ADMINISTRATIVE PROCEEDING
FILE NO. 3-6555

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
LOUIS R. TRUJILLO	:

INITIAL DECISION

April 23, 1987
Washington, D.C.

Jerome K. Soffer
Administrative Law Judge

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APPEARANCES: Gary S. Lapidus and Bobby C. Lawyer, of the San Francisco Branch Office of the Commission, counsel for the Division of Enforcement.

Robert M. Romano and Francis C. Musselman, Counsel for respondent.

BEFORE: Jerome K. Soffer, Administrative Law Judge

On September 10, 1985, the Commission issued an order for public proceedings (Order) pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") naming Louis R. Trujillo as respondent.

The order is based upon allegations by the Division of Enforcement ("Division") that Trujillo, while employed as Administrative Manager of the San Francisco Branch Office maintained by Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch" or "Registrant") between 1980 and 1983 failed reasonably to supervise the activities of one Victor G. Matl ("Matl") a registered representative employed in that office who, during the period stated, wilfully violated the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. [1/]

The Order directed that a public hearing be held before an administrative law judge to determine the truth of the allegations set forth and what, if any, remedial action is appropriate in the public interest for the protection of

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1/ On the same date as the Order, the Commission instituted related public administrative proceedings against Matl, Merrill Lynch, and Robert M. Fisher ("Fisher") the office manager of the registrant's San Francisco Office, which arose out of the same facts described in the Order. Simultaneously, the Commission accepted offers of settlement submitted on behalf of each of those respondents (Exchange Act Release No. 22395).

investors. Public hearings were held in San Francisco, California between December 11 and 17, 1985 and between January 14 and 16, 1986 at which Trujillo was represented by counsel in the employ of Merrill Lynch.

Following the close of the hearings, consecutive proposed findings of fact and conclusions of law, together with supporting briefs, were filed by the Division and by respondent. A reply brief was filed by the Division.

The findings and conclusions herein are based upon the evdience as determined from the record and upon observation of the demeanor of the witnesses. The preponderance of evidence standard of proof has been applied. 2/

Merrill Lynch is a corporation with its principal place of business in New York, New York. It has been registered with the Commission as a broker-dealer since March 12, 1959. Registrant is a member of the National Association of Securities Dealers, Inc. ("NASD"), a national securities association registered with the Commission, as well as of the New York Stock Exchange, Inc., the American Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., and other national securities exchanges registered wtih the Commission.

2/ See Steadman v. S.E.C., 450 U.S. 91 (1981).

Official notice is taken of the fact that registrant is the largest broker-dealer organization in the country, operating numerous offices nationwide. Registrant maintained during the relevant period herein an office at 300 California Street in the City of San Francisco ("The California Street Office") which employed approximately 225 persons, of whom 70 to 80 were registered representatives with the title of "account executive" ("AE"). The office had some 25,000 to 30,000 accounts and generated annual revenues of approximately $20,000,000.

During the period from October 1980 to December 1983, Fisher was the office manager and Trujillo was the "administrative manager" working directly under Fisher. Trujillo was employed on a salaried basis. Fisher's earnings depended to some extent upon the profitability of the office.

Matl was a registered representative employed in the California Street office from about April 1977 to March 1983. During this 6-year period of employment, he generated some $1.8 million in sales commissions of which he personally received approximately $600,000. Matl was consistently among the top five producers of commissions in that office.

Respondent

Respondent is 41 years old, married, and has four children. He is a high school graduate and has been

attending evening college for the past 20 years towards earning a degree. He served honorably in the United States Air Force. His employment in the securities industry began in 1970 as a cashier trainee at a firm later absorbed by Merrill Lynch. He has held various jobs at Merrill Lynch including that of operations manager at various branches. He was promoted from that position at the California Street Office to that of administrative manager in July of 1980, a position which he continued to hold through November of 1983. He is a registered principal as well as a registered options principal. He is currently employed as administrative manager of the Northwest Regional Office of Merrill Lynch.

Management at the California Street Office

In the Merrill Lynch scheme, the office or branch manager (in this case, Fisher) was the leader solely responsible for the planning, operating and controlling the affairs of the branch. He is the one to whom all branch personnel report directly or indirectly. He has a very high degree of authority and responsibility, particularly for compliance, as well as for the surveillance and disciplining of account executives.

The administrative manager is an assistant to the office manager and carries out a wide variety of administrative and some supervisory tasks. As described by O. Ray Vass, the

manager of the Merrill Lynch compliance department, he serves as "the eyes and the ears" of the office manager.

Other mangerial employees at the California Street Office included a sales manager (at first Robin Corkery and later Ronald Carminati) who was primarily responsible for supervising and training account executives as well as their transactions. The sales manager also assumed the duties of office manager when Fisher was not present. The operations manager (Steven Nissenson) was primarily responsible for the operations of the office including the back office. Although all of the managers were expected to work together each reported separately to Fisher. [3/] There were some functions that any of the managers could perform including approval of margin trading and of order tickets for particular types of trades, such as mutual fund liquidations, trades of 50 or more options (particularly when they involved naked writing trades of 1000 shares or more), "Cash Management" (or "CMA") accounts of more than $50,000 [4/] and the approval of transactions involving the

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3/ Fisher deemed the sales manager to have been superior to the other managers, despite the apparent equality otherwise, solely because he would assume the functions of office manager in Fisher's absence.

4/ The CMA was a popular type of investment, having the high-interest features of a money-market fund, and check-writing. It also authorized trading in securities on margin.

purchase and sale of municipal investment trusts ("MIT").

So far as pertinent hereto, the chain of management above and beyond the branch office includes a regional director (in this case, Jack DuLong), the Compliance Department in the New York City headquarters of Merrill Lynch, particularly the Surveillance and Review Section, and the office of general counsel, also in New York City.

In the "Exempt Position Description" manual of Merrill Lynch, in effect since at least July 15, 1979 (but the details of which were not known by Trujillo until some time in 1982), the position of administrative manager is described as being accountable for compliance by the branch office with all regulatory laws and regulations, and for effective processing and overseeing of a number of administrative matters such as expense control. Depending upon the structure of the branch office, this position can have the responsibility of supervision of sales support personnel (i.e., the clerical employees who assist account executives). The manual states that the administrative manager reports directly to the office manager and any major decisions which might have significant impact on the office are deferred to the office manager. Decisions by the administrative manager are stated to be made with respect to minor matters, such as smaller customer complaints, routine errors

made by account executives, or minor policy settlements.

Among other duties of the administrative manager, as described in the manual, is the supervision of the activities of the AEs to assure compliance with regulatory agencies through a daily review of business transacted, and of the activity in customer accounts for suitability. In addition to a number of administrative duties, the administrative manager confers with the office manager on major problems and matters affecting the sales staff and consults with the Law and Compliance Department concerning legal matters and interpretations of policy. The manual recognizes that one of the major or unusual problems to be faced in achieving the basic purpose of the position would be the difficulty in evaluating the activity in a client's account for suitability because of the relationship between the AE and the customer. The manual also points out that among the resources available in meeting problems is the reliance on information supplied by AEs as well as by the staff of various home office departments.

When Trujillo assumed the new position of administrative manager at the California Street office in the latter part of 1980, Fisher presented him with a written memorandum outlining Trujillo's responsibilities. These included

the review of the "Compliance 1028" form, a daily report of all transactions at the branch, to seek out specifically whether any transactions reported thereon involved the solicitation by the AE of so called "6-6" or "no opinion" securities, 5/ to find evidence of day trades (i.e., a purchase and a corresponding sale of the same security on the same day), missing documents, excessive trading and "large trades".

In addition, Fisher's instructions stated that Trujillo was responsible to review and sign new accounts, to have responsibility for and supervision over options accounts, to deal with customer complaints, and to approve AE operations and correspondence.

In approving new accounts, including options and margin accounts, Trujillo had the responsibility of being aware of the New York Stock Exchange Rule 405 (the "Know Your Customer" Rule) requiring the use of due diligence to learn the facts relating to every customer.

5/ These are securities for which the Merrill Lynch research department had no opinion or an unfavorable opinion. AEs were forbidden to solicit transactions in these securities without approval from the home office by way of Fisher. However, sales could be made where they were unsolicited. Since the Compliance 1028 was prepared from order tickets made out by the AE, it would reflect his reporting of whether a "6-6" transaction was solicited or unsolicited.

New account opening forms were filled out by the AE with respect to personal information concerning the customers, their assets, income, net worth, and trading objectives. From this information, the supervisor (i.e., respondent) would determine whether to approve the account, and, in the case of options customers, to determine suitability for and the particular trading strategy to be authorized.

New options account review requirements are set forth in the Merrill Lynch Policy Manual, Section 03.3, drawn to comply with the rules of the Chicago Board Options Exchange (C.B.O.E.) and the American Stock Exchange obligating "every office manager or his designees" to properly qualify each prospective options customer. The Policy Manual directs the manager qualifying the account to insure that the customer is fully advised of the risks involved and that the options program selected is suitable for the customer. To this end, Fisher would routinely send to each new options customer a form letter detailing the risks involved as well as a copy of the prospectus issued by the Options Clearing Corporation explaining options transactions and strategies. [6/]

6/ The options account opening form (Code 1014) had blank spaces for affirming that the customer had in fact received the requisite information. A copy of the Code 1014 would be sent to the Merrill Lynch Compliance Department for further examination as to customer suitability. At one time, there was no requirement that a completed copy of the approved options account form be sent to the customer involved. Now there is such a requirement.

As to the duty imposed upon respondent by Fisher to supervise options accounts, the Policy Manual would require that he conduct regular and systematic reviews of the activity in the account to insure that it is consistent with the customer's objectives. The Manual also suggests that the manager or his designee should review daily a so-called "Red Flag" checklist as set forth therein.

With respect to the authority delegated to Trujillo to deal with the customer complaints, he was responsible for investigating them promptly, to dispose of the minor ones (generally involving less than $5,000), and to turn over to Fisher for disposition the results of his investigation as to the larger claims or those involving a violation of Merrill Lynch policy.

Fisher was primarily responsible for the supervision of the AEs, except to the extent that he delegated such responsibilities to the administrative manager, Trujillo, who already had the duty to assure compliance by the AEs with regulatory requirements.

Only Fisher as office manager had the authority to discipline AEs by monetary fine, by formal written censure, by limiting their activities, or by discharging them.

Respondent had the authority to orally reprimand the AEs, or to reverse a trade of less than $5,000, and to

charge the AE not only with the loss of commissions, but also with any market loss sustained by Merrill Lynch resulting from the reversal. Where the amount involved was substantial, then only Fisher could reverse the transaction.

Of course, it was expected that respondent would refer to Fisher any evidence of impropriety by any account executive which he, Trujillo, discovered but could not dispose of or which only Fisher could deal with.

Originally, the Fisher memorandum of responsibility also had required Trujillo to examine "monthly activity reviews" (a report prepared by office staff which was generated when cumulative revenues during the year in an individual account exceeded a minimum figure, originally $2,500 and later increased to as much as $5,000 or when there were a stated number of trades in a given month). However, for his own reason, Fisher almost immediately thereafter reserved unto himself alone the examination of the monthly activity review forms. 7/

7/ The monthly activity review would contain information as to the account's investment objectives, risk factors, the investment products desired and the type of trading desired, all of which information is filled in by the account executives. The review was also accompanied by a profit and loss statement for that year's activity prepared by the AE and showing the net profit or loss (FOOTNOTE CONTINUED)

The Statute

Section 15(b)(4), and particularly sub-paragraph (E) thereto, imposes upon a broker-dealer, or any of its associated persons, a duty reasonably to supervise their employees with a view to preventing violations of the various securities laws. The Section reads, in part:

> (4) The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds, on the record after notice and opportunity for hearing, that such censure, placing limitations suspension, or revocation is in the public interest and that such broker or dealer, * * * or any such person associated with such broker or dealer * * *
>
> (E) * * * has failed reasonably to supervise with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this subparagraph (E) no person shall be deemed to have failed reasonably to supervise any other person, if --

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7/ (CONTINUED)
to the customer to the date it was prepared. The form would also be accompanied by the customer's holding record which shows all of the transactions in the customers account by a particular AE, as well as a copy of the account opening statement or the option trading opening statement for the particular customer. It would seem that except for the holding pages and the account opening statements, the reviewer of the monthly activity review is relying on information furnished entirely by the AE.

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by any such other person, and

(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

Thus, the Division has the burden of proving that Matl violated the securities laws and the rules and regulations promulgated thereunder, and also that respondent "failed reasonably to supervise" him "with a view to preventing" such violations.

Matl's Customers

Evidence was presented concerning the extent of Matl's violative conduct and of respondent's supervision with respect to some 14 customers of Matl, 13 of whom testified at the hearing. 8/

Richard Dickinson, a self-employed painting contractor, opened a margin trading account at Merrill Lynch in the Spring of 1980 upon the solicitation of Matl by depositing almost $30,000 worth of stock in three corporations. The acquisition of this stock in 1979 represented the sum total of his previous

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8/ Evidence concerning one account, Kevin Peak, was given through other witnesses and documents.

securities experience. Although he intended to earn enough to pay off a $50,000 mortgage, he merely told Matl that he wanted to "increase his bankroll". Matl immediately sold off Dickinson's stockholdings. Thereafter, and for the next six months, he executed a series of trades in the account, almost all on margin, and all made at the suggestion of Matl who, with typical high pressure techniques, induced Dickinson's consent. The period involved, from April through October of 1980, was just prior to Trujillo's appointment as administrative manager at the California Street Office. [9/] During the period, the account purchased $548,390 worth of stocks and $297,143 worth of options which produced commissions of approximately $30,000.

Matl recommended investments in options, including naked options, to which Dickinson, having little knowledge of these transactions, agreed. Matl also induced Dickinson to invest in options he termed "one-day substitutions", a form of day-trading, by telling Dickinson that he would not have to pay the purchase price since the position would be closed out prior to settlement.

9/ Respondent's predecessor as administrative manager had approved the account for options trading, including the writing of covered and uncovered call options and of put options.

On October 24 and 27, 1980, by which time Trujillo was newly in place as administrative manager, Matl induced Dickinson to purchase a total of 60 Teledyne naked call options at a cost of well over $100,000, a sum far beyond any assets then owned by Dickinson. When the price began to decline, Dickinson directed Matl to sell out his position, but Matl refused asserting that there would be a turnaround and an eventual profit. Matl also feared that other of his clients would be adversely affected by a sudden sellout of Dickinson's position.

Trujillo first became aware of a problem with Dickinson on October 31, 1980 when he learned that the account faced a Regulation T call to cover the purchase of some 60 call options and that the account did not have sufficient funds or assets to cover the call, as required. He discussed this with Matl and told him that he should not have permitted the account to have become overextended, that requiring the customer to liquidate a portion of his options positions rather than to deposit cash or securities should only be as a last-resort, and that the forced liquidation would constitute a form of free-riding contrary to established Merrill Lynch policy.

Trujillo then advised Fisher of Matl's improper conduct with respect to the overextension of the Dickinson account and the apparent free-riding violation.

On November 5, 1980, Dickinson wrote Fisher complaining that Matl had churned his account, that Matl had failed to carry out his sell order of the Teledyne options, and demanding that he be paid his market loss of $21,250 resulting from Matl's disobedience of his instructions. Fisher turned this letter over to Trujillo for investigation, which was the first Trujillo knew of a customer complaint. He asked for and received from Matl a written version of the transaction, obtained the order tickets with respect to them and turned all of the documentary information to Fisher for his consideration. Thereafter, respondent had nothing further to do with the matter.

As a result of his complaint, Dickinson ultimately settled with Matl and Fisher for a return of $5,000 against his claimed losses.

Patricia A. Roane, whose previous securities experience comprised investment in a mutual fund, on August 5, 1981 deposited $10,000 into a Merrill Lynch "ready asset account" (a liquid interest-bearing money market fund). She later deposited an additional $8,500 therein.

Shortly thereafter, Matl, her assigned AE, telephoned and suggested that she use her ready asset funds to buy an oil stock, Natomas. He was persistent in his sales pitch and she finally concluded the conversation with the words "all

right", by which she intended to merely to end the conversation but which he interpreted as an agreement to buy and immediately executed the transaction. She called him 30 minutes later and was told that he had already made the purchase, that it was too late to do anything about it unless she placed a sell order. The next day she wrote Matl that she was not interested in trading in stocks and wanted her account reinstated to its prior condition. Having received no response, on August 24 she went to the offices of Merrill Lynch, and met with Matl and Trujillo, and again demanded her account be reinstated immediately. Trujillo told her she would have to do so by way of a formal sell order and suffer the market loss unless she would await the outcome of his investigation. The next day, she wrote a letter to Fisher insisting that her account be reinstated. On the following day her attorney spoke either to Matl or Trujillo and within a week thereafter her account was reinstated without any cost to her. She later closed her account.

After the first meeting with Roane, Trujillo caused Matl to write down his version of the affair. He then concluded that she was unsuitable for trading in stocks. Trujillo asserts that he, with the concurrence of Fisher, caused the trade to be reversed and the market loss of $2,400 be charged to Matl plus the loss of his commission.

Trujillo received a telephone complaint from a customer named Kevin Peak involving a margin purchase of Winnebago stock (a favorite of Matl) at the suggestion of Matl. Peak complained that Matl did not fully explain the risks to be faced in this type of a purchase, particularly that margin maintenance requirements were higher for such low-priced stocks. As a result, Peak's position was closed out through margin calls. Trujillo's investigation included examination of the holding pages and a conversation with Matl. He then wrote a memorandum to Fisher on July 22, 1981 pointing out that this account showed evidence of churning, that Matl had solicited the purchase of a "no opinion" stock in violation of Merrill Lynch rules,[10/] described Matl as having engaged in "unconscionable behavior for a Merrill Lynch broker", and indicated that the situation involved a suitability problem. As a result of this letter, Fisher reprimanded Matl who then agreed in writing that he would no longer recommend "no-opinion" stocks without the prior approval of the Compliance Division. Trujillo also advised Peak to write to Fisher outlining his complaint. Ultimately, Peak was paid his market loss of $1,900, which was charged to Matl along with the loss of his commissions.

10/ Matl blatantly admitted to Trujillo to incorrectly marking the Winnebago purchases as "unsolicited", and evidenced no concern over Peak's losses.

Some five months before the Peak affair, Trujillo, from his review of daily activity reports, found Matl to have been soliciting sales of "no opinion" stocks, and reprimanded Matl who promised not do so again.

About two months subsequent to the Peak problem, Trujillo again found evidence that Matl was recommending a "no-opinion" stock. He took this up with the sales manager and as a result Fisher again reprimanded Matl.

Since January of 1978, Joseph A. Stetz, Jr., a physician, has been maintaining a personal trading account and a Keogh retirement account with Merrill Lynch which he had opened at the solicitation of Matl. Because he had very little investment experience, he came to rely almost entirely upon Matl for investment decisions. He had informed Matl that he wanted his Keogh account to be handled conservatively but that more liberties could be taken with his personal account which permitted margin trading.

In June of 1981, Matl recommended the purchase by Dr. Stetz of "Winnebago" (a "no-opinion" stock), a company engaged in manufacturing recreational vehicles. At first, Stetz objected to the acquisition but finally agreed to the purchase, allegedly for his personal account only, upon Matl's representation that the stock was highly recommended by Merrill Lynch.

Several weeks thereafter, upon returning from a vacation trip, Dr. Stetz found that Winnebago purchases were made in his personal account, and in his Keogh account. Further, the stock had been sold out of his personal account during this trip. As a result of these transactions he lost some $4,200 in his personal account and about $8,000 in his Keogh account.

After several unsuccessful attempts to contact the sales manager at the California Street Office, Dr. Stetz called Merrill Lynch in New York complaining about Matl's conduct in purchasing Winnebago for his Keogh account. Shortly thereafter, Trujillo's secretary called him, and took note of his complaint. Subsequently, Trujillo advised Dr. Stetz that he would be hearing further after the matter was investigated.

On February 24, 1982, some six months after the transactions took place, Dr. Stetz filed a written complaint with this Commission about Matl's execution of unauthorized transactions, not only of the unauthorized purchase for the Keogh account, but also (apparently for the first time) of the unauthorized sale of the stock out of his personal account. On April 16, 1982, the Merrill Lynch Customer Services Department in a letter to the Commission and to Dr. Stetz denied that any redress was due, based upon Matl's report that the

understanding was that both accounts would follow the same investment strategy, which they, in fact, did without complaint by Dr. Stetz until the Winnebago matter.

Trujillo's investigation was limited to the complaint of an unauthorized purchase for the Keogh account, since at that time Stetz had made no claim of an unauthorized sale out of the general account. His examination of the records showed that in every instance stock purchases and sales were executed simultaneously for both accounts. Trujillo turned his findings over to Fisher, who in turn, concluded that the complaint was unjustified and for Trujillo to so advise Dr. Stetz. It would appear that the sale of Winnebago out of the personal account was done to meet a margin call while Dr. Stetz was on vacation, rather than as the affirmative act of Matl.

Leroy T. Pennington, a retired railroad switchman, opened a Cash Management Account ("CMA") at Merrill Lynch in the Spring of 1981 with a deposit of $29,000 derived from a disability award of $129,000.[11/] His annual income of $16,000 was derived from a pension and from rents from two pieces of real estate in which he had an interest. In addition, he was earning about 17% interest on a $100,000 certificate

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11/ The Merrill Lynch CMA account has the attributes of a money-market fund and permits trading on margin. It generally yielded a higher rate of return than savings accounts and included check-writing features.

of deposit. Matl was assigned as his account executive. It was agreed that he would invest the account funds in stocks. Pennington had very little prior experience or knowledge about the stock market.

During the next five months, Matl recommended and Pennington agreed to some 22 purchases and corresponding sales of stock. Pennington traded on margin, although he claims not to have known exactly what margin trading involved. Early on, the trading proved profitable, so that by some 5 to 6 weeks after trading had commenced, profits from the transactions aggregated more than $18,000. Thereafter, however, every transaction lost money. At one time, Pennington was advised of a margin call resulting in the sale of some of his securities. On another occasion, he held both a long and short position in "Ranger Oil" stock that Matl advised was a "short sale against the box", a term about which Pennington had no understanding. Matl represented that Merrill Lynch had bought a block of this stock and that it was a "good deal". (In fact, its research department characterized Ranger Oil as "speculative".) Matl also recommended Pennington to purchase the stock of Dean Witter Reynolds a "no-opinion" security.

As the account continued to lose on the transactions, particularly in Ranger Oil and Natomas, another oil stock,

Pennington complained directly to Matl and asked to get out of these stocks. Matl dissuaded him from doing so and to await an expected turnaround, which did not occur. Thereafter, Pennington called and spoke to respondent complaining of the manner in which Matl handled his account and of his refusal to sell Natomas and Ranger Oil. He complained further of being "rolled over and over" by Matl.

Trujillo made a routine examination of the account documents, including the holding pages. He questioned Matl, who explained that he merely tried to discourage the customer from selling the oil stock. Trujillo chose to believe this explanation rather to verify the matter with the customer. Trujillo was satisfied from his examination that Pennington was suitable for the transactions made in this account.

Respondent turned the matter over to Fisher, because of the large amount of money involved, including the documentation and the statements made to him by Matl. He expressed to Fisher his opinion that the customer was perfectly aware of what was going on and was only complaining because he began losing money but did not complain when profits were being made. Although the account records clearly showed purchases of no-opinion stock despite Matl's prior assurances that he would refrain from doing so, Trujillo did not specifically call this to Fisher's attention. Thereafter, Fisher determined

that the customer should not be entitled to any restitution.

During the five months of trading, Pennington suffered a net loss of approximatley $14,000. He later through an attorney made claim against Merrill Lynch who settled the matter for the sum of $5,600.

Albert Iaccarino and his wife, Rose Scalise, both physicians, had been maintaining separate Keogh and other retirement accounts with another broker firm. As a result of repeated solicitation by Matl, the Iaccarinos transferred their respective Keogh accounts to Merrill Lynch in April of 1981. At the time, they informed Matl that they wanted these retirement accounts to be maintained on a conservative basis. The accounts had values of $56,000 and $72,000, respectively. Some 85% to 90% of the securities therein were stocks of public utility companies.

Within a few days after the transfer was made, Matl, who had no discretionary authority, and without the knowledge of the Iaccarinos, caused all of the utilities holdings in both accounts to be sold and replaced with more speculative common stocks, such as Bally Manufacturing Corp., Pan Am World Airways, Homestake Mining, and Winnebago Industries. 12/

12/ When questioned about these transactions at a later time, Matl showed Trujillo copies of letters allegedly sent the Iaccarino's advising of this investment strategy. However, they deny having received them and there is no proof in the record that they were ever sent.

As soon as Dr. Iaccarino learned of these transactions, he expressed his objections to Matl who, however, counseled trust in his judgment. As the price of the securities kept declining, and Dr. Iaccarino continued to protest, Matl advised patience because experts at Merrill Lynch were issuing recommendations not to sell them. Since he continued to complain, Matl made arrangements for a meeting with Trujillo in late December of 1981 or early 1982, telling Trujillo he was having a "personality conflict" with these customers. At the meeting Dr. Iaccarino asked that his account be reinstated to its original position and complained bitterly about Matl's handling of his affairs and his acting without authorization in selling off his holdings and replacing them with others.[13/] Trujillo denied having any responsibility for what happened and stated that he could not reinstate Iaccarino's original position since he was only working in an administrative capacity at Merrill Lynch.[14/] Nevertheless, he arranged for the Iaccarino and Scalise accounts to be transferred to Robert

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13/ These original transactions were the only ones by Matl in these accounts during the ensuing 6 or 7 months.

14/ Trujillo denies having made this statement. He further asserts that Iaccarino never complained about unauthorized trading, never asked for compensation or to reinstate his original position. He only complained about Matl's handling of the account and that he wanted another AE.

Ansara, a more conservative AE at the California Street Office. Ansara thereafter sold the securities that Matl had acquired and repurchased mostly utility stocks. Iaccarino has been satsfied with the services of Ansara, and he and his wife are still customers of Merrill Lynch. As a result of Matl's handling, the Iaccarino account lost $18,000 in value and the Scalise account declined $46,000 in value. Transactions by Matl produced commissions of $7,154. None of these losses has been compensated.

Although the transactions took place in June of 1981, Iaccarino did not complain to Matl's supervisor until Feburary of 1982 having been lulled by Matl's assurances that all would turn out profitably.

Trujillo considers the taking of the accounts away from Matl as an ego-deflating form of punishment.

Max L. Christensen, a retired clergyman, jointly with his wife opened a Cash Management Account at Merrill Lynch in July of 1981 with a deposit of $42,000. He advised Matl, his assigned AE, both orally and in writing, that he had conservative investment objectives, that he wanted nothing to happen in his account for at least 3 or 4 months and that he always wanted to maintain a minimum of about $10,000 cash for ready withdrawal.

The question of margin arose during his first discussion with Matl and Christensen expressed a fear of engaging in transactions of this type. However, Matl reassured him that he would be able to avoid the risks involved.

On August 6, 1981, Matl sent Christensen material concerning stock in "Natomas", and study material on margin buying, suggesting that he follow Natomas in the newspaper. At the very same time, Matl purchased on margin, without prior authorization, 2000 shares of Natomas at a cost in excess of $70,000. Christensen first learned of the transaction when he received his August monthly statement. He complained to Matl about the purchase, particularly the margin features, but was assured as to the safety of the investment and hence he acquiesced in it. At the direction of Christensen, who had begun to receive margin calls on the stock, Natomas was sold some 3 months later at a substantial loss. At about the same time upon Matl's recommendation the account purchased another oil stock, "Dome Petroleum" [15/] for $12,625. However, during the next 2 1/2 months, the stock declined in value and Christensen ordered it sold and suffered a substantial loss.

15/ This stock had been categorized by Merrill Lynch as "high risk".

Matl encouraged Christensen to purchase and sell options, assuring him that there was no risk because of his, Matl's, expertise in the field. He sent the customer some literature concerning options which Christensen admits he neither read nor studied. Matl sent him an application form "Code 1014" to authorize trading in options, which he and his wife signed in blank on January 27, 1982 and returned to Matl. They did not complete any of the financial information called for in the application, ostensibly because they were not sure they wanted to trade in options. 16/

On January 22, 1982, some 5 days before the option agreement was signed by Christensen, Matl sold 9 calls and 9 puts in Natomas, without prior authorization. 17/ Christensen first learned of the transaction when he received his monthly account statement at which time he called Matl who was unavailable, and asked his secretary for a copy of his options application.

16/ However, Christensen testified, at page 361 of the transcript "And I said - told the woman who answered what I had previously stated, that I didn't fill out the blanks for the reason that whatever statement I had to make about myself was the $42,000 which I had deposited, and that nothing else was relevant. And if that material - that was not enough, then there would be no other - there would be no deal on the options business".

17/ Additional unauthorized options transactions were executed on January 26, March 10 and March 24, 1982. On March 10, Christensen was undergoing surgery for a serious ailment.

When he received it, he noticed that all of the information concerning his and his wife's assets, income, and investment objectives, which was omitted when they signed it, had been filled out by Matl, and the financial information was grossly overstated. Matl signed the form on February 9, after the options transactions, seeking authority to buy puts and calls and to write covered and uncovered calls. Trujillo approved it on that day, denying approval for writing uncovered calls but authorizing put writing instead, relying upon the financial and income information it contained concerning the Christensens. Many months later, he became aware that the figures were inflated.

In June of 1982, Matl advised Trujillo that he might have a problem with Christensen which caused Trujillo to examine various aspects and records concerning this account, although no complaint had been made as yet. He concluded from this investigation that there was nothing unsuitable about the Natomas transactions. In fact, Merrill Lynch had recommended this stock and had a high opinion of it.

Some time thereafter he was contacted by Christensen's attorney complaining of the fact that the financial information in the Code 1014 Form was incorrect. Pursuant to instructions given him in July of 1982 (discussed hereinafter) concerning complaints about Matl's activities prior to that date, Trujillo

arranged for a meeting between Christensen's attorney and headquarters counsel for Merrill Lynch rather than taking any action or making any recommendation on his own. 18/

During the approximate 10 months of trading, the Christensen account suffered losses of about $35,000. Through counsel, Christensen obtained a settlement of his complaints against Merrill Lynch for the sum of $19,000.

Robert Reeves, a junior high school principal, opened a stock trading account at Merrill Lynch in September of 1981 as the result of intensive solicitation by Matl. Reeves, who only had limited prior securities experience, advised Matl that since he was saving to buy homes for his children he did not want to take many risks in trading. Matl promised that by virtue of his superior trading skills Reeves would make at least a profit of 25 percent annually. Reeve's initial investment was slightly over $6,000. Upon Matl's strong recommendation, he agreed to the purchase of shares of "Sunshine Mining", a stock about which Merrill Lynch had no opinion, but for which Matl obtained permission from the Compliance Department to solicit. During the next 3 1/2

18/ In the Summer of 1982, counsel for Christensen contacted Merrill Lynch's regional director complaining of possible churning, suitability and margin violations. He in turn referred the matter to the California Street sales manager who in turn reported the matter to Fisher. Fisher then asked Trujillo to get details of the complaint.

months he went through some 14 stock and options purchases as suggested by Matl. At the end of the period, his total losses amounted to $9,397.

The bulk of the losses resulted from trading in the stock of Ranger Oil, considered a speculative stock by Merrill Lynch researchers, commencing on November 3, 1981, and, more significantly, of Marathon Oil stock on December 10 and 11, followed by the purchase of Marathon Oil calls on December 21 (three calls), and January 20 and 21, 1982 (24 calls). Matl induced Reeves to purchase Marathon both as a stock and an option on the representation that this was a "no lose" situation because of an expected takeover by another oil company.

Reeves had signed an options agreement on December 31, 1981, with most of the required financial information left blank, some 10 days after Matl had commenced trading in Marathon Oil options. [19/] Matl had signed the options application as AE on December 22, prior to the signature of Reeves. Trujillo approved the account on January 7, 1982, but limited options trading to buying puts and calls. The financial figures had by this time been filled in, although it is not clear by whom. The amount with respect to Reeves' income and assets was substantially correct. It showed his

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19/ As noted heretofore, Merrill Lynch and stock exchange rules forbade trading in options before the customer had signed the options account agreement.

net worth to be $187,000, although the new account form executed some months prior thereto showed it to be $1 million.

The losses on the trading in Marathon Oil stock and options accounted for virtually all of the losses sustained. When Reeves questioned Matl about these losses in the light of his assurances that Marathon was a "no lose" situation, Matl denied having made the statement. The account generated commissions during this period of about $5,000 (of which $1,283 represented trading in Marathon Oil) or about 80% of the initial investment.

Reeves telephoned Trujillo explaining his disturbance over his losses in Marathon, and particularly about Matl's "no lose" representations. Trujillo promised a return call but did not do so.[20/] When Reeves eventually reached him, Trujillo advised that he would turn the matter over to Fisher, which he did. Thereafter, Reeves complained directly to Fisher about Matl's misrepresentations. On February 26, 1982, Fisher advised him that, after consultation with the New York Office of Merrill Lynch, he would take no further action.[21/]

20/ Trujillo claims to have placed several calls to Reeves without success.

21/ Matl boasted to Reeves that it was he who told Fisher what to say in the letter, and that since he was a volume producer he carried "a lot of weight" around the office.

Reeves then complained to the NASD seeking arbitration of his claims. Merrill Lynch paid Reeves $8,300 in settlement thereof.

Marvin DeHeus, a general manager for an insurance company, opened a CMA account at the California Street office of Merrill Lynch in July of 1981 with a deposit of $20,000.[22/] He had limited prior experience in the stock market. Shortly thereafter, he was contacted by Matl, his AE, who convinced him to trade in stocks, to buy on margin, and some time later, to trade in options. In all cases, DeHeus relied solely upon Matl's advice in making investment decisions.

During the ensuing 8-month period until March 25, 1982, the account made 8 buys and corresponding sales transactions, 3 being margin purchases of stock and 5 being options trades, resulting in an overall net loss in the account of more than $18,000.

On February 17, 1982, DeHeus wrote a letter to Fisher complaining about the manner in which his account was being managed. Fisher replied thereto by denying any liability or any wrong-doing in the management of the account. Subsequently, DeHeus filed suit against Merrill Lynch arising out

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22/ He subsequently made an additional deposit of $43,000 in the account.

of these transactions in his account which was settled for the sum of $42,500.

DeHeus asserts that he was never apprised by Matl of the risks involved in margin or options trading. However, the record shows that on October 21, 1981, Fisher sent DeHeus a form letter outlining the risks involved in writing or buying options together with a copy of the CBOE prospectus. 23/

At the time he approved the CMA account opening statement, Trujillo noted DeHeus was a bank officer, and was required by the New York Stock Exchange (Rule 407) and by Merrill Lynch to have a letter of approval from his supervisor for margin trading. Trujillo notified Matl to obtain such a letter from DeHeus on a number of occasions. Matl had sent DeHeus a copy of the Merrill Lynch rule, but DeHeus was not satisfied, insisting that he first wanted a copy of the Stock Exchange Rule before he would seek the letter from his superiors. In the meantime, margin transactions had been executed in the account. Finally, Fisher turned this matter over to Trujillo, who sent a copy of Rule 407 to DeHeus.

23/ Although in his letter to Fisher, DeHeus indicated that both options and margin trading were commenced in his account prior to his signing the requisite agreements, the record shows that such agreements were in fact timely executed.

John and Tina Mehan had been maintaining a CMA account at Merrill Lynch with a balance of $40,000, their sole liquid assets, in order to derive interest income. John Mehan was a school teacher with a salary of $30,000 per year. In addition, the Mehans owned real estate valued between $1 million and $1 1/2 million dollars from which they derived net income of about $120,000 annually.

About a year and a half after they opened the CMA account, they were contacted by Matl as their assigned account executive, who strongly suggested they buy an oil stock, Dome Petroleum, upon his representation that they would make a very quick profit of at least 5 points.[24/] The couple was reluctant to follow this advice, never having invested in stocks before. However, Matl was insistant, and reassured them that they could not lose. They thereupon consented to the purchase of 1000 shares of Dome at 10 3/4. A few days later, the stock having gone up several points, Matl again suggested they buy an additional 1000 shares, making the same assurances of his investment skill and of a quick profit.

Finally, about a week thereafter, he recommended they buy an additional 2000 shares, and, since they did not have

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24/ As seen previously, the Merrill Lynch Research Department had characterized Dome Petroleum as "high risk".

sufficient equity in their account, to buy on margin. The couple had only a vague idea of margin trading and Matl never explained to them the risks involved. To overcome this reluctance, Matl promised to enter a stop-loss order for their Dome shares to prevent losses. On this basis, the Mehans agreed to the margin purchase of 2000 additional shares at $13. All 4000 shares were purchased within a week. At that point, virtually all of their savings were concentrated in the stock of one oil company.

Thereafter, as the price of the stock began to decline, Matl continued to reassure the Mehans that they were in a good stock, that he expected it to go back up, and that they were protected by the stop-loss order. At one point he recommended that they sell a thousand shares in January or February of 1982. The stock continued to decline, ultimately reaching a level of about $2 per share. In late 1982, they filed a complaint with the NASD against Merrill Lynch and as a result of an arbitration hearing, they were awarded the sum of $27,000 to compensate them in full for their losses in Dome.

Trujillo first became aware of a problem regarding the Mehan account when he received a letter from an attorney representing the Mehans requesting documentation for their account. Since this request referred to activity prior to

the restrictions that had been placed upon Matl by Fisher in July of 1982, (discussed hereinafter), he sent the letter to the New York litigation office of Merrill Lynch as per his instructions from Fisher. Prior thereto, he claims to have had no reason to believe that there was a problem with that account. He failed to notice the concentration of securities in this one account, since the purchases occurred over a period of a week and not readily noticeable in the daily trading activities report. There is nothing in the record to show that this account generated a monthly activity report which, if it had, should have alerted Fisher to the concentration.

Jan Haraszthy, a retired wine merchant, opened a Merrill Lynch "ready asset trust" account in the Spring of 1982 with a deposit of $15,000. Shortly thereafter, Matl, his AE, strongly recommended that he purchase units of a tax exempt municipal investment trust ("MIT"). Haraszthy declined to do so and told Matl specifically not to touch the funds, particularly since he did not need the tax advantages of an MIT.

Upon returning from a brief vacation, he learned that Matl nevertheless had transferred his funds out of the ready asset account to purchase MIT units. He called Matl to complain about this and was told that he had, in fact,

authorized the transaction and, further, that in any event Haraszthy was "stuck" with the purchase. Immediately thereafter, in early May of 1982, Haraszthy complained to Trujillo of the unauthorized transaction and asked that his ready asset account be restored to its original position. Respondent advised that this could cost him "a couple of hundred dollars". Trujillo stated he would investigate the matter and call Haraszthy back.

Being unsuccessful in hearing from or contacting Trujillo, on May 17, 1982, Haraszthy wrote this Commission to complain of the unauthorized transaction. On May 24, he received a letter from the New York Headquarters of Merrill Lynch advising that an investigation was being made. A month thereafter, he received another letter from the same office advising him that all of the trades relating to the MIT purchase will be cancelled and an adjustment made to the ready asset trust account. During this interval, Trujillo began his investigation by speaking to Matl who insisted that the purchase of the MIT was authorized by Harazthy. Trujillo, however, decided to believe the customer but assumed that Matl's contentions were probably based upon a misunderstanding of the customer's instructions. Therefore, he caused the trade to be reversed and adjustments made on May 10, effective May 17, 1982. He also directed that Matl's commission on the

transaction be denied. He also advised Fisher of his decision to reverse the trade and expressed to him the opinion that Matl's tactics in persuading customers to enter into transactions against their will was inappropriate.

Martin Koyle, a physician, having had a previous experience with a Merrill Lynch ready assets account, opened a similar one in March 1982 at the California Street Office with a deposit of $10,000, his life's savings. He intended to withdraw these funds within a year because of an expected move to Boston. His net worth at that time was approximately $20,000 to $25,000.

Matl, his AE, suggested that Dr. Koyle, might want to use his funds in other "conservative investments", and urged that the $10,000 be invested in $100,000 of long-term U.S. Treasury bonds on a 10 percent margin basis, representing that an anticipated decline in interest rates would cause the price of the bonds to increase, and a profit for Dr. Koyle by the end of the year of between 100% and 300% on his investment. Matl further reassured that because this was a safe and conservative investment the most he could lose would be about $2000. Matl did not mention that interest would be charged on the $90,000 margin loan, nor did he give Dr. Koyle any oral or written information concerning the risks of margin trading.

When at first Dr. Koyle expressed reluctance to enter into the proposed transaction and wanted time to investigate further, Matl pressured him by stating that he would have to have an answer that day and reassured him, as he repeated many times thereafter, that this was a conservative investment in which he could not lose. He then agreed to the purchase.

Subsequently, interest rates began to rise and the value of the bonds began to decline resulting in a margin call which was met by the selling of some of the bonds. When Dr. Koyle suggested that he get out of the treasury bonds investment, Matl persisted in his advice that he not do so, that it was a still safe investment and that Koyle would eventually make money. However, the price continued to decline resulting in further margin calls. Ultimately the $10,000 investment had been reduced to $1,700.

In late June, 1982, Dr. Koyle wrote to Jack Dulong, the California Regional Director of Merrill Lynch, complaining of the high pressure tactics of an (unnamed) broker in the California Street office putting him in long-term government bonds on margin, and of his misleading statements as to the maximum amount of loss to be incurred. Failing to receive a response to this letter, he wrote to the New York Headquarters of Merrill Lynch. DuLong forwarded Dr. Koyle's letter to Fisher who turned the matter over to Trujillo. Respondent obtained Matl's version, and then spoke to Dr. Koyle who made a claim

for the difference between his actual losses and the $2,000 maximum loss promised by Matl. Trujillo arranged for him to meet with Fisher. A conference was held at the San Francisco office with three officials of Merrill Lynch (not including Trujillo). They agreed to a settlement of the claims for $3,500, leaving Dr. Koyle with a net loss of $4,800.

Kenneth Elliott, a retired lithographer, having been solicited by Matl, opened a securities account with Merrill Lynch in June of 1982 with the expressed objective of investing in long-term capital gains or tax-free securities and not in speculative investments.

At the recommendation of Matl, he initially invested about $17,000 in a municipal bond fund and two stock mutual funds between June and September 1982. In December, Matl, without prior authorization, sold these three securities at a profit of about $1,800 and invested the proceeds in 1,404 shares of a mutual gold fund, International Investors. Elliot first learned of this transaction when he received the notices of confirmation. The commission on this transaction, since International Investors had a front-end load of 8 1/2%, about equalled the profits theretofore made in the account. 25/

25/ Thereafter, Matl induced Elliot to purchase additional shares of International Investors on June 6 (596 shares) on January 11 (124 shares) and February 3, 1983 (554 shares. Elliot is still holding the shares acquired by these three purchases.

On January 20, 1983, Matl without prior authorization, sold the original 1,404 shares of International Investors purchased only three weeks before and invested the proceeds in Hecla Mining, all without the consent of Elliott. 26/

Again, he only learned of these transactions when he received the trade confirmations. Matl purchased additional shares of Hecla on January 31, this time on margin (and the only margin transaction in the account). Elliott had not executed a margin agreement but one was sent to him by Matl, which he and his wife signed and was approved by Trujillo some 3 or 4 days after the margin purchase.

Matl had not informed Elliott of the risks of trading on margin or that he would be paying margin interest.

A short time thereafter, on February 11, 1983, Matl advised Elliott that Hecla was "falling apart". Elliott instructed Matl to sell Hecla and get him out of margin and to hold the cash proceeds. Matl sold Hecla but contrary to these instructions, invested the proceeds in an additional 691 shares of International Investors. Elliott tried to get Matl to reverse the last transaction without success.

26/ In accordance with Merrill Lynch policy requiring a manager's approval for the sale of mutual fund shares, both the liquidation of International Investors as well as the previous sales of the mutual funds were approved by the sales manager at the California Street office, Ron Carminati, not by Trujillo.

By the end of March, Matl had left the employ of Merrill Lynch. Hence, what followed thereafter had no supervisory effect over him. Briefly, Elliott later complained to Fisher about Matl's "churning", his unauthorized trading and his refusal to follow instructions as to the proceeds from the Hecla sale. Fisher turned this letter over to Trujillo to investigate, which was the first time he became aware of a problem in this account. Ultimately, Trujillo caused the purchase of 691 shares of International Investors on the previous February 14 to be reversed.

Elliot paid approximately $5,500 in commissions to Merrill Lynch in the 45 days that his account was trading securities, from December 1982 to February 1983.

Dr. Anthony Rienzi, a practicing psychiatrist, opened a CMA account with Merrill Lynch in August, 1982, at the solicitation of Matl, in order to gain the high interest and other features of this account. He told Matl that he had no intention of investing in stocks. His previous securities experience involved trading in "penny" stocks using a fund of about $5,000 for that purpose. His inital CMA deposit was $20,000; over the next several months, he added an additional $30,000 at the urging of Matl.

Aware of a rising stock market, he agreed to allow Matl to invest in stocks provided he would limit losses to no more

than $10,000, since he needed $46,000 in April of 1983 to pay taxes and to buy some property.

In the beginning, trading was done in some stocks recommended by Matl to which Rienzi raised no objection. In March of 1983, he agreed to allow trading in his account in options (having in the interim signed an options account form) subject to the $10,000 limit on losses. Until that time, Rienzi had no complaint as to the handling of his account by Matl, the account balance then being some $58,000. Matl agreed that a balance of $46,000 would be maintained at all times.

In March of 1983, Matl began trading heavily in options for Reinzi on a virtual discretionary basis. Although Rienzi concurred in all of the recommendations that Matl had made with respect to the strategies to be employed, he contends that he was not giving an "informed" consent. Thus, between March 3 and March 18 there was some 37 buy transactions of options with a corresponding sale in each instance, representing the purchase of some $500,000 worth of options for this account and resulting in a net loss of over $40,354.

Many of the transactions involved opening and closing positions in one day, with some being held over night or over a weekend. (Rienzi had instructed Matl not to hold a position in an option overnight or over a weekend due to their

volatility). Thus, on March 8, 1983 alone, Rienzi had purchased 7 call and 2 put options which were closed on the same day with a net loss in these transactions of more that $6,700.

Towards the end of March, Rienzi became concerned about the activities in his account, particularly with the margin purchase by Matl of an oil stock "Natomas" which put Rienzi at risk for some $90,000. He thereupon telephoned Fisher but was referred to Trujillo instead. He complained that Matl had not traded his account in the manner authorized and that he wanted to submit it to arbitration. After several phone calls back and forth in which Trujillo asked for time to examine the account, he informed Rienzi that his account was in a terrible state and ultimately, that all his money was gone. By this time Matl had left Merrill Lynch. Rienzi engaged counsel and proceeded with a claim against Merrill Lynch which was eventually settled for $38,000 in September of 1983.

Discussions and Conclusions

Matl's Violative Conduct

The Order for Proceeding herein alleges that between December 1977 and March 1983, Matl violated the anti-fraud provisions of the securities laws [27/] in misrepresenting and

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27/ Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of any securities (Footnote continued)

omitting to state material facts to individual investors regarding, among other things:

(1) the risks and rewards of listed options trading and the risk of trading on margin;

(2) that he engaged in churning activities by recommending to individual investors securities transactions which were excessive in size and frequency in view of their financial resources and the character of these accounts;

27/ (FOOTNOTE CONTINUED)
by the use of any means or instruments of transportation or communication in interstate commerce, or the use of the mails, directly or indirectly -- to do any of the following:

"(1) to employ any device, scheme or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any ommission to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Section 10(b) of the Exchange Act makes it unlawful, in connection with the purchase or sale of any security, to use or employ "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection or investors."

Rule 10b-5 promulgated thereunder, extends, in effect and with a few language changes, the provisions of 17(a) relating to sales of securities to both the <u>purchase or sale</u> thereof.

(3) that he recommended to these investors unsuitable securities transactions;

(4) that he effected transactions beyond the scope of the authority granted by investors; and

(5) that he failed or refused to liquidate investors' positions as requested.

Options and Margin Trading

The record establishes that Matl failed to disclose to Dickinson, Reeves and DeHeus the risks of trading in options, particularly naked options. 28/ It is true that each of them signed options account opening forms in which they acknowledged receipt of the Options Clearing Corp. prospectus, their awareness of the special risks attendant upon options trading, and that they were financially able to sustain losses. In some cases (Dickinson and DeHeus), where the account had shown sufficient activity to generate a monthly report form for review by Fisher, he sent them a routine letter advising generally of the risks inherent in options trading.

28/ As noted in the Report of the Special Study of the Options Markets to the Securities and Exchange Commission, H.R. Comm. print. IFC3, 96th Cong., First Sess. 1 (1978), transactions in listed options involved "a high degree of financial risk". This is especially true with respect to the sale of naked call options since such transactions can theoretically result in unlimited losses.

In the last analysis, however, the customers paid little heed to these advisories, relying instead on the bold assertions by Matl that he was Merrill Lynch's number one salesman, that he would through his expertise protect them from serious losses, that they should and could "trust" him, that they could not lose, etc. Since the customers were unsophisticated in the ways of options trading, and were repeatedly subjected to Matl's pressures it is only to be expected that they would and did "trust" him in the ways of margin trading, rather than rely upon manuals and letters. Moreover, in some instances, Matl began trading in options for customers even before they executed the options account opening forms and received the O.C.C. prospectus.

The record also shows that customers placed in margin trading by Matl, such as Peak, Christensen, Pennington, DeHeus, Dr. Koyle and Elliott, were not fully aware nor did Matl explain to them, the risks inherent in margin trading. Many of them did not have the resources to meet margin calls when the prices of the securities declined and they faced losing all or substantially all of their investments. As with the options customers, the margin traders also succumbed to the blandishments of Matl, the "number one" salesman who could be "trusted".

The failure to disclose the risks in options and margin transactions, plus Matl's assurances that losses would be

minimal or nonexistent, were material misrepresentations, in that there is "a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of a reasonable shareholder", TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). This is particularly significant with respect to the investors here, most of whom had conservative objectives and lacked the knowledge, understanding and resources to engage in the options and margin trading to the extent in which Matl operated.

As the Commission stated in Michael E. Tannenbaum, 24 SEC Docket 799, 809, SEA Release No. 18429 (Jan. 19, 1982):

> As for customers' sophistication, respondent notes that customers were requested to verify receipt of a prospectus, their income and net worth, and any previous trading history in options, and acknowledge that they wished to commit a portion of their funds to options trading, that they considered themselves sophisticated in investment matters, and that they had sufficient income or other assets to sustain the risk inherent in such an investment. *** In any event, such acknowledgements were no guarantee of customers' 'sophistication', ***. (underlining added)

Churning

In order to establish churning, it must appear: (1) that the broker in question exercised control over the trading in the account; (2) that the trading in the customers' account was excessive in light of his investment objectives; and (3) that the broker acted with intent to defraud, or with willful

and reckless disregard for the interest of his client. Rolf v. Blyth, Eastman, Dillon and Co., Inc., 424 F.Supp. 1021, 1039-1040 (S.D.N.Y. 1977), aff'd, 570 F.2d 38 (1978), cert. den. 439 U.S. 1039; and Mihara v. Dean, Witter & Co., 619 F.2d, 814, 821 (C.A. 9, 1980). Churning essentially involves improper purpose on the part of the broker to derive profits for himself with little regard for the interests of his customer. Stevens v. Abbott, Proctor and Paine, 288 F.Supp. 836, 845 (E.D. Va., 1968).

The record herein establishes that to a lesser or greater extent, Matl churned the accounts of Dickinson, Peak, Reeves, Koyle, Elliott and Rienzi.

While in none of these instances was Matl given direct discretionary authority over these accounts, he, in affect, exercised de facto control. With but few exceptions they relied upon Matl to make all of the trades for their respective accounts. They rarely suggested transactions on their own, particularly with respect to options purchases and margin purchases. It was Matl's salesmanship and strong solicitation which determined the trades. See Mihara v. Dean Witter, supra, P. 821; and Hecht v. Harris Upham & Company, 283 F.Supp. 417 (N.D. Cal. 1968), aff'd 430 F.2d 1202 (C.A. 9, 1970).

Whether trading is "excessive" in the light of the investment objectives of the customer must be examined in the light of the "totality" of the circumstances". Some situations

may be examined in the light of the "turn-over rate", as set forth in Looper & Company, 38 S.E.C. 291, 297 (1957) which is computed by dividing the cost of the purchases by the average investment, the latter representing the cumulative total of the net investment in the account at the end of each month, exclusive of loans, divided by the number under consideration. Thus, an annual turnover rate of six would reflect excessive trading (Mihara, supra, P. 821) but a rate of no more than 1.85 would not (Rolf, supra, P. 1039).

Still, there are other factors which should be examined in order to determine whether churning has occurred with respect to the type of account under consideration, such as the nature of the account, the number of trades and the frequency thereof, the "in-and-out trading", the amount of commissions earned, the length of time the securities were held, and their percentage of the representatives's income. See Stevens v. Abbott Proctor & Paine, supra, at p. 846. In the Dickinsen account, there were purchases of over $800,000 worth of securities on an initial deposit of $30,000 which produced commissions of $30,000 in six months of trading. In the case of Patricia Roane, who wanted her money to remain in a ready asset account, Matl in disregard of her instructions invested her funds in a speculative oil stock which she immediately demanded to be reversed. In the Reeves account where there was initial investment of $6,000, commissions of

$5,000 were earned within a 3 1/2 month period. With respect to Koyle, a young physician just starting out in practice, Matl put him in a highly leveraged (90%) purchase of treasury bonds which carried a high commission for himself. In Elliott's case, Matl put him in and out and back again in a gold fund with a high front-end load, with total commissions earned of $5,500 in about a month and a half. This points to excessive trading in this account. Finally, wild and numerous options trading in a two-week period in March of 1983 in the Rienzi account involving multiple purchases and sales of put and call April options, resulted in large commissions for Matl and putting Rienzi at risk for the loss of large sums contrary to his expressed instructions. These all point to excessive trading on Matl's part.

With respect to the third element requisite in the establishment of churning, "scienter" - or the intent to defraud- this requirement may also be satisfied by a showing of reckless conduct on the part of the broker, i.e., the willful and reckless disregard for the interests of his client. Hence, a willful intent to defraud need not to be found and in this instance, the "totality of the circumstances" is sufficient to establish that recklessness.

In view of the foregoing, it is concluded that the charge of excessive trading, or churning, has been adequately

established against Matl. Moreover, churning is in itself a scheme or artifice to defraud and a fraudulent and deceptive device within the meaning of Rule 10b-5. Mihara v. Dean Witter & Co., supra, at page 821; Cosetello v. Oppenheimer & Co., 711 F.2d 1361, 1367-8 (7 Cir. 1983). 29/

Suitability

The allegation that Matl recommended to investors securities transactions which were unsuitable is premised on New York Stock Exchange Rule 405 (the so-called "Know Your Customer" rule) and NASD Rules of Fair Practice, Article 3 Section 2. 30/

29/ Judge Conner of the U.S.D.C., S.D.N.Y. stated in the recent case of Levine v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., decided July 22, 1986, C.C.H. Fed. Sec. L. Rep., current transfer binder, ¶92,841, at p. 94,090:

"I am sure that Merrill Lynch's attorneys do not need plaintiffs' attorney to tell them that churning is a violation of Rule 10b-5."

30/ The NASD Rule reads: "In recommending to a customer the purchase, sale or exchange of any security, a member should have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other securities holdings and as to his financial sitatution and need.

The "Know Your Customer rule" reads, in part, "Every member organization is required through . . . a principal executive officer or person designated . . . to (1) use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization. . ."

A broker who knowingly engages in unsuitable trading violates the antifraud provision of the federal securities laws. Prudential-Bache, Securities, Inc., SEA Rel. No. 34-22755, 34 S.E.C. Docket 1456, 1473 (January 2, 1986), Citing Mauriber v. Shearson American Express, 567 F.Supp. 1231 (S.D.N.Y. 1983).

In its brief, respondent concedes that unsuitable recommendations were made by Matl for Roane, Pennington, Iaccarino, Reeves, Koyle, Mehan, Christensen and Elliott. This concession is well in accord with the facts developed at the hearing.

It is apparent that the elements involved in the suitability issue are similarly involved in the questions of churning and the allegation of fraudulent misrepresentations or omissions.

Unauthorized Trading and Refusal to Execute Orders

The record establishes that in the accounts of Roane, Iaccarino, Haraszthy, Elliott and Rienzi, Matl engaged in transactions which were not authorized by the customers at the time they were made.

Matl's presistent salesmanship and "hard sell" approach towards Mrs. Roane prevented him from understanding her desire not to purchase the stock involved. Matl disregarded the wishes of Iaccarino to be invested in conservative

stock by selling his utility holdings and buying more speculative stock. In the Haraszthy account, Matl effected the purchase of units of a tax exempt MIT despite Haraszthy's expressed directions not to touch the funds in his account, and in disregard of the absence of need for the tax advantages of an MIT. Matl disobeyed Elliott's instructions to hold the proceeds of the Hecla sale and otherwise made investments without prior approval of the customer. Matl took Rienzi through a rapid series of unauthorized options transactions in a very brief period without prior approval, thereby putting him at risk for the loss of large sums contrary to the customer's express instructions.

Matl disobeyed direct instructions from Dickinson to sell out his position involving 60 Teledyne naked call options, thereby causing far greater losses than would have been sustained had his instructions been obeyed.

Respondent in his brief takes the position that unauthorized trading, <u>without more</u>, is not fraud and is actionable, at best, as a breach of contract, citing <u>Brophy v. Redivo</u>, 725 F.2d, 1218, 1220 (9th Cir. 1984) and other cases in other circuits. The basis of these holdings is that in <u>civil</u> fraud actions under Section 10(b) and Rule 10b-5 there must be a showing of scienter and the existence of a manipulation or a scheme to defraud. In situations

not involving a manipulative scheme, the conduct alleged as fraudulent must include deception, misrepresentation, or non-disclosure. Pross v. Baird, Patrick & Co., Inc., 585 F.Supp 1456 (S.D.N.Y. 1984).

With respect to the customers involved herein, more than a mere unauthorized transaction occurred. Thus, when Dickinson gave Matl instructions to sell out his Teledyne calls, Matl made the representation that there would be a turnaround in the price, and, further, that a sudden sell-out would adversely affect other of his clients owning the same security. There does not appear to be any truth to these representations. Matl misrepresented to Iaccarino that experts at Merrill Lynch were issuing recommendations not to sell the speculative stocks in which he had placed him. He misrepresented that Haraszthy was "stuck" with the purchase of the MITs. Hence, with respect to these accounts, there was more than a mere unauthorized trade; the trades were accompanied by misrepresentations.

Moreover, this is not a private civil action but a proceeding in the public interest based upon violations of all the anti-fraud provisions found in Section 17(a) as well as Section 10b and Rule 10b-5.

It is true that one of the elements required to be established to show a violation of Rule 10(b)-5 and Section

17(a)(1) of the Securities Act is that the respondent acted with "scienter", defined as "a mental state embracing intent to deceive, manipulate, or defraud". Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, n.12 (1976). Scienter is established by knowing or intentional conduct. Aaron v. S.E.C., 446 U.S. 680, 690 (1980). It may also be established by reckless conduct. Nelson v. Serwold, 576 F.2d 1332, 1337-8, (9th Cir.), cert. den., 439 U.S. 970 (1978). Courts recognize that, absent an admission by defendant, scienter may be inferred from circumstantial evidence which "can be more than sufficient". Herman & McLean v. Huddleston, 103 S.Ct. 683, 692 n.30 (1983). There is no question that respondent engaged in reckless conduct. (Respondent's brief at page 4 attributes Matl's compliance problem as being "his reckless, egotistical salesmanship".) Non-disclosure of margin account credit terms has been held fraudulent in Angelastro v. Prudential-Bache Securities, Inc., 764 F.2d, 939, 943-944 (3rd Cir.) 1982)) cert. den. No. 85-421 (October 21, 1985). Misrepresentation of risks of margin trading is fraudulent. Arrington v. Merrill, Lynch, Pierce, Fenner and Smith, 651 F.2d, 615 (9th Cir. 1981). Confirmations to a customer of unauthorized trades is fraudulent (R.A. Holman & Co., v. S.E.C., 366 F.2d, 446, 451 (2nd Cir. 1966)).

In any event, scienter is not a required element of violation of Subsections (2) and (3) of Section 17(a),

Aaron v. S.E.C., supra, both of which have been found to have been violated by Matl. Nor do these subsections require the existence of a scheme to defraud, deceive or manipulation. Under those subsections, the mere engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser sufficiently establishes the fraudulent conduct of the perpetrator, in this case, Matl.

Moreover, as seen hereinabove, the churning violation is in itself a scheme or artifice to defraud and a fraudulent and deceptive device within the meaning of Rule 10b-5.

Thus, the unauthorized transactions, coupled with the misrepresentations and the fact that violations of Section 17a(2) and (3) do not require scienter, are sufficient to sustain the allegations in the order concerning unauthorized transactions and failure to liquidate an investor's position. (See Corbey v. Grace, 605 F.Supp. 247 (D. Minn., 1985) [31/].

31/ Other conduct of Matl would support findings that he was engaged in a continuing course of deceptive and fraudulent conduct, although not specifically mentioned in the Order for Proceedings. He recommended "no-opinion" stocks in violation of Merrill Lynch regulations, he traded in options before the appropriate account opening forms were signed in violation of NASD Rules, he traded on margin before approval from the customer's bank employer (DeHeus) in violation of an NASD Rule, he disobeyed promises to Rienzi that he would maintain an account balance of $46,000, and to Mehan that he would (FOOTNOTE CONTINUED)

In his proposed conclusions of law No.4, Trujillio advances a finding that at various times in 1981, 1982 and 1983, Matl did violate Sections 17(a) and 10(b) and Rule 10b-5 and specifically that his violative conduct comprised his "fraudulent recommendation of investments and/or investment techniques to Merrill Lynch customers which were not suitable to the investment objectives, risk tolerance, and/or resources of "said customers". In his supporting brief, at pages 3 and 4, respondent admits that there can be no question that the evidence supports the finding that Matl defrauded many of his customers and blames it on "his awesome powers of persuation, his incredible ability to convince customers", his "relentless" selling style, his "insistent and incessant salesmanship", and his "insensitivity to concepts of risk and suitability", and that the

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31/ (FOOTNOTE CONTINUED)
enter a stop-loss order. Finally, he made misrepresentations as to specific profitability that the customers might derive from his transactions. Thus, he promised Mehan a quick profit of at least 5 points in a particular security, he promised Koyle a profit of between 100% and 300% within a year, he promised Koyle that he would keep losses below $2,000 and he promised Reeves that he had placed him in a no-loss situation.

Predictions of very substantial prices rises to named figures with respect to speculative securities are "the hallmark of fraud". See Alexandria Reid & Co., Inc., 40 S.E.C. 986, 991 (1962) and John H. Brick & Co. v. S.E.C., 43, 52 (1975).

results of his actions were at times, "disastrous". Thus, respondent is willing to concede that Matl violated the anti-fraud statutes but only to the extent of the unsuitability of some customers for the transactions Matl made on their behalf. The record does not justify such a limitation on Matl's fraudulent activities.

Trujillo's Awareness of Violations

As alleged in the order, it is clear that respondent in one way or another became aware of Matl's violations, as heretofore described with respect to the individual customer-witnesses. There is no question that Matl was the leading problem salesperson in the San Francisco Street office. Most of the customer complaints were about him.

According to the operations manager, Nissenson, there were occasional meetings of all the various managers at the California Street Office more or less on a monthly basis, at which Trujillo invariably attempted to engage in discussions concerning Matl's activities. Nissenson states that this subject eventually became the number one item on every agenda; that Trujillo would complain that problems with respect to Matl were "coming out of the woodwork", problems including option suitability, mutual fund difficulties and customer complaints; and that although Fisher would listen to these presentations, he made no comments concerning them.

Merrill Lynch's Awareness

In June of 1982, Trujillo reported to Richard Drew, the Merrill Lynch vice-president in charge of the Surveillance and Review Section, that Matl had been engaging in heavy sales of U.S. Treasury bonds to some 30 or 40 of his customers, and had been allowed higher than normal commissions by the Merrill Lynch bond trader. He also questioned the suitability of the Matl clients to engage in these highly margined transactions. (For example, in the account of Dr. Koyle, $100,000 worth of bonds were purchased with as little as $10,000 in cash).

Motivated in part by the possibility of a kickback scheme in the treasury bond situation, and to a great extent by the expected visit of an S.E.C. investigator to the San Francisco Street Office to investigate complaints about Matl's activities, Drew visited this Office on or about June 17, 1982, to examine the situation first hand. He had discussions with the various managers, including Fisher and respondent. Trujillo complained to him that he had many problems with Matl, that he spent about 60% of his time in investigating complaints concerning him, and gave Drew for review some 46 customer complaint files, including 6 which related to customer-witnesses herein. Drew discussed with Matl his violations of Merrill Lynch policy concerning

recommendations of no-opinion stocks, as well as the suitability for margin purchases by his customers of treasury bonds and other securities.

Drew told Fisher he found problems with Matl in approximately 6 to 9 of the complaints. Fisher expressed an awareness of the situation and questioned whether Matl's employment with Merrill Lynch should be terminated. This matter was taken up at a meeting some 10 days later attended by the regional director, the general counsel, Mr. Drew and Mr. Fisher, at which they concluded that Matl appeared to be a hard-selling account executive with a tendency to ride rough-shod over clients but that they would be interested in retaining him as a salesperson if he could be properly supervised by Fisher and if he would change his selling methods. Respondent also attended that meeting but expressed very little, if any, opinions concerning Matl.[32/] He was not involved in the decision to retain him. A meeting with Matl followed where he expressed his contrition and promised to change his ways.

32/ Although respondent had discussed with Drew Matl's failure to advise customers of the risks of option trading, his execution of unauthorized trades, and the excessive activities which appeared in some accounts, none of these subjects were mentioned at the subsequent meeting in which it was decided to keep Matl in the employ of Merrill Lynch.

As a result of this decision, Fisher in a memorandum dated July 6, 1982 to Matl outlined a series of compliance controls that would be set up to monitor his performance (Exhibit EEE in evidence). The memo included provisions that no new margin accounts would be opened unless authorized by Fisher in advance; that there would be a daily review of all trade tickets; that Matl was to concentrate on preservation of capital for his customers and avoid risky leveraged investments and speculations; that Matl was to tone down his aggressiveness and "hard-sell" approach; that Matl would pay special attention to suitability; and, finally, that he would never recommend "no-opinion" stocks.

The following day Matl replied with a written memorandum in which he stated that he fully understood the severity of the situation that he would comply with all the items set forth by Fisher and, in particular, to avoid hard-sell tactics.[33/]

Trujillo received copies of both memoranda. It would seem that as a result of the decision to retain Matl, Fisher was assuming greater responsibility to supervise Matl.

33/ About a month previously, on June 19, 1982, Matl sent Fisher a memorandum itemizing seven ways (including the ones later outlined by Fisher) in which he promised to avoid future compliance problems. The memo ended with a plea to "Please save me and give me a fresh start. I don't want to be fired."

Further, Trujillo was instructed to refer complaints about Matl for matters occurring prior to July, 1982 to the New York headquarters, but to continue to handle complaints for those occurring thereafter.

About a month later, and as part of the decision to retain him, Matl was invited to the New York office of Merrill Lynch where at his own expense he spent two days in being indoctrinated by employees and officials of Merrill Lynch in such surveillance and compliance matters as suitability, the "Know Your Customer" rule, and disclosure to clients of the risks involved in option and margin trading. 34/

Starting in July 1982 and until March of 1983, Trujillo had no occasion to challenge Matl on any transactions arising during that period. As described by Trujillo, Matl seemed to be a "changed man".

Matl's Discharge

When towards the end of March, 1983, Rienzi complained to Trujillo about the manner in which his account was being traded, respondent examined the Forms 1028 for the previous weeks and concluded that a serious problem existed. At that time, Fisher was out of the country and the sales

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34/ It is noted that out of some 10,000 salespersons employed by Merrill Lynch, very few are given this kind of special training.

manager, Carminati, was in charge of the office. Trujillo, recognizing that the Rienzi trading represented an obvious violation of the agreement Matl had previously made, consulted with the legal and the litigation departments of Merrill Lynch in New York and it was agreed that Matl would probably have to go. Several days later, a conference telephone call was had with Fisher, the New York office officials, and respondent and the other managers at the California Street Office, as a result of which Matl's employment was forthwith terminated.[35/]

In March of 1983, and as noted heretofore, Matl began trading the Rienzi account heavily in options, with some 37 buy and sell transactions during a two-week period, representing the purchase of about $500,000 worth of options for a net loss of over $40,000. On one particular losing day there were 9 buy and sell transactions. Although these many transactions could have been noticed on the daily report Forms 1028, Trujillo failed to notice them.

It is clear that Trujillo once having learned of the situation, played a significant part in the events leading up the dismissal of Matl. What is not clear is whether

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35/ Both Carminati and respondent testified that as Matl was leaving the premises, he turned to respondent and said "You did this to me" and "It's all your fault".

Trujillo was following the daily activities Form 1028 as closely as he should have. He explains his failure to note this obvious breach by Matl as due to his preoccupation with another investigatory matter, his reliance upon his assistants to spot such obvious trading activities (which they did not), and a belief based upon an earlier overheard conversation that Fisher was aware of the trading in options in the Rienzi account. Finally, Trujillo admits he may have been lulled by Matl's good conduct for the period immediately prior.

Respondent's Supervisory Conduct

Respondent concedes that under Section 15(b)(4)(E) he was a person associated with a broker-dealer and Matl was subject to his jurisdiction.

As seen heretofore, Trujillo's duties, as assigned in the Merrill Lynch Exempt Position Manual, were mainly administrative in nature and related principally to branch office operations. However, the Manual also made him accountable for, *inter alia*, dealing with compliance matters, making decisions with respect to minor customer complaints, correction of AE errors, minor policy settlements, and review of activity in customer accounts to determine suitability of investments. He shared with the sales and operations managers the approval of new margin accounts and of customers' mutual fund liquidations.

Additionally, Fisher assigned to Trujillo the duties to review Daily Activities Reports, to review and assign new accounts, to supervise options accounts (he became the branch's Registered Options Principal), and to deal with customer complaints.[36/]

The Order charges respondent with failure reasonably to have supervised Matl, in the following specified respects:

1. In failing to verify the accuracy of investor asset and income figures on new account forms for Matl's customers.

2. In failing to conduct reasonable suitability reviews of Matl's customers as to margin account trading, options trading and tax shelters.

3. In failing to detect and prevent the churning of customer accounts with respect to purchase and sale of mutual funds, options, and common stocks.

Approval of New Accounts

With respect to the first specification, the Division charges that respondent failed to follow Merrill Lynch's procedures by not personally verifying the accuracy of the information on new account forms, especially in view of the many customer complaints about Matl, by directly contacting Matl's customers to

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36/ As noted heretofore, the making of major decisions are deferred by the Manual to the office manager. He alone possesses the authority to impose upon the sales personnel significant sanctions, such as firing, suspensions, and reversal of large trades.

check the asset and income figures presented. However, according to the testimony of Merrill Lynch officials, including its Director of Compliance and Fisher, Trujillo's only obligation was to review the form for completeness and accuracy, not to contact customers to verify the information on the account forms.[37/] They further state that previous accusations of AE misbehavior would not warrant supervisory interference between the AE and his customers.

In the usual Merrill Lynch procedures, Matl's sales assistant would complete new account forms based upon information from Matl and from the customer, and send out copies of Merrill Lynch brochures on such subjects as mutual funds, options and margin trading. In Trujillo's review of these forms, errors or omissions would be called to Matl's attention. In addition, he would evaluate the investment strategies sought, and, in several instances, he narrowed the scope of the options trading strategy requested, as in the Reeves and Christensen accounts. His assistants were under his explicit instructions to carefully scrutinize the form to be sure it was complete and accurate.

In one instance, Trujillo reprimanded Matl in a written memorandum (Exhibit FF) for his failure to complete a new

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37/ The Merrill Lynch Policy Manual, Section 05.32, states that: "The consequences of incomplete or incorrect information on a new account form are the responsibility of the individual accepting the account as well as the account executive who opens it."

account form for one of his customers, emphasized Matl's full responsibility to gather pertinent data from his clients, criticized Matl's "attitude" with respect to such matters, and reminded him to comply with the "Know Your Customer" Rule. A copy of this memorandum was sent to Fisher and to the sales manager.

In two instances, specifically in the Christensen and Reeves accounts, Matl had commenced options trading prior to the new accounts form being signed off by the customer and approved by Trujillo, which was in violation of Merrill Lynch and industry rules. In both instances, detection was primarily the responsibility of the operations manager who was in charge of the wire room where order tickets are processed and checked for appropriate documentation. Trujillo did not report the violations to Fisher, but made sure that the new account forms were eventually signed and filled out as required.

It also should be noted that Trujillo, in his perusal of Matl's account opening forms, detected the fact that DeHeus, being a bank official, was required by Stock Exchange rules to obtain written approval from his superiors to engage in margin trading and instructed Matl to obtain it.

In several of the accounts, the information concerning assets and income was inaccurately set forth. However, there was nothing in the information as presented which should have alerted Trujillo to these inaccuracies or which would call for a separate inquiry by Trujillo of the customer.

Suitability Reviews

The second specification in the Order raises questions as to failure by respondent to conduct reasonable suitability reviews of Matl's customers as to margin account trading, options trading, and tax shelters.

There is nothing in this record to show that Trujillo put in place, in accordance with the duties conferred on him by Fisher, procedures for a "regular and systematic" review of the activity in options accounts to ensure consistency with customer objectives. On the other hand, it is also clear that once a complaint was made he would, among other things, examine the suitability of the transactions complained of.

In the absence of complaints, the only tool utilized by respondent to bring to his attention the suitability of transactions for any particular customer was the Daily Activities Report. However, since it did not contain any client information it was not useful to determine client suitability. Although the examination of this Form would show whether there were transactions on any one day in "no-opinion" stocks, if the AE indicated that they were "unsolicited" (as Matl seemed to do), there would be no reason for any further inquiry. Nor would a review of this report detect such things as unauthorized trading, disobedience of customer instructions, or oral misrepresentations by the AE to his customers.

The Division suggests that because of Matl's history of customer complaints, respondent should have made special suitability inquiries of Matl's customers. Whether this should have been the approach taken, it is clear that reaction to customer complaints was the principal tool used to detect unsuitability. As a result of his investigation of complaints by Matl's customers, he reported to Fisher that Matl was recommending "no-opinion" stocks to Peake; he noted the unsuitability of Roane for the transaction made on her behalf which he caused to be reversed; and, because of the unsuitability of the Iaccarino trades, he caused Matl to be removed as the AE and a more conservative one substituted. Trujillo began an investigation of Haraszthy's complaint and determined that the trades were unsuitable and should be reversed. Having done so, he reported to Fisher criticizing Matl's tactics in persuading customers to enter into transactions against their will. On the other hand, when he turned over the Pennington complaint to Fisher for action, he did not point out specifically (although apparent in the records) that Matl was continuing to solicit "no-opinion" stocks and was putting Pennington into unsuitable trades such as "short against the box" and purchases of high-risk oil stocks.

From the foregoing, it is concluded that once a complaint was filed Trujillo would diligently investigate the question of suitability and report thereon in most cases to Fisher or take

action on his own account against Matl to the extent he was able. As seen, he restricted on suitability grounds options trading for several of Matl's customers. However, respondent was derelict in not complying with the requirements that he systematically and regularly review activity in customer options accounts for suitability. Such a systematic review might have prevented to some extent the unsuitable transactions for which Matl was responsible.

Churning

As to the third specification in the Order that respondent failed to detect and prevent Matl's churning of customers accounts, it is clear that when complaints were filed and investigated by respondent, he discovered evidence of churning and so reported to Fisher. The question remains, however, as to whether respondent could, by reasonable supervision, have detected and prevented the churning before the transactions occurred.

Other than customer complaints, the one source of Matl's transactions available to Trujillo was the Daily Activity Report. The extent of and limitations to the information available therefrom has been discussed above.

Since the Report represents but a single day's activities, it is not the vehicle likely to turn up evidence of churning. Unless there were an unusual number of transactions in one account on the same day, including day-trading, it would be

very difficult to discover the existence of a systematic excess of ongoing transactions designed to earn commissions at the expense of the customers. Churning by its nature spans a period of time far longer than one day.

The most likely vehicle to turn up evidence of churning would be the Monthly Activity Review because of the longer time period covered.[38/] As noted, Fisher had reserved unto himself the examination of these Reviews which were generated when an account had earned a designated dollar amount of commissions, and prepared by one of Trujillo's secretaries and sent directly to Fisher.

It is concluded, therefore, that respondent did not have the ability to take steps to prevent or detect churning in advance or to discover its existence, absent a complaint. However, this is not true with respect to the Rienzi account.

Had Trujillo been reviewing the Daily Activities Report in March of 1983, he would have had to take note of the excessive options trading in Rienzi's account. As described heretofore, between March 3 and March 18 of 1983, there were some 37 buy transactions of options with a corresponding sale in each instance representing the purchase of some $500,000 worth of options for this account. Many of the transactions involved opening and closing positions in one day with some being held

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38/ The Review would also be the vehicle more likely to uncover unsuitable trading.

overnight or over a weekend. On March 8th alone, Rienzi's account showed the purchase of 7 call and 2 put options all of which were closed on the same day with a net loss of mroe than $6,700. Not until respondent reviewed the account on March 25, after receiving Rienzi's complaint, did he note that Matl had engaged in activities in this account that went far beyond the restrictions that had been placed upon Matl by Fisher some nine months earlier. At first, respondent did not call this to Fisher's attention because of a belief that Fisher was aware of the activity. 39/

Trujillo admits that had he noticed the problem earlier, he might have been able to alter the course of events in the Rienzi account. In his defense, he asserts his reliance upon his staff to have detected such excessive options trading, his preoccupation in investigating another matter involving the salesmen in the office, and that he was lulled by Matl's good behavior during the previous nine months.

It can only be concluded that Trujillo's failure to have detected Matl's unusual activity in the Rienzi account as it was occurring represents a supervisory failure on his part. 40/

39/ Respondent ultimately recognized that the Rienzi account represented a "real disaster" and, as noted, led to the firing of Matl.

40/ "Failure to supervise" violations may involve negligent, rather than willful, conduct. See SEC v. Geon Industries, Inc., 531 F.2d 39, 53-54 (2d Cir. 1976).

Additional Matters

The Division asserts additional specifications of respondent's purported failure to reasonably supervise Matl than those set forth in the Order. Basically, these allegations comprise a series of "failures to detect" before they occurred such violations as recommendations of "no-opinion" stocks, several options and margin trades before proper documentation had been submitted, and excessive trading and concentration of trading in customer accounts.

Insofar as these allegations imply that Trujillo should have detected these violations in advance, it has been shown that the supervisory tools at his command were insufficient to achieve such a result. The trades were already done when he received information as to the lack of documentation, the acts of churning, or trading in "no-opinion" securities. In each of these instances, after learning of the facts, Trujillo did take action, such as requiring that documentation be obtained, and reporting to Fisher evidence of churning and "no-opinion" transactions (as in the Peak account).

In fact, the record shows that when Trujillo became aware that Matl was trading customer Peak in a "no-opinion" stock, he sent a written memo (Exhibit NN) to Fisher complaining about Matl's improper and unsuitable margin transactions for Peak,

that the account showed evidence of churning, and;

> "Additionally . . . Victor admits soliciting WGO, which is a no-opinion stock, and it doesn't seem to bother him.
>
> He is now say(ing). . . just get rid of him (Peak). . . he no longer is of any value to Merrill Lynch - he has no more money! Unconscionable behavior for a Merrill Lynch broker ***.
>
> Please review the above and advise what action you want me to take".

As a result of this memo, Fisher required Matl to state in writing (Exhibit PP) that he would no longer recommend a "no-opinion stock" without prior consent from the Compliance Department. The foregoing is illustrative of the fact that Trujillo did not ignore a complaint made to him. Rather, he made an investigation of all the circumstances and reported to Fisher thereon. 41/

Other Supervisory Conduct

Because of the size of the San Francisco Street office, employing some 70 to 80 AEs, and the large number of

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41/ In this regard, the Division contends that whenever Trujillo received a complaint, he would first contact Matl to get his version of the facts, and that he would invariably take Matl's word over that of the customer. It would seem that contacting Matl would be a normal early step and there is no proof to support the latter charge.

accounts,[42/] Trujillo had to delegate many of his supervisory functions to his two assistants. When customer complaints were received, they would first acknowledge to the customer the receipt thereof on a form devised by respondent. They would discuss the matter with the customer and the particular AE involved, research the records of the office, collect the necessary documentation and report to respondent using a form which he devised for this purpose. Trujillo had instructed his staff to keep the customer informed and to return all calls promptly. There would be weekly meetings with his assistants to review their work.

Trujillo's assistants would also review the Daily Activities Reports and were instructed to report to him any unusual transactions such as missing documentation, day trades, concentration of trading in one account, and solicitation of "no-opinion" securities. He devised a form to notify account executives when documentation was missing, advising them of their responsibility to supply such documentation, and threatening a loss of commissions for repeated violations. Trujillo also prepared a special form to be filled in by the AE to explain any solicited transaction in a "no-opinion" stock when shown on the Daily Activities Report.

42/ Between 1981 and 1983, respondent approved approximately 30,000 new accounts with daily totals reaching as high as 100.

In reviewing new account options applications (Form 1014), he would not only check to see that all of the required information was completed but he further would determine what options strategy would be appropriate for the particular account. In the compliance area, he would prepare, from time to time, memoranda and commmunications to the staff, including sales assistants and account executives, as to various compliance matters of a specific or general nature.

Although the record shows that Trujillo performed many of his supervisory duties in a reasonably satisfactory manner, given his newness to the position when he assumed it, his limited sanctioning powers, and the tools available to him to detect improper conduct on the part of the account executives, nevertheless, the record also discloses several shortcomings in the execution of his assigned supervisory functions, specifically his failure to conduct, or set up a program to conduct "regular and systematic" reviews of the activity in the options accounts to insure its consistency with customer objectives (See M.L. Policy Manual Section 03.3). This was particularly critical with respect to Matl who generated a relatively large number of customer complaints and other problems such as where account opening forms were not properly filled in, or where trading had begun in options or on margin without completion of these forms. The issue of suitability looms large in this proceeding, and the use of a regular and systematic review

would have been extremely useful. Instead, Trujillo's supervision of Matl was for the most part reactive to complaints.43/ As stated in Reynolds & Co., 39 S.E.C. 902, 912 (1960):

> "Supervising personnel cannot rely solely upon complaints from customers to bring misconduct of employees to their attention, particularly where customers may be inexperienced and may fail to realize that they have been mistreated . . ."

Then, of course, was Trujillo's failure to take note of the frenzied and extreme trading in options that took place in the Rienzi account in March 1983 as heretofore described.

These failures on the part of Trujillo justify a conclusion that under all of the circumstances disclosed in this record he failed reasonably to supervise Victor Matl with a view to preventing his violations of law.

The record does not demonstrate that Merrill Lynch had established procedures which were reasonably expected to protect against Matl's violations. In particular, the procedures were defective in separating the review of daily activities from the monthly reviews since, as heretofore observed, respondent's review of daily activities would not

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43/ Exceptions to this conclusion can be found in the case of Christensen, who was called to Trujillo's attention by Matl himself reporting a misunderstanding, and with respect to Koyle, whose problems were discovered as part of Trujillo's review of U.S. Treasury transactions.

uncover evidence of churning and unsuitability. 44/

As the Commission has previously pointed out:

> "in large organizations it is especially imperative that the system of internal control be adequate and effective and that those in authority exercise the utmost vigilance whenever even a remote indication of irregularity reaches their attention." Reynolds & Co. & Co., supra, P. 916.

Thus, in Merrill Lynch, Pierce, Fenner & Smith, 45 S.E.C. 185, 189 (1973) where a supervisor was under a company obligation to find an exemption under the Act for any proposed sale when he has reason to believe or if circumstances indicate that the customer offering the security for sale may be an underwriter, and he had been informed that the circumstances strongly indicating that the customer might be a statutory underwriter, his failure to make further inquiries of the customer or to find the exemption under the Securities Act constitutes a failure to reasonably supervise the salesmen involved and resulted in a five-day suspension from association with any broker or dealer for five days.

Again, in Mississippi Valley Investment Company, 46 S.E.C 499, 501-502 (1976), where three elderly women failed to complain about extensive and unauthorized trading in their

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44/ As the Commission observed in Paine, Webber, Jackson and Curtis, 43 S.E.C. 1042, (1969); in finding similar procedues not adequate to detect churning:

> "In our view, these procedures left important gaps. The review of the daily blotter and the underlying order tickets, on which the principal reliance was placed, was not an adequate procedure to prevent or detect excessive trading. . . and is not likely to uncover excessive activity or changes in the nature of the securities traded in a particular account".

accounts over a period of some 2 1/2 years, and the supervisor was advised that the NASD had filed a complaint against the salesman charging unsuitable and excessive transactions in these same accounts, the failure of the supervisor to discuss the matters raised in the complaint with the customers, thereby permitting the salesman to continue his fraudulent activities for several more months, constituted a breach of duty to supervise, and resulted in a suspension from association with a broker-dealer for a period of six months.

The Division places strong reliance upon the Commission's decision in Michael E. Tennenbaum, 24 S.E.C. Docket 799 (SEA Release No. 18429, January 19, 1982).

In that case, the Commission concluded from the facts that the respondent therein was the firm's highest official in the options area, had personal regulatory responsibility with respect to option transactions, was the only official who could give a salesman authority to handle discretionary options account and also had the power to revoke that authority, who did not adhere to his own designed compliance procedures, and, despite specific warnings that the salesman might be engaging in excessive trading, did nothing for almost 3 years. As a result, the Commission approved a sanction suspending the respondent from association with any broker or dealer for one month.

The difference between Tennenbaum's supervisory conduct and Trujillo's conduct is quite apparent. The failure of the

former, as found by the Commission, constitute far more egregious conduct than that found to have been engaged in by respondent herein. The comparison is not even close.

Nor is Trujillo's situation similar to that found in other cases cited by the Division, including Shaw, Hooker & Company, 46 S.E.C. 1361, 1367 (1977), wherein it was found that the supervisor, who had reason to know that the salesman's pitch to his customer was in all probability misleadingly optimistic, should have communicated with customers in order to get a complete picture of what the salesmen was telling them. As a result, the supervisor was censured.

Likewise, in Paine, Webber, Jackson & Curtis, supra, supervisors were also censured wherein the procedures relied upon were not adequate to detect churning, and they failed to comply with their supervisory duties to spot check customer's ledger accounts.

Public Interest

In its brief, the Division proposes that respondent be suspended from association with any broker or dealer for a period of eight months. Respondent, on the other hand, urges that the public interest requires a dismissal of these charges, citing In the Matter of Tallman, 44 S.E.C., 230 (1970) [45/]

45/ In this case, an individual 23 years of age was designated as "compliance director" of the broker dealer with a wide range of duties but very little power to implement them, said power being retained by the dealer's officers. As a result, he did not effectively carry out the supervisory duties he was supposed to perform. The Commission found that there was created merely an appearance of an effective compliance mechanism and in consideration of his inexperience and young age, it held that the public interest did not require that respondent be sanctioned even though he had agreed to a censure in an offer of settlement to the Commission.

In assessing a sanction, due regard must be given to the facts and circumstances of each particular case, since sanctions are not intended to punish a respondent but to protect the public interest from future harm. See Berko v. S.E.C., 316 F.2d 137, 141 (2d Cir. 1963); Leo Glassman, 46 S.E.C. 209, 21 (1975); Robert L. Lynch, 46 S.E.C. 5, 10, n. 17 (1975); and Collins Securities Corp., 46 S.E.C. 20, 42 (1975). Sanctions should also serve as a deterrent to others. Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n. 67 (1976).

Each case, of course, must be decided on its own facts. Thus, unlike the "Compliance Director" in Tallman, where no sanction was imposed, Trujillo was not an inexperienced youngster having no powers to enforce his supervisory authority. On the other hand, neither was his situation like Tennenbaum where there was a total absence of supervision for a long period of time by one who had authority to avoid the fraudulent practices of the account executive.

The record herein establishes that Trujillo for the most part carried out his supervisory duties in a reasonably satisfactory manner. As seen heretofore, he responded to complaints, he imposed punishment within the limitations of his authority and the tools available to him and reported to the office manager, Fisher, when necessary with respect to Matl's violations which he was able to discover.

However, the deficiencies in respondent's supervision have also been noted, particularly with respect to his failure

to conduct systematic reviews of client accounts and his failure to detect the excessive and unusual trading in options in the Rienzi account.

Under all of the circumstances, including consideration of the testimony of three character witnesses on behalf of respondent who testified as to his honesty and reputation for expertise in the field of compliance rules and regulations, and the fact that he has a previously unblemished record, it is concluded that the public interest requirements will be served by a censure of respondent. 46/

Accordingly, it is ordered that Louis R. Trujillo be censured.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision

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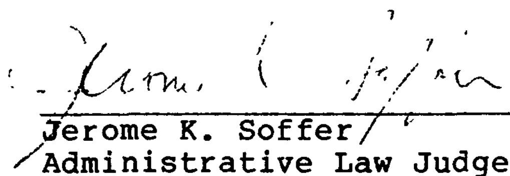
46/ In their briefs and arguments, the parties have requested the Administrative Law Judge to make findings of fact and have advanced arguments in support of their respective positions other than those heretofore set forth. All such arguments herein have been fully considered and the Judge concludes that they are without merit, or that further discussion is unnecessary in view of the findings herein.

pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Jerome K. Soffer
Administrative Law Judge

April 23, 1987
Washington, D.C.