NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. GEORGE A. MURPHY, JR. (CRD No. 1036919) 329 CHERRY LANE HAVERTOWN, PA 19083 Respondent.	Disciplinary Proceeding No. C9A030023 Hearing Officer – DRP **DECISION** May 6, 2004

Respondent is barred from association with any member firm in any capacity for: (1) churning two customers' accounts, in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder and NASD Conduct Rules 2120 and 2110, and (2) recommending unsuitable trading in two customers' accounts, in violation of NASD Conduct Rules 2310 and 2110 and IM-2310-2. Because of the bars, Respondent is not further sanctioned for exercising discretionary power in two customers' accounts without written authority, in violation of NASD Conduct Rules 2510 and 2110.

Appearances

For the Department of Enforcement: David Newman, Regional Counsel, Philadelphia, PA (Rory C. Flynn, Esq., Washington, DC, Of Counsel).

For the Respondent: George A. Murphy, Jr., *pro se*.

Decision

I. Procedural History

The Department of Enforcement filed a six-count Complaint on July 7, 2003, charging that George A. Murphy, Jr. (Murphy or Respondent) churned the accounts of customer DS and the joint account of customers LF and JF, recommended quantitatively unsuitable trading in those accounts, and exercised discretionary power in those accounts without the customers' written authorization or approval from his firm.

Respondent failed to file an Answer, but in response to Enforcement's motion for entry of a default decision, he asserted his innocence and requested a hearing. On February 3, 2004, a one-day hearing was held in Philadelphia, before a hearing panel composed of the Hearing Officer, a current member of District Committee 9, and a former member of District Committee 8. Enforcement called three witnesses, customers DS and LF, and Joseph Tranchitella, a senior compliance examiner for NASD, and introduced eighteen exhibits in evidence. Respondent offered no exhibits but testified on his own behalf.[1]

II. Findings of Fact and Conclusions of Law

A. Jurisdiction

Murphy was registered with NASD member Raymond James & Associates, Inc. (Raymond James) as a general securities representative and general securities principal from March 8, 2000 until his registration was terminated on August 6, 2001.[2] Prior to joining Raymond James, Murphy was associated with several other member firms, including Dean Witter Reynolds, Inc. (Dean Witter) and First Union Brokerage Services, Inc. (First Union).[3]

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[1] References to the hearing transcript are noted as Tr. Enforcement's exhibits are cited as CX; Respondent did not offer any exhibits.

[2] CX-1. Though not currently registered, Murphy is subject to NASD jurisdiction for purposes of this proceeding, because the Complaint was filed within two years of the termination of Respondent's registration with Raymond James and charges him with misconduct that occurred while he was registered. *See* NASD By-Laws, Article V, Section 4.

[3] CX-1.

B. Trading in the Accounts of DS

In 1998, DS opened a brokerage account at First Union with approximately $30,000 to $40,000 he had inherited. DS, who was then forty-six, had no experience in the stock market. Respondent, who was First Union's director of brokerage services in Pennsylvania, was his account executive; DS transferred his account to Dean Witter when Respondent moved to that firm in 1999. (Tr. 100-103, 219.)

When Respondent moved to Raymond James in March 2000, DS again transferred his account. DS signed new account forms at that time but did not discuss his trading goals or objectives with Respondent in detail.[4] Respondent, who completed the forms while meeting with DS in March 2000, asked the customer if he wanted to "do a little high risk." Respondent did not explain what type of trading would be involved in "high risk" but told DS that he could lose money as quickly as he made it. DS gave Respondent permission to "play with" a percentage of his portfolio but instructed that he "leave the rest alone."[5] DS agreed to some high risk trading, because he had known the Respondent for two years and trusted him. (Tr. 107-109, 176, 220, 241.)

In March 2000, DS was working as a plumber and told Respondent he earned "near" $50,000 annually. Aside from his residence and bank accounts, he had no assets other than his two brokerage accounts.[6] In the spring of 2000, the combined value of his

[4] DS testified that he discussed his investment goals with Respondent when he first opened his account in 1998. At that time, Respondent recommended investing in "some kind of fund," but DS did not understand the description and Respondent "might as well be talking French." (Tr. 101.)

[5] At one point, DS testified that he told Respondent he could "play games" with 25 percent of his portfolio. (Tr. 107-108.) He later testified that he gave Respondent permission to take ten percent and "play games" with that amount. (Tr. 176.)

[6] DS testified that based on a friend's advice, and after consulting Respondent, he spent approximately $7,000 to purchase gold with money he inherited in 1998. (Tr. 136-137.)

brokerage accounts was approximately $100,000 to $120,000.[7] His new account form, which Respondent completed, showed income between $50,001 and $100,000, net worth of $100,001 to $250,000 (excluding personal residence), and a primary investment objective of growth. (Tr. 101-102, 104, 106, 110, 112; CX-2; CX-3.)

While at First Union, Respondent made few trades in DS's account. Though he apparently increased trading in DS's account at Dean Witter,[8] Respondent called DS prior to every trade. According to DS, this pattern changed at Raymond James. (Tr. 103-104, 112.)

In May 2000, DS asked Respondent about a "happiness" or active trade letter he had received from Raymond James.[9] Respondent told DS it was of no concern. Because DS trusted the Respondent, he signed the letter to confirm that "the size and frequency of the transactions in [his] account are in accord with [his] investment and trading objectives." DS refused to sign two subsequent letters, however.[10] (Tr. 121-122; CX-5.)

[7] DS opened a second (retirement) account with approximately $55,000 from a defunct 401(k) account. (Tr. 113.)

[8] DS received a "happiness" letter about trading in his account while Respondent was at Dean Witter. (Tr. 151-153.)

[9] Though no evidence was elicited regarding "happiness" letters, the Hearing Panel notes that many firms will generate and send a letter to a customer whose account is being actively traded to confirm that the activity has been approved by the customer.

[10] Enforcement introduced two letters from Raymond James, dated July 7, 2000 and November 22, 2000, advising DS of the number of trades in his account and gross commissions generated. (CX-6; CX-7.) The July letter states that DS suffered a realized loss of $2,847.12 on 73 transactions, resulting in $5,602.47 in commissions (in three months) but does not refer to a specific account. The November letter references 42 transactions processed in DS's personal account, generating $13,251.50 in commissions (in eight months). Though DS testified that he was not sure he had received the two letters, these exhibits appear to be the two "happiness" letters that DS declined to sign.

In the spring of 2000, DS talked to Respondent two or three times per month, but they did not discuss each trade in his accounts.[11] DS did not recall giving Respondent discretion to trade his accounts but trusted the Respondent, even after accumulating a stack of customer confirmations about three inches high. (Tr. 116-117, 134-135, 148.)

As he started losing money, DS called Respondent more frequently. Even though he knew little about the stock market, DS believed "something was wrong" when Respondent sold a stock only to buy it back the following day. DS had not initiated these trades. When DS saw the account value dropping, he called Respondent repeatedly to ask about the account, and eventually instructed Respondent to pull his money out of the market. (Tr. 124-125, 166-167, 171-172.)

DS testified that he had told Respondent to keep $10,000 in cash in one account for an emergency.[12] When DS saw $10,000 "disappear," he took his trading records to friends at First Union, one of whom (LC) said that Respondent was churning the accounts. DS did not understand the term, which LC defined as buying and selling stocks to make commissions. After DS told LC his concerns, she drafted a letter that DS sent to Raymond James in early January 2001. (Tr. 114-115, 126-128; CX-8.)

In the letter, DS wrote that he had asked Respondent to curtail trading in his accounts in October 2000.[13] DS said he had also asked Respondent to maintain $10,000 in cash that no longer appeared on his account statement.

[11] Respondent disputes this testimony and claims that he and DS had many conversations and meetings to discuss stocks. (Tr. 230-231.)

[12] Respondent disputed that DS told him to keep $10,000 liquid in his account. (Tr. 222.)

[13] DS sent two letters to Raymond James in January 2001. *See* Cx-8; CX-9.

In response, DS received a phone call from a supervisor at Raymond James, who pointed out that DS had signed a letter stating he was happy with the handling of his account. DS was not satisfied with the firm's response and sent complaint letters to the compliance division of Raymond James and to the SEC. In April 2001, DS moved his accounts back to First Union. (Tr. 129-132; CX-10; CX-11.)

Between April 28, 2000 and October 31, 2000, DS lost approximately $18,300 in his regular account and approximately $6,357 in his retirement account.[14] During this six-month period, there were approximately 165 trades in his regular account and approximately 113 trades in his IRA account,[15] with approximately $272,057 in purchases in the regular account and approximately $168,645 in purchases in the IRA account.[16] Based on the dollar amount of purchases from May through October 2000, the

[14] The first cause of Complaint alleges that Respondent engaged in misconduct in or about May 2000 through in or about October 2000. The Hearing Panel reviewed monthly account statements in evidence and noted the amount lost during this six-month period. The Hearing Panel also noted that DS lost more money in his two accounts in November 2000 ($26,555), than the total amount lost during the preceding six months ($24,657). *See* CX-3; CX-4 (DS's monthly account statements). It does not appear, however, that Enforcement charged Respondent with wrongdoing for trading in DS's accounts in November 2000, despite 50 trades and $90,410 in purchases during that month. *See* CX-17 (turnover ratio calculated for May through October 2000 only). Accordingly, the Hearing Panel did not consider the trading in DS's accounts during November 2000 in rendering this Decision.

[15] The Complaint alleges that Respondent recommended 185 transactions in the personal account and 119 transactions in the IRA account during the relevant period. In reviewing the evidence, the Hearing Panel noted 165 transactions in DS's personal account and 113 transactions in his IRA account during this period. The discrepancy may arise from two missing pages in the account statements in evidence. The difference is not material to the turnover ratio or the cost-equity ratio that Enforcement calculated to demonstrate that trading in these accounts was excessive.

[16] Enforcement calculated $256,997 in purchases in the regular account. *See* CX-17. The Hearing Panel relied on its independent review of the evidence to determine the amount of purchases in DS's regular account. *See* CX-3.

turnover ratio in DS's regular account was 5.83 and 2.81 in his retirement account. This would equate to an annualized turnover ratio of 11.66 and 5.63, respectively.[17]

Additionally, DS paid approximately $10,292 in gross commissions for trades in his regular account and approximately $7,269 in gross commissions for trades in his retirement account during this period.[18] This is the equivalent of an annualized commission-to-equity ratio of 44% in the regular account and 24% in the retirement account.[19]

C. Trading in the IRA account of LF and JF

LF and his wife, JF, opened a joint IRA account with Respondent at First Union after a bank teller referred them to Respondent for help with retirement planning.[20] LF's only prior investment experience was with mutual funds.[21] (Tr. 28-29, 32-33.)

When Respondent moved to Dean Witter a few months later, LF maintained his account at First Union, but he transferred the account to Raymond James shortly after Respondent moved there. When LF made the transfer in April 2000, he was almost 55 years old and working as a banquet server at the Four Seasons Hotel in Philadelphia. He and his wife, a certified nursing assistant, had a combined annual income of

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[17] CX-17. Based on the Hearing Panel's review of the evidence, the turnover ratio is slightly higher (5.83 during the six-month review period or 11.66 annualized) than that alleged by Enforcement (5.51 and 11.02, respectively).

[18] Again, these figures are based on the Hearing Panel's review of the evidence. *See* CX-16. The discrepancy is minimal. (Enforcement calculated $10,847 in gross commissions for the regular account and $7,334 in gross commissions for the IRA account. *See* CX-17.)

[19] CX-17. Using the commissions calculated by the Hearing Panel, the annualized commission-to-equity ratio was slightly lower (44%) than Enforcement's computation (46%).

[20] LF could not recall exactly when this occurred, but based on other testimony, it appears that he and his wife opened this account in 1998 or early 1999.

[21] Though this was a joint account, there was no evidence regarding JF's involvement with the account or that she had any contact with Respondent. For brevity, it will be referred to as LF's account.

approximately $100,000. Their approximate net worth was between $250,000 and $300,000. (Tr. 30-31, 33-34, 36-38.)

LF signed a new account form when he moved his IRA account to Raymond James, but Respondent completed the forms. The new account form reflected annual income between $100,001 and $200,000, net worth between $250,001 and $500,000 (excluding personal residences), and an investment objective of growth. As of April 28, 2000, the value of LF's IRA account was $103,908. (Tr. 220, 241; CX-12; CX-13.)

In April 2000, LF told Respondent he wanted enough money to retire in ten years but did not discuss with Respondent the types of securities or trading he preferred, because he knew very little about the subject. LF believed Respondent was "running the show" and told him "you know better than I," but did not recall signing an agreement giving Respondent discretion to trade his account. LF trusted Respondent and left "everything in [his] hands." (Tr. 38-44, 76, 87-88, 98-99.)

When the account value dropped, LF phoned to question Respondent, who explained that the economy was bad but predicted that the market would bounce back. LF made a few subsequent calls to Respondent, which he failed to return. At some point, Respondent's branch manager asked LF to attend a meeting to discuss the amount of trading in his account.[22] The manager characterized it as "heavy" trading, and LF replied that he was at Respondent's mercy.[23] In August 2001, LF received a call from a man

[22] Respondent testified that the meeting occurred in January 2000 (Tr. 234), but he was not registered with Raymond James at that time. The Hearing Panel believes Respondent misspoke and intended to say that the meeting occurred in January 2001.

[23] Respondent testified that his former supervisor suggested they meet with LF due to his age and the amount of trading in his account. Respondent agreed that a meeting was in order to "confirm" that LF still wanted to trade aggressively. According to Respondent, as a result of the meeting, LF decided he did not want to be as aggressive, and Respondent stopped trading his account. (Tr. 234-235.)

who identified himself as LF's new broker at Raymond James. After another conversation with the branch manager, LF contacted an attorney about losses in his account.[24] (Tr. 46-48, 50-53, 61, 67.)

From May 31, 2000 to December 29, 2000, LF lost approximately $40,936 in his IRA account.[25] During this seven-month period, there were 197 trades in the account and approximately $428,520 in purchases.[26] The fewest transactions occurred in July (11), while the most occurred in November (44). The turnover ratio was 4.38 for the period, which equates to an annualized rate of 7.49. Additionally, LF paid approximately $16,036 in gross commissions for trades between June 1, 2000 and December 29, 2000, for an annualized commission-to-equity ratio of 27%.[27] (CX-13; CX-18.)

D. Discussion

The charges considered by the Hearing Panel were whether Respondent: (1) churned the customers' accounts, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder and NASD Rules 2210 and 2110; (2) recommended unsuitable trading in those accounts, in violation of NASD Rules 2310 and 2110 and IM-2310-2; and (3) traded the customers' accounts without discretionary authority, in violation of NASD Rules 2510 and 2110.

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[24] Raymond James paid $50,000 to settle LF's claim against the firm and Respondent. (Tr. 53-55.)

[25] The second cause of Complaint alleges misconduct from in or about June 2000 through in or about December 2000.

[26] The Complaint alleges 199 transactions during this period; again, the slight discrepancy is most likely due to a missing page in one account statement and is immaterial.

[27] In reviewing the evidence, the Hearing Panel calculated a slightly higher amount in commissions than did Enforcement, but the difference did not change the commission-to-equity ratio computation.

1. Churning

Churning violates the antifraud provisions of the Exchange Act [28] and NASD Rules 2120 and 2110.[29] "Churning occurs when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interests, for the purposes of generating commissions." *Sandra K. Simpson*, Exch. Act Rel. No. 45923, 2002 SEC LEXIS 1278, at *52 (May 14, 2002), quoting *Olson v. E.F. Hutton & Co*., 957 F.2d 622, 628 (8th Cir. 1992) (other citations omitted).

Churning has been found where the broker exercised control over an account, trading was excessive in light of the investment objectives, and the broker acted with intent to defraud or with reckless disregard for the interests of the customer. *See Dep't of Enforcement v. Castle Securities*, No. C3A010036, 2004 NASD Discip. LEXIS 1, at *14 (NAC Feb. 19, 2004); *Roche*, 1997 SEC LEXIS 1283, at *12-13. Here, all three elements have been met.

a. Control

Control is established if the account is discretionary (*Peter C. Bucchieri*, Exchange Act Rel. No. 37218, 1996 SEC LEXIS 1331 (May 14, 1996)), or if the broker exercises *de facto* control of the account. *De facto* control of an account may be shown when the client does not understand the trading activity in his or her account or routinely follows the broker's advice. *District Business Conduct Committee v. Gliksman*, No. C02960039, 1999 NASD Discip. LEXIS 12, at *24 (NAC March 31, 1999).

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[28] *Donald A. Roche*, Exchange Act Rel. No. 38742, 1997 SEC LEXIS 1283 (June 17, 1997).

[29] Conduct Rule 2120, NASD's anti-fraud rule, parallels SEC Rule 10b-5. *Dep't of Enforcement v. U.S. Rica Financial, Inc.*, No. C0100003, 2003 NASD Discip. LEXIS 24, *14, n. 5 (NAC Sept. 9, 2003).

Although neither DS nor LF gave Respondent written authority to exercise discretion in trading his account, each customer turned over decision-making to him. Respondent testified that he met many times with DS and discussed as many as ten stocks during a typical conversation. He often recommended the price at which DS should buy or sell a specific stock, then asked if DS agreed with his assessment.[30] DS testified that this might have happened a few times while Respondent was at Raymond James but was not sure.[31] Even if Respondent's testimony is credited, DS was not directing the trading in his own accounts; he simply agreed with and followed Respondent's advice.

Similarly, LF testified that he left all decisions to Respondent, who was "running the show." LF said he trusted Respondent and left "everything in [his] hands." Respondent did not dispute this, except to say that LF did not agree with Respondent's recommendation to sell his mutual funds.

Furthermore, the customers testified that they did not understand much of the information on their monthly account statements and essentially focused on comparing the current value of the account with the value of the account from the prior statement.[32] They were unsophisticated investors, with little or no experience in the stock market, who trusted Respondent with their accounts. Their testimony on key points was quite similar, entirely believable and showed they lacked sufficient experience or knowledge to evaluate Respondent's recommendations. The Hearing Panel credits the customers' testimony and finds that Respondent controlled these accounts.

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[30] Tr. 230-231.

[31] Tr. 146-148.

[32] LF said he looked at the account value or "principal" amount of money in his account. (Tr. 49, 78.) DS testified that the account statement was "Martian" to him, and he only understood the current account value versus the account value at the end of the prior month. (Tr. 144, 146.)

b. Excessive Trading

Several factors, including the turnover ratio, the cost-equity ratio, "in and out" trading, and the number and frequency of trades in an account may provide a basis for a finding of excessive trading. *Gliksman*, 1999 NASD Discip. LEXIS 12, at *25 (other citations omitted). It is generally recognized that an annual turnover ratio of six reflects excessive trading (*Bucchieri*, 1996 SEC LEXIS 1331, at *11, n. 11, citing *Mihara v. Dean Witter & Co., Inc.*, 619 F.2d 814, 821 (9th Cir. 1980)), though lower rates may provide "strong support" for a finding of liability. *See, e.g., Roche*, 1997 SEC LEXIS 1283 (turnover rates of 3.3, 4.6 and 7.2); *Michael H. Hume,* Exchange Act Rel. No. 35608, 1995 SEC LEXIS 983 (April 17, 1995), citing *Samuel B. Franklin & Co.,* Exchange Rel. Act No. 7407, 1964 SEC LEXIS 562 (Sept. 3, 1964) (turnover rates of 3.5 and 4.4).

A review of monthly statements for DS's accounts shows that from May through October 2000, Respondent placed 165 trades in DS's regular account and 113 trades in his IRA account, reflecting approximately $272,058 in purchases in the former and approximately $168,645 in the latter. The average monthly equity was $46,665 in the regular account and $60,057 in the IRA account. For the six-month period at issue, the turnover rate in DS's regular account was 5.83 and 2.81 in his retirement account, for an annualized turnover rate of 11.66 and 5.63, respectively.[33]

[33] The turnover ratio is calculated using the "Looper Formula," named for *Looper & Co.,* 38 SEC 294 (1958), which divides the total cost of purchases made during a given period by the average monthly investment. In accounts that primarily hold securities rather than cash, a modified Looper formula is used, which divides the total cost of purchases by the average monthly equity. *See Dep't of Enforcement v. Stein*, No. C07000003, 2001 NASD Discip. LEXIS 38, at *16, n. 15 (NAC Dec. 3, 2001), citing *Allen George Dartt*, 48 SEC 693 (1987). The modified formula was utilized here.

A review of LF's account statements shows that from June through December 2000, Respondent placed a total of 197 trades in LF's IRA account, reflecting approximately $428,520 in purchases. The average monthly equity was $97,940. For the seven-month period, the turnover ratio in LF's account was 4.38, for an annualized turnover ratio of 7.49.

The high turnover rate reflects excessive trading in each of these accounts. This finding is further supported by a high commission-to-equity ratio, which measures the amount an account must appreciate on an annual basis to cover commission costs. *Cf. Frederick C. Heller*, Exchange Act Rel. No. 31696, 1993 SEC LEXIS 14, at *4 (Jan. 7, 1993) (excessive trading is established by a high cost-equity ratio, i.e., costs associated with operating the account, commissions plus margin interest). Here, the annualized commission-to-equity ratio was quite high -- 44% in DS's regular account, 24% in his retirement account, and 27% in LF's account.

Turning to the customers' investment objectives, their new account forms are identical. Each lists "growth" as the primary investment objective, and "high" for the level of risk tolerance. Respondent testified that he completed the forms while consulting the customers, and he believed that both DS and LF had high tolerance for risk, "because they could do what they needed to do."[34] It appears that Respondent made this determination for his customers.

DS testified that his only objective was "to make money."[35] While Respondent asked if he was interested in "a little high risk," Respondent did not define the term. DS

[34] Tr. 225.

[35] Tr. 143.

allowed Respondent to "play around" with a small percentage of his portfolio, a portion that did not warrant selecting "high" as the level of risk tolerance on DS's new account form, in the Panel's view.

LF expressed only one investment objective -- he wanted enough money to retire comfortably in ten years. Respondent testified that with a time horizon of ten years, LF could be aggressive with this account.[36] While the Panel agrees that LF had a fairly conservative portfolio when he transferred his account to Raymond James, and that a different strategy might have been needed to meet LF's objective, the level of trading activity in his account was excessive and unwarranted.[37] This was particularly true in the second half of 2000, when the number of transactions rose from 17 in June and 11 in July, to 26 in August and 22 in September, before jumping to 40 in October, 44 in November and 37 in December.[38]

There is no credible evidence that Respondent had LF's approval to take such an aggressive approach, or that he discussed his trading philosophy with his customer, who deferred all decisions to Respondent. Furthermore, Respondent conceded that the amount of trading in LF's account prompted his supervisor to meet with LF to discuss that very topic. Trading in LF's account dropped precipitously thereafter -- there were only seven trades during the seven months between the January 2001 meeting and the

[36] Tr. 229.

[37] When LF opened the Raymond James account, he had approximately $85,000 invested in various unit investment trusts (UIT) and about $16,000 in cash. No evidence was presented regarding UITs, but the Hearing Panel notes that they are similar to mutual funds. Like a mutual fund, a UIT invests in a portfolio of securities, usually stocks or bonds, then sells units to investors that typically expire at a specified future date.

[38] Respondent claimed that he and LF were executing a "tax selling" strategy at the end of 2000 and testified that LF needed to save money "by selling and not buying back." (Tr. 234.) In December 2000, however, Respondent made purchases totaling $103,281 and sales totaling $103,815 in LF's account. In the Hearing Panel's view, this completely refutes Respondent's testimony.

termination of Respondent's registration with Raymond James in August 2001.[39]

The Hearing Panel finds that the level of trading in all three accounts was at odds with the customer's financial needs and objectives. The high annualized turnover rates (11.66 in DS's personal account, 5.63 in his IRA account, and 7.49 in LF's account) and commission-to-equity ratios (44%, 24% and 27%, respectively) supports this conclusion, and the Panel finds there was excessive trading in each of the accounts at issue.

c. Scienter

For excessive trading to constitute churning, however, there must be scienter. The essential issue is whether the volume of transactions, in light of the nature and objectives of the account, was so excessive it indicates the broker's intention to profit at his customer's expense. *Castle Securities*, 2004 NASD Discip. LEXIS 1, at *14-15, citing *Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1368 (7th Cir. 1983). As discussed, the volume of trading in each account was excessive, particularly in LF's IRA account during the last quarter of 2000.

In reviewing the evidence, the Hearing Panel also noted the type of trading employed by Respondent. He often sold a security, reinvested the proceeds by purchasing another security, and then sold the newly-acquired security soon thereafter, often referred to as short term or "in and out" trading. He repeated this pattern throughout the relevant period, and though the customers occasionally earned a small

[39] CX-13. Throughout this period, Respondent reinvested dividends LF received; the Panel did not count these transactions as trading activity in the account.

profit, they often sustained a loss. Each transaction generated commissions for Raymond James and Respondent, however.[40]

Respondent claimed that DS and LF wanted to pursue this aggressive approach and that neither complained until he started losing money.[41] Respondent attributed losses in their accounts to several factors, including the general decline of the stock market in 2000.[42] There is no evidence that either customer understood this type of trading, nor the risks inherent in this approach, and certainly nothing to suggest that they directed Respondent to engage in short term, "in and out" trading or had approved it. Rather, it appears that Respondent chose this course of action, and despite mounting losses in the accounts, he continued trading in this manner until the customers, or his firm, put an end to it.

The Hearing Panel finds that Respondent employed an extremely aggressive and risky strategy of trading that was particularly questionable in a volatile, weak market. The volume of transactions in these accounts and the short-term trading by Respondent generated substantial commissions for him and his firm, but was detrimental to his

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[40] In some instances, he bought and sold the same security within days. Some examples demonstrate how this worked to Respondent's advantage more than to his customers' benefit. On May 24, Respondent bought 50 shares of the Nasdaq 100 Trust (QQQ), which he sold on June 5, for a profit of $146.87. However, DS was charged $142.50 in commissions for the two trades in his personal account; thus, his actual profit was about $4. On September 25, Respondent bought 100 shares of Home Depot (HD), which he sold on October 2, for a profit of $81.25. Again, DS was charged $142.50 in commissions for the two trades in his IRA account, turning his so-called profit into a loss of $61.25.

In LF's IRA account, Respondent did the following: on November 24, he bought 50 shares of Extreme Networks (EXTR), which he sold on November 28, for a profit of $187.50. He then bought 100 shares of EXTR on November 29, which he sold on November 30, for a profit of $412.50. On November 21, Respondent bought 100 shares of Immunex, now Amgen (AMGN), which he sold on November 28, for a loss of $206.25. Thus, in nine days, LF appears to have made a profit of $393.75; however, once commissions totaling $486.49 are deducted, these six trades actually cost LF $92.74.

[41] Tr. 227.

[42] Tr. 217-219, 225.

customers and at odds with their financial needs and investment objectives. Respondent abused his control of these accounts and acted in reckless disregard of his customers' best interest.[43] The Panel finds that the volume of transactions in each account was so excessive that Respondent intended to profit at his customers' expense.

Accordingly, the Hearing Panel finds that Respondent acted with scienter and churned these accounts in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as NASD Conduct Rules 2120 and 2110, as charged in the first and second cause of the Complaint.[44]

2. Unsuitability

A registered representative must have a reasonable basis for believing that a recommended transaction is suitable based on the customer's investment objectives and financial situation. *See* NASD Conduct Rule 2310. Suitability usually refers to the quality of the recommended security, but the quantity of trading in an account may also render transactions unsuitable. *Paul C. Kettler,* Exchange Act Rel. No. 31354, 1992 SEC LEXIS 2750 (Oct. 26, 1992). "Excessive trading represents an unsuitable frequency of trading and violates NASD suitability standards." *Id.* at *5.

In considering the churning charge, the Hearing Panel found that Respondent controlled the accounts of DS and LF, who either deferred all trading decisions to him or routinely concurred with his recommendations. Based on the overall number of

[43] Recklessness has been held sufficient to satisfy the scienter requirement of Section 10(b), Rule 10b-5 and NASD Conduct Rule 2120. *See, e.g., Dep't of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at *62 (NAC Oct. 28, 2002).

[44] A violation of an SEC or NASD rule also constitutes a violation of Conduct Rule 2110's ethical obligation to observe high standards of commercial honor and just and equitable principles of trade. *See Steven J. Gluckman*, Exchange Act Rel. No. 41,628, 1999 SEC LEXIS 1395, *22 (July 20, 1999) (citations omitted).

transactions and the turnover and commission-equity ratios, the Hearing Panel also found that Respondent engaged in excessive trading in those accounts.[45] Furthermore, the Panel observed that Respondent engaged in frequent and short-term trading in the accounts, which conflicted with his customers' financial needs and investment objectives.[46]

Though Respondent claimed that DS and LF wanted to take an aggressive approach, he acknowledged it was his obligation to determine the type and amount of trading suitable for his customers.[47] Even when a customer wishes to engage in speculative or aggressive trading, it is the broker's "duty to refrain from making recommendations that are incompatible with the customer's financial situation and needs." *Dep't of Enforcement v. Chase*, No. C8A990081, 2001 NASD Discip. LEXIS 30, at *17 (NAC Aug. 15, 2001) (other citations omitted). By pursuing a risky and aggressive strategy in a declining market, for customers who did not have the financial resources to withstand significant losses, Respondent breached his duty to recommend and pursue a course of trading that offered a degree of risk commensurate with his customer's financial situation and needs.

Thus, the Hearing Panel finds that Respondent engaged in trading in his customers' account that was quantitatively unsuitable, in violation of NASD Conduct Rules 2310 and 2110 and IM-2310-2, as charged in the third and fourth cause of the Complaint.

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[45] *See* pp. 12-15 *infra*.

[46] *See* pp. 15-17 *infra*.

[47] Tr. 243-244.

3. Exercising discretionary power without written authority

NASD Conduct Rule 2510 prohibits a registered representative from exercising discretionary authority in a customer's account without prior written authorization from the customer and written approval from his firm. DS and LF each testified that he trusted Respondent to handle his accounts, and LF went so far as to say that he left everything to Respondent, who was "running the show." In considering the churning charge, the Hearing Panel found that Respondent exercised *de facto* control of these accounts.[48] Moreover, Respondent testified that he felt he controlled these accounts, but conceded that neither DS nor LF gave him written authorization to exercise discretion to trade his accounts.[49] Accordingly, the Hearing Panel finds that Respondent violated NASD Conduct Rules 2510 and 2110, as charged in the fifth and sixth cause of the Complaint.

III. Sanctions

Enforcement seeks to bar Respondent for egregious misconduct and requests disgorgement of commissions as "partial restitution" to the customers.[50]

NASD Sanction Guidelines (Guidelines) for churning or excessive trading recommend a fine of $5,000 to $75,000, plus the amount of financial gain; in addition, they recommend a suspension in any or all capacities for ten business days to one year. In egregious cases, a longer suspension or a bar is recommended. Guidelines at 86 (2001 ed.). The Guidelines for unsuitable recommendations are virtually the same. The only

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[48] *See* pp. 10-11 *infra*.

[49] Tr. 244, 270.

[50] Tr. 263-264. Enforcement asked that Respondent disgorge $18,181 in commissions paid by DS and $15,649 in commissions paid by LF, as reflected in CX-17 and CX-18.

distinction is that the recommended fine amount is $2,500 to $75,000 for unsuitability. Guidelines at 99.

The Guidelines list no specific factors for adjudicators to consider when imposing sanctions for churning or excessive trading or unsuitable recommendations, but the Hearing Panel finds Respondent's misconduct was egregious for several reasons. Respondent's actions demonstrated his willingness to ignore his responsibilities to his customers and resulted in injury to both DS and LF. He intentionally or recklessly churned their accounts over an extended period and engaged in a pattern of unsuitably frequent trading at his customers' expense. He profited from his misconduct, then blamed others for losses in the accounts -- his clients, a volatile stock market and research analysts.[51] In short, he faulted everyone but himself.

While at First Union, Respondent was director of brokerage services, as well as the compliance officer. He testified that he knew what "needs to be done with" customers' accounts.[52] That Respondent was well aware of his obligations renders his misconduct all the more disturbing. Respondent took advantage of two unsophisticated customers who placed their trust in him.

The Hearing Panel finds no mitigating factors or circumstances in this case. Respondent testified that he has been in the securities industry for twenty years and never had a complaint,[53] but the lack of a disciplinary history is not a mitigating factor when

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[51] Tr. 208, 217-219, 228-229, 262-265.

[52] Tr. 219-220.

[53] Tr. 217.

determining sanctions. *Dep't of Enforcement v. Roethlisberger,* No. C8A020014, 2003 NASD Discip. LEXIS 48, *18 (NAC Dec. 15, 2003).[54]

The Hearing Panel believes that Respondent engaged in serious wrongdoing, which warrants imposition of a bar. The churning and unsuitability causes involve the same transactions; accordingly, a bar is imposed for each.

The Guidelines for exercising discretion without written authorization recommend a fine of $2,500 to $10,000, plus the amount of the respondent's financial benefit from the transactions, and, in egregious cases, a suspension of 10 to 30 business days. Guidelines at 94. The Guidelines list as principal considerations in determining sanctions for these violations: (1) whether the customer's grant of discretion was express or implied, and (2) whether the firm's policies prohibited discretionary trading and/or whether the firm prohibited respondent from exercising discretion in customer accounts.

DS and LF never explicitly gave Respondent power to exercise discretion in trading their accounts. There was no evidence introduced regarding the firm's policies on discretionary trading or whether Raymond James prohibited Respondent from exercising discretion in these (or other customers') accounts.

In light of the bars imposed, the Panel will not further sanction Respondent for exercising discretion without written authorization.

With respect to financial sanctions, the amount of disgorgement Enforcement requested is based on gross commissions paid by the customers to Raymond James.

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[54] The Hearing Panel feels compelled to note that Respondent did not appear to take these proceedings seriously. Ten minutes before the hearing was scheduled to commence, he phoned counsel for Enforcement to say he was home with the flu. After the Hearing Officer phoned to advise him that the witnesses and panelists were assembled and, absent a note from his physician, his failure to appear would result in a default decision against him, he grudgingly agreed to appear. He arrived almost two hours late, did not exhibit any flu-like symptoms, then expressed dismay that the hearing might not conclude in time to allow him to pick up his child from an after-school activity. At the end of the hearing, Respondent apologized for his "temperament."

Enforcement did not prove the amount Respondent earned, nor demonstrate that his commission for each and every transaction was an "ill-gotten gain." Because the evidence does not adequately quantify Respondent's gain, nor the customers' losses, the Hearing Panel is unable to order disgorgement as "partial restitution" in this case.[55]

IV. Conclusion

Respondent George A. Murphy, Jr. violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder and NASD Conduct Rules 2120 and 2110 for churning two customers' accounts. He also violated NASD Conduct Rules 2310 and 2110 and IM-2310-2 for recommending unsuitable trading in two customers' accounts. For these violations, Respondent is permanently barred from association with any member firm in any capacity. Respondent also violated NASD Conduct Rule 2510 and 2110 by exercising discretionary power in two customers' accounts without written authority from the customers or approval from his member firm, but no additional sanction is imposed, in light of the bars.[56] Finally, Respondent shall pay costs in the amount of $2,553.90, which includes an administrative fee of $750 and hearing transcript costs of $1,803.90.

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[55] *Cf. U.S. Rica Financial, Inc.*, 2003 NASD Discip. LEXIS 24, *51, n. 17 (NAC Sept. 9, 2003). The Panel notes that both DS and LF have pursued other avenues to obtain restitution.

[56] The Hearing Panel has considered all of the arguments of the parties. They are sustained or rejected to the extent they are in accord or inconsistent with the views expressed herein.

These sanctions shall become effective on a date set by NASD, but not earlier than 30 days after this Decision becomes the final disciplinary action of NASD.

HEARING PANEL

By: Dana R. Pisanelli
Hearing Officer

Dated: May 6, 2004
Washington, DC

Copies to: George A. Murphy, Jr. (*via overnight and first class mail)*
David Newman, Esq. (*via electronic and first class mail)*
Rory C. Flynn, Esq. *(via electronic and first class mail)*