>\$236,867</u>	<u>100%</u> <u>\$240,706</u>

9 29. The recording of the Devenney's investment objectives on their MSDW new account
10 form is another example of ROBERT FROST's failure to adhere to the Devenney's stated
11 investment objectives. The Devenneys' A.G. Edwards new account form lists their only investment
12 objective as **aggressive taxable income**. Emphasis added. On the other hand, the investment
13 objectives listed on the Devenneys' MSDW new account form are entirely out of character and
14 contrary to their expressed wishes. ROBERT FROST recorded the Devenneys' investment
15 objectives in order of importance as **capital appreciation**, **speculation**, **aggressive income** and
16 lastly, **income**. Unlike the A.G. Edwards' new account form which requires the client's signature
17 acknowledging the accuracy of the information, MSDW's new account had no such requirement.
18 The Devenneys never saw their MSDW new account form so they had no opportunity to confirm
19 that it accurately reflected their investment objectives.

20 30. The Devenneys were clear and unambiguous about their investment objectives; they
21 wanted to increase their monthly income payout without risking their principal. However,
22 ROBERT FROST listed income as the least important investment objective while listing capital
23 appreciation as their primary investment objective. Furthermore, the fact that ROBERT FROST
24 even listed speculation makes it clear he failed to follow the Devenneys' instructions. The
25 Devenneys never discussed nor considered speculation as an investment objective as they had no
26 intention of increasing their investment risk.

1 31. Contrary to the Devenneys' practice of and desire to maintain a conservative
2 investment portfolio, ROBERT FROST improperly and inappropriately subjected approximately
3 87% of their retirement funds to substantially increased investment risk. It is clear from a review
4 of the Devenneys' retirement portfolio mix before and after their involvement with ROBERT
5 FROST that ROBERT FROST's recommendations were entirely inconsistent with what the
6 Devenneys intended. The Devenneys were looking for investments that would provide stable
7 income but without the risk of loss to their principal. ROBERT FROST's recommendations could
8 not achieve that objective.

9 32. The Devenneys' prior investments were income producing from which the Devenney's
10 withdrew, on a monthly basis, the income produced. These withdrawals did not result in the
11 invasion of their capital. ROBERT FROST represented that by placing all of their retirement funds
12 into mutual funds they could receive a monthly income draw that exceeded what they were then
13 receiving. What the Devenneys did not understand and what ROBERT FROST did not explain was
14 that the funds ROBERT FROST was recommending were not income producing investments.
15 Instead, their ability to withdraw a monthly amount without invading principal depended entirely
16 on sufficient continued growth of the market to translate into additional fund shares and an increase
17 in net asset value. This change in the method of generating monthly income substantially increased
18 the risk that the Devenney's would invade their principal.

19 33. All but one of the funds ROBERT FROST purchased were MSDW proprietary funds.
20 In other words, funds offered only through MSDW. Even the nonproprietary Van Kampen
21 Technology Fund was owned by MSDW. Several of the funds purchased by ROBERT FROST
22 presented unacceptable risk to the Devenneys' account in terms of volatility, historical
23 performance and lack of diversification.

24 34. As previously noted, ROBERT FROST purchased a MSDW "small-cap" fund. Small-
25 cap funds invest in smaller, less well-established companies. Stocks in these companies are
26 significantly more volatile than "blue chip" stocks. ROBERT FROST also purchased the Van

1 Kampen Technology Fund which was a sector fund that had only begun operations a few months
2 before ROBERT FROST made the purchase. At the time, the fund had virtually no historical
3 information from which to evaluate its performance, risk and suitability for any given investor.
4 ROBERT FROST also purchased a MSDW Information Fund, which, like the Van Kampen fund,
5 invested in industries heavily dependant upon technology. In fact, only one of the funds ROBERT
6 FROST purchased reasonably conformed to their stated investment objective of income. Yet that
7 purchase constituted less than 3% of the Devenneys overall portfolio. Thus, with no income
8 producing funds and only 13% set aside as cash reserve in money market fund, the majority of the
9 Devenneys' retirement funds were invested in investments that were neither consistent with their
10 primary investment objective nor suitable.

11 **V.**

12 **VIOLATION OF A.R.S. § 44-1991**

13 **(Fraud in Connection with the Offer or Sale of Securities)**

14 35. In connection with the offer or sale of securities within or from Arizona, ROBERT
15 FROST directly or indirectly made untrue statements of material fact or omitted to state material
16 facts which were necessary in order to make the statements made not misleading in light of the
17 circumstances under which they were made. ROBERT FROST's conduct includes, but is not
18 limited to, the following:

- 19 a) recording investment objectives that bore no relation to the Devenneys' stated
20 investment objectives;
- 21 b) purchasing funds that were not in keeping with the Devenneys' stated investment
22 objectives;
- 23 c) failing to disclose to the Devenneys that the funds he was recommending and
24 purchasing substantially increased the risk of loss to their investment principal; and
- 25 d) misleading the Devenneys by assuring them that the market would recover when in
26 fact, ROBERT FROST could not make such a prediction.

1 36. This conduct violates A.R.S. § 44-1991.

2 **IV.**

3 **REMEDIES PURSUANT TO A.R.S. § 44-1962**

4 **(Denial, Revocation or Suspension of Registration of Salesman; Restitution, Penalties, or other**
5 **Affirmative Action)**

6 37. ROBERT FROST's conduct is grounds to suspend or revoke ROBERT FROST's
7 registration as a securities salesman with the Commission pursuant to A.R.S. § 44-1962. Given
8 their age, financial standing, long-term investment practices and their stated investment
9 objectives, ROBERT FROST recommended to the Devenneys the purchase of securities without
10 reasonable grounds to believe that such recommendations were suitable within the meaning of
11 A.R.S. § 44-1962(10) and A.A.C. Rule R14-4-130(A)(4).

12 38. ROBERT FROST's conduct is grounds to assess restitution, penalties and/or take
13 appropriate affirmative action pursuant to A.R.S. § 44-1962. Given their age, financial standing,
14 long-term investment practices and their stated investment objectives, ROBERT FROST
15 recommended to the Devenneys the purchase of securities without reasonable grounds to believe
16 that such recommendations were suitable within the meaning of A.R.S. § 44-1962(A)(10) and
17 A.A.C. Rule R14-4-130(A)(4).

18 **XII.**

19 **REQUESTED RELIEF**

20 The Division requests that the Commission grant the following relief:

- 21 1. Order ROBERT FROST to permanently cease and desist from violating the
22 Securities Act, pursuant to A.R.S. §§ 44-1962 and 2032;
- 23 2. Order ROBERT FROST to take affirmative action to correct the conditions resulting
24 from his acts, practices or transactions, including a requirement to make restitution pursuant to
25 A.R.S. §§44-1962 and 2032.

1 shood@cc.state.az.us. Requests should be made as early as possible to allow time to arrange the
2 accommodation.

3 **XIV.**

4 **ANSWER REQUIREMENT**

5 Pursuant to A.A.C. R14-4-305, if ROBERT FROST or ROBIN FROST requests a hearing,
6 ROBERT FROST or ROBIN FROST must deliver or mail an Answer to this Notice of
7 Opportunity for Hearing to Docket Control, Arizona Corporation Commission, 1200 W.
8 Washington, Phoenix, Arizona 85007, within 30 calendar days after the date of service of this
9 Notice. A Docket Control cover sheet must accompany the Answer. A cover sheet form and
10 instructions may be obtained from Docket Control by calling (602) 542-3477 or on the
11 Commission's Internet web site at www.cc.state.az.us/utility/forms/index.htm.

12 Additionally, ROBERT FROST or ROBIN FROST must serve the Answer upon the
13 Division. Pursuant to A.A.C. R14-4-303, service upon the Division may be made by mailing or by
14 hand-delivering a copy of the Answer to the Division at 1300 West Washington, 3rd Floor,
15 Phoenix, Arizona, 85007, addressed to Phillip A. Hofling, Esq.

16 The Answer shall contain an admission or denial of each allegation in this Notice and the
17 original signature of each RESPONDENT or RESPONDENT's attorney. A statement of a lack of
18 sufficient knowledge or information shall be considered a denial of an allegation. An allegation
19 not denied shall be considered admitted.

20 When ROBERT FROST or ROBIN FROST intends in good faith to deny only a part or a
21 qualification of an allegation, ROBERT FROST or ROBIN FROST shall specify that part or
22 qualification of the allegation and shall admit the remainder. ROBERT FROST and ROBIN
23 FROST waive any affirmative defense not raised in the answer.

24 The officer presiding over the hearing may grant relief from the requirement to file an
25 Answer for good cause shown.

1 Dated this 3RD day of April, 2003.

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4 Mark Sendrow
5 Director of Securities

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