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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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AZ CORP COMMISSION
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In the matter of

JAMES T.M. VERBIC
(CRD # 2125770)
7880 N. 71st Street
Paradise Valley, Arizona 85253

Respondent.

DOCKET NO. S-03435A-01-0000

JOINT PRE-HEARING STATEMENT

Arizona Corporation Commission

DOCKETED

APR 02 2003

DOCKETED BY

Respondent James Timothy Michael Verbic ("VERBIC," or "Respondent") and the Arizona Corporation Commission ("Commission"), Securities Division ("Division"), by their undersigned counsel, hereby make stipulations of fact, and stipulations regarding the admissibility into evidence of particular exhibits. Further, VERBIC and the Division each identify their proposed additional facts, which are not stipulated. The parties request a hearing of approximately three hours, in order to present argument regarding the admissibility of each side's proposed additional facts and any supporting documents, and argument regarding the sanction(s) that the Commission should impose.

VERBIC admits the jurisdiction of the Commission over his person and the subject matter of this administrative action.

I.

STIPULATIONS OF FACT

1. VERBIC became a registered securities salesman in Arizona on June 28, 1991. He was associated with Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill") from that date until

1 January 3, 2000. During the period of his association with Merrill, VERBIC worked in Merrill's
2 Scottsdale, Arizona branch. VERBIC's last known address is 7880 North 71st Street, Paradise
3 Valley, Arizona 85253.

4 2. Pursuant to A.R.S. § 44-1949, VERBIC's registration was automatically suspended on
5 January 3, 2000, when his employment with Merrill ended. Since that date, VERBIC has not been
6 registered in association with a dealer, and accordingly his registration expired on December 31,
7 2000, pursuant to A.R.S. § 44-1947(B). Nonetheless, pursuant to A.R.S. §§ 44-1963(D) and 44-
8 1947(D), the Commission has the power to bring this action and to suspend or revoke VERBIC's
9 registration as a securities salesman.

10 3. During the period from at least January 1996, until in or about April 1999, VERBIC
11 was the Merrill "Financial Consultant" (*i.e.*, registered securities salesman) with responsibility for
12 the Merrill accounts legally or beneficially owned by a certain couple, who will be referred to in
13 this Order as "Customer" and "Wife," or collectively as the "CUSTOMERS."

14 4. Neither Customer nor his Wife is a relative of VERBIC.

15 5. Neither Customer nor his Wife was a person in the business of lending funds during the
16 time period relevant to this Order.

17 6. In or about October 1996, VERBIC told Customer that another Merrill registered
18 securities salesman was acquainted with a contractor, who wanted to borrow money short-term, to
19 fund construction costs. VERBIC told Customer that the lender could expect to receive a high
20 interest rate, relative to the then-current prime rate.

21 7. Customer did not know the contractor, did not request or receive financial statements of
22 the contractor, did not request or receive information regarding the location where the construction
23 would take place, or the schedule for completion of the construction, or any other information a
24 lender would normally review prior to making a business loan or construction loan.

1 8. Customer agreed to make a \$30,000 loan. Pursuant to the agreement, Customer made
2 the loan by a personal check in the amount of \$30,000, payable to VERBIC's wife, which
3 Customer sent to VERBIC and his wife at their home.

4 9. Customer did not ask for or receive a promissory note or other writing, either from the
5 contractor or from VERBIC. The only evidence Customer had of the loan, was his bank account
6 statement. The cancelled check, had he obtained one from his bank, would have shown that the
7 \$30,000 was deposited in a joint personal checking account of VERBIC and his wife. The loan
8 had no stated maturity date, interest rate, or amortization schedule.

9 10. The Customer received repayment with interest, in the form of five bank cashier's
10 checks from VERBIC's wife, totaling \$37,480.00, plus a final cash payment of \$2,880.00, between
11 1996 and 1998.

12 11. When Customer sent the \$30,000 check to the home of VERBIC and his wife,
13 Customer relied upon the financial strength of VERBIC to assure repayment of the loan and
14 payment of an interest return on the loan.

15 12. On January 5, 1999, VERBIC disclosed to Merrill that he was engaged in an outside
16 business activity, which he called BJ Music, by providing a written disclosure form to his
17 compliance manager. This disclosure included the information that VERBIC's partner in the BJ
18 Music business was one of his customers, and that each partner owned 50% of the business. The
19 written disclosure did not mention the CUSTOMERS.

20 13. In January, 1999, Customer made a second \$30,000 loan, the proceeds of which
21 VERBIC used in the BJ Music business venture. "BJ Music" was never organized as a
22 corporation, partnership, or other entity. VERBIC and his wife both executed a promissory note
23 dated January 18, 1999, in which they promised to pay \$30,000 plus interest to Customer, by May
24 15, 1999. Customer made a personal check in the amount of \$30,000, dated January 19, 1999, and
25 sent it to VERBIC and his wife at their home.

26

1 3. Accompanying the check, Customer sent an instruction to Kondamoori, that
2 \$50,000 was for a purchase of Internext stock by Customer himself, and the remaining \$50,000
3 was for a purchase of Internext stock by VERBIC. (Division's Exh. S-17.) Customer made that
4 check and instruction pursuant to a prior discussion and agreement between Customer and
5 VERBIC. (Customer Transcript, Respondent's Exh. 20, p. 34, line 8, through p. 39, line 16.)

6 4. No one ever negotiated the \$100,000 check that Customer sent to Kondamoori
7 on August 8, 1997. Neither VERBIC nor Customer ever received Internext stock certificates as a
8 result of the check. Consequently, VERBIC did not owe, or make, payments of principal or
9 interest to Customer with regard to the August 8, 1997 check.

10 5. Nonetheless, as of August 8, 1997, VERBIC and Customer had each done
11 everything that was in his power, to effect the borrowing of \$50,000 from Customer by VERBIC.
12 Kondamoori, or other persons associated with Internext who were not under the control of either
13 VERBIC or Customer, had sole power to choose whether or not to negotiate the \$100,000 check.
14 VERBIC agreed to borrow the \$50,000, and he performed his side of the agreement by sending, or
15 telling his wife to send, the IOU to Customer. Therefore, VERBIC's conduct in connection with
16 the August 8, 1997, events, constituted dishonest or unethical conduct, and grounds for revocation
17 or suspension, under A.R.S. § 44-1962(A)(10). Rule 14-4-130(A) declares that the dishonest or
18 unethical practices which constitute grounds for revocation or suspension, "shall include but not be
19 limited to" the twenty practices listed in the rule. Accordingly, it is not necessary to find that the
20 August 8, 1997, events constituted a "loan." The question is whether, on and about August 8,
21 1997, VERBIC "engaged in dishonest or unethical practices in the securities industry." A.R.S. §
22 44-1962(A)(10).

23 6. VERBIC admitted that he did not receive prior written approval from Merrill to
24 order the purchase of Internext stock for his own account on August 8, 1997. (Respondent's
25 Request for a Hearing and Response to Notice of Opportunity for Hearing, dated December 31,
26 2001, ¶ 18. This document is on file with Docket Control, and accordingly, the Hearing Officer

1 may take judicial notice of its contents.) VERBIC also admitted that Customer's and VERBIC's
2 orders to buy \$50,000 worth, apiece, of Internext stock, were not reflected on the books and
3 records of Merrill. (*Id.*)

4 7. On August 8, 1997, Internext Compression, Inc., was an existing corporation, as
5 proved by the August 7, 1997, registration statement filed with the SEC by NUKO Information
6 Systems, Inc. ("NUKO"). (*See* Division's Exh. S-28, p. 10 of 32, discussing a May 6, 1997,
7 transaction between Internext and NUKO.) Therefore, VERBIC's defenses that "Internext never
8 happened," and that it was "impossible" for these orders to buy Internext stock to be reflected in
9 Merrill's books and records, are not well-taken. It was at all times possible for VERBIC to write a
10 memo to his managers at Merrill concerning his plan to order Internext stock for his own account
11 in a private transaction. The Commission should reject VERBIC's defenses in this regard.

12 8. On August 8, 1997, VERBIC agreed to borrow \$50,000 from Customer, for the
13 purpose of engaging in a private securities purchase that he did not disclose to his dealer. As
14 discussed above, A.A.C. R14-4-130(A) is not an exclusive list. VERBIC did engage in dishonest
15 and unethical practices in the securities industry, on and about August 8, 1997.

16 9. VERBIC also engaged in dishonest and unethical practices on and about January
17 18, 1999, when he borrowed \$30,000 from Customer. Because "BJ Music" was never organized as
18 a corporation, partnership, or other entity (*see* Stipulation of Fact No. 13, above), "BJ Music" was
19 incapable of borrowing money, of owning a bank account or cashing a check, of being sued for
20 repayment of a debt, or of owning any assets of any kind. The first bank account which bore the
21 name "BJ Music" was a Bank of America account titled in the name of "JAMES T VERBIC, DBA
22 (doing business as) BJ Music," opened in October 1999, several months after the Customer's loan.
23 (*See* Division's Exh. S-25, the first account statement.) VERBIC's partner in the BJ Music
24 business did not sign the promissory note – VERBIC and VERBIC's wife did sign the promissory
25 note. Therefore, Customer's January 1999 loan was a loan to James VERBIC and his wife, and not
26 a loan to "the business." Indeed, VERBIC and his wife told their attorney that they had borrowed

1 \$30,000 from the Customer in January 1999, according to a letter the attorney wrote, dated May
2 20, 1999. (Division's Exh. 5.) The letter does not even mention "BJ Music."

3 10. VERBIC concealed from Merrill Lynch, the facts regarding the October 1996
4 loan, the August 1997 dishonest and unethical conduct regarding Internext, and the January 1999
5 loan:

6 a. If VERBIC had sent checks out from VERBIC's office at Merrill, the checks
7 would have been read by Merrill personnel, as are all outgoing written communications from
8 personnel of a dealer, under industry-standard practices. Knowing this, VERBIC instead had
9 his wife send all repayment checks to the Customer from outside Merrill, using a FedEx
10 account belonging to his wife's mother. (Division's Exhs. S-13 and S-24, repayment checks
11 and associated FedEx airbills.)

12 b. For the purpose of repaying the 1996 and 1999 loans, VERBIC had his wife
13 purchase bank cashier's checks, rather than using checks drawn on the joint checking account
14 of VERBIC and his wife.

15 c. VERBIC had his wife sign the IOUs in 1997 and 1999 (Division's Exhs. S-15
16 and S-19), until the Customer demanded one with both the VERBIC's signatures (Division's
17 Exh. S-20).

18 d. In that promissory note with James VERBIC's signature, is included the term:
19 "THIS NOTE WILL BE SURRENDERED TO JAMES VERBIC UPON FINAL PAYMENT<
20 ALL COPIES WILL BE DESTROYED." (Division's Exh. S-20.) The obvious reason for
21 VERBIC insisting on this term, is that VERBIC knew that borrowing from his Customer was
22 wrong, and he wanted to conceal his promissory note.

23 e. VERBIC, responding to a New York Stock Exchange inquiry, admitted that he
24 had not disclosed this January 1999 loan to Merrill. (Division's Exh. 26, p. 2.) VERBIC is
25 estopped from making the opposite claim here.

26

1 f. In connection with the Internext events in August 1997, VERBIC requested the
2 Customer to send the \$100,000 check directly to Kondamoori, again evading inspection by
3 Merrill personnel. (Customer Transcript, Respondent's Exh. 20, page 34, line 8, through page
4 39, line 16.)

5 11. Sometime after April, 1999, Customer and his wife commenced an arbitration
6 proceeding before the NASD, against Merrill and VERBIC (Arbitration No. 99-03480). Merrill
7 and VERBIC jointly filed an answer denying the CUSTOMERS' claims, in October, 1999. In their
8 answer, Merrill and VERBIC made statements and arguments to the NASD concerning the 1996,
9 1997, and 1999 events discussed above, among other subjects. Their statements and arguments can
10 be summarized fairly, with the following quote from page 16: "There is nothing that prohibits
11 financial consultants employed by Merrill Lynch from engaging in a variety of business activities
12 outside of Merrill Lynch. No improprieties took place."

13 12. Legal conclusions that were advocated to the NASD by Merrill and VERBIC in
14 their arbitration defense, are not authoritative in Arizona, or binding upon this Commission. Such
15 legal conclusions are not evidence in this action.

16 13. Factual assertions that may have been made by Merrill and VERBIC in their
17 arbitration defense, are merely an item of (hearsay) evidence, to be treated as any such evidence, in
18 the context of all the available evidence. The Commission should find that the law and the facts
19 are otherwise than as stated in Merrill and VERBIC's joint answer in the arbitration case.

20 14. The Securities Act, and the rules the Commission has created under that
21 statute's authority, forbid an Arizona-registered securities salesman from borrowing money or
22 securities from his customer. In addition, the Securities Act and related rules provide that the
23 Commission may revoke or suspend a salesman's registration, if the Commission finds that the
24 salesman has engaged in dishonest or unethical conduct in the securities industry. Three instances
25 of VERBIC engaging in such conduct, in 1996, 1997, and 1999, are established by the evidence
26

1 here. The law does not say that the salesman may do such acts if his dealer knows about them, and
2 the law does not say that he may do such acts if his dealer approves of them.

3 15. A registered or licensed individual is responsible for knowing and complying
4 with the law applicable to his profession in Arizona. In that regard, VERBIC's violations are not
5 excused by pointing to any conduct or statement of his dealer.

6 16. VERBIC's conduct subjects VERBIC to an order of revocation or suspension,
7 pursuant to A.R.S. § 44-1962(A)(10) and A.A.C. R14-4-130(A)(15). VERBIC's registration
8 should be suspended for a period of at least six months.

9
10 **IV.**
11 **RESPONDENT'S PROPOSED ADDITIONAL FACTS AND CONCLUSIONS OF**
12 **LAW**

13 1. The Respondent proposes to augment the stipulated facts as follows (proposed
14 augmentations are underlined):

15 2. Paragraph 6.

16 In or about October 1996, VERBIC told Customer that another Merrill registered
17 securities salesman was acquainted with a contractor, who wanted to borrow money
18 short-term, to fund construction costs. VERBIC told Customer that the lender could
19 expect to receive a high interest rate, relative to the then-current prime rate. VERBIC
20 relied upon the other securities salesman to disclose the pass-through loan to Merrill,
21 and the other securities salesman informed Mr. VERBIC that he had made the
22 disclosure to the Regional Vice President of Merrill.

23 3. This augmentation is justified because we have attached a sworn affidavit of the other
24 securities salesman who has affirmed that he disclosed the transaction to the Regional Vice
25 President of Merrill. See attached affidavit of Jason B. Smith.
26

1 4. Paragraph 8:

2 Customer agreed to make a \$30,000 loan to the contractor. Pursuant to the
3 agreement, Customer made the loan by a personal check in the amount of \$30,000,
4 payable to VERBIC's wife, which Customer sent to VERBIC and his wife at their
5 home.

6 5. This augmentation is justified because Mr. Paster admitted in his deposition that he knew
7 that Mr. Verbic was not the ultimate recipient of his money, rather it was going to the builder. See
8 Deposition of Gary Paster, page 43, lines 1-3.

9 6. Paragraph 10:

10 The contractor repaid the loan through Verbic together with interest. The Customer
11 received repayment with interest, in the form of five bank cashier's checks from
12 VERBIC's wife, totaling \$37,480.00, plus a final cash payment of \$2,880.00,
13 between 1996 and 1998.

14 7. This augmentation is justified because there is testimony from Mr. Paster that he knew that
15 the money ultimately went to the contractor. See Deposition of Gary Paster, page 43, lines 1-3.
16

17 8. Paragraph 12.

18 On January 5, 1999, VERBIC disclosed to Merrill that he was engaged in an outside
19 business activity, which he called BJ Music, by providing a written disclosure form
20 to his compliance manager, Richard Pello. This disclosure included the information
21 that VERBIC's partner in the BJ Music business was one of his customers, and that
22 each partner owned 50% of the business. Pello signed the form, signifying his
23 consent to the activity, and forwarded it for final review by Merrill compliance.
24 VERBIC was not advised by Pello, because Pello did not know, that under the
25
26

1 Securities Act and Commission rules, borrowing money from a customer is defined
2 as a dishonest or unethical practice.

3 9. This augmentation is supported by the documentary evidence in Division's Exhibit S-9
4 wherein Mr. Verbic completed an Outside Interest Questionnaire. The last sentence is supported by
5 the sworn testimony of Mr. Pello and has been stipulated as admissible into evidence as
6 Respondent's Exhibit 21. See Deposition of Richard Pello, page 25, lines 3-16.

7
8 10. Paragraph 13.

9 In January, 1999, through Verbic, the Customer loaned \$30,000 to BJ Music, the
10 proceeds of which were used in the BJ Music business venture. VERBIC and his
11 wife both executed a promissory note dated January 18, 1999, at Merrill's office, in
12 which they promised to pay \$30,000 plus interest to Customer, by May 15, 1999.
13 Customer made a personal check in the amount of \$30,000, dated January 19, 1999,
14 and sent it to VERBIC and his wife at their home.

15 11. This augmentation is supported by the sworn affidavit of the other securities salesman who
16 has affirmed that he was personally familiar with the transaction. See attached affidavit of Jason B.
17 Smith.

18
19 13. Additional Paragraph to be added in between Paragraphs 9 and 10 of the Stipulated Facts.

20 VERBIC did, in fact pass on to the contractor the proceeds of the loan.

21 14. This addition is supported by the sworn affidavit of the other securities salesman who has
22 affirmed that he was personally familiar with the transaction. See attached affidavit of Jason B.
23 Smith.

24
25 15. Pursuant to A.R.S. § 44-1949, VERBIC's registration was automatically suspended on January
26 3, 2000, when his employment with Merrill ended. Since that date, VERBIC has not been registered

1 in association with a dealer, and accordingly his registration expired on December 31, 2000, pursuant
2 to A.R.S. § 44-1947(B). Accordingly, Mr. VERBIC has not worked in or attempted to work in the
3 securities industry in over three years.

4 16. Since that time, Mr. VERBIC has never re-applied for registration of any of his securities
5 licenses in any jurisdiction and in fact all of his licenses have lapsed. Accordingly, if Mr. VERBIC
6 were to elect to pursue a career in the securities industry he would have to re-qualify and re-take all of
7 his securities examination. As such, any suspension of his registration would be illusory inasmuch as
8 he is not currently registered nor could he become registered unless he requalified.

9
10 17. In each of the events described in Stipulations of Fact section hereinabove, the CUSTOMER
11 was made more than whole. Specifically, in each instance, the CUSTOMER received repayment of
12 principal and interest. In fact, there are absolutely no allegations whatsoever that the CUSTOMER
13 was injured in any capacity as a result of his participation in those two events.

14
15 18. Mr. VERBIC's supervisor has admitted under oath that he was unaware of the relevant
16 Arizona rule prohibiting registered persons from borrowing money from customers.

17 19. Mr. VERBIC's former employer, Merrill, has acknowledged in its Statement of Answer in the
18 CUSTOMER's NASD Arbitration that it was aware of all of the dealings between VERBIC and the
19 CUSTOMER and further stated that "Respondents surmise that these events are included in the
20 Statement of Claim solely for the purpose of attempting to create a false impression that Mr. Verbic
21 was improperly engaging in activities outside of Merrill Lynch and behind Merrill Lynch's back. This
22 is simply not the case. There is nothing that prohibits financial consultants employed by Merrill Lynch
23 from engaging in a variety of business activities outside of Merrill Lynch. No improprieties took
24 place." See Respondent's Exhibit 15, page 16.

1 20. In light of the facts that (i) Mr. VERBIC has been unregistered and has not attempted to
2 register as securities salesman for over 3 years, thereby effectively suspended for a period of 39
3 months, and counting, to date, (ii) he does not currently possess any valid securities licenses, (iii) his
4 dealings with CUSTOMER were fully disclosed to his employer, and (iv) CUSTOMER made, not lost
5 money on each transaction, no legitimate interest of the taxpayers of the State of Arizona would be
6 served by suspending a registration that lapsed years ago. Mr. VERBIC has been categorically
7 excluded from his prior profession for over 3 three years and in fact, no longer possesses the requisite
8 licenses to participate in that profession. Accordingly, as a matter of equity, VERBIC respectfully
9 requests that no further suspension be imposed.
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1 Dated this 2nd day of April, 2003.
2

3 **Terry Goddard**
4 Attorney General for the State of Arizona

5 

6 **Amy J. Leeson**
7 **Special Assistant Attorney General**
8 Attorneys for the Securities Division of the
9 Arizona Corporation Commission

10 **Sichenzia Ross Friedman Ference LLP**

11
12 _____
13 **Michael H. Ference, Esq.**
14 Attorneys for Respondent

15 Original and 13 copies
16 filed with Docket Control
17 on April 2, 2003.

18 One copy delivered by hand to:
19 Philip Dion, Hearing Officer,
20 on April 2, 2003.

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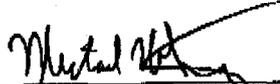
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Dated this 2nd day of April, 2003.

Terry Goddard
Attorney General for the State of Arizona

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Special Assistant Attorney General
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Arizona Corporation Commission

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Michael H. Ference, Esq.
Attorneys for Respondent

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