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BEFORE THE STATE AUDITOR
AND COMMISSIONER OF SECURITIES
HELENA, MONTANA

IN THE MATTER OF:)	CASE NO. I-06-06-06-222
)	
RUSSELL MILLARD SQUIRE, III, individually and in his capacity as a securities salesperson,)	NOTICE OF PROPOSED AGENCY DISCIPLINARY ACTION
)	AND OPPORTUNITY FOR HEARING
Respondent.)	

Staff of the Securities Department (Department) of the Office of the State Auditor as Commissioner of Securities of the state of Montana (Commissioner), pursuant to the authority of the Securities Act of Montana (Act), § 30-10-101, et seq., MCA (2005), are proposing to the Commissioner that he take specific action against Russell Millard Squire, III, (Squire), a former securities salesperson, as identified above for violations of the Montana Securities Act. The Commissioner has authority to take such action under the provisions of §§ 30-10-102, 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, and 30-10-309, MCA (2005).

In particular, the Department's staff recommends specific action against Squire, including imposition of appropriate fines, appropriate restitution with interest and denial of any of Respondent's current or future applications for registration pursuant to the provisions of the Act.

Service of process is pursuant to §30-10-107 (8), MCA.

REASONS FOR ACTION

There is probable cause to believe that the following facts, if true, justify and support such specific action. Furthermore, there is reason to believe that the following facts will be proven true and, therefore, justify and support immediate issuance of an order denying Respondent's application for registration as a securities salesperson and to cease and desist his activities in violation of the Montana Securities Act.

ALLEGATIONS OF FACT

1. Squire worked as a registered securities salesperson for broker-dealer firm D.A. Davidson from approximately May 1991 until approximately September 2003. The Central Registration Depository (CRD)¹ indicates Squire was allowed to resign from the firm in or around September 2003.
2. The CRD reveals Squire had two disclosable customer complaints that were resolved by the firm.
3. According to the CRD, one customer complaint against Squire was resolved on or about March 2004 with a payment to the customer of \$2 million. This complaint alleged Squire engaged in unsuitable and excessive trading.

¹ The CRD is a repository maintained by the National Association of Securities Dealers (NASD) that contains certain required information. The CRD is relied upon by state regulators to track complaints and other regulatory related matters.

4. According to the CRD, another customer complaint against Squire was resolved on or about December 2004 with a payment to the customers of \$110,000. The complaint alleged Squire engaged in unsuitable trading, fraud, misrepresentations, and that D.A. Davidson failed to supervise Squire.

5. The Department learned of these two customer complaints when Squire came under investigation for selling securities in Montana while he was not registered to sell securities in Montana.

6. Because Squire is now in the process of attempting to obtain a securities license with the Department, the Department reviewed the CRD and learned of the two substantial complaints against Squire. The Department requested specific information from D.A. Davidson relevant to the accounts involved in the customer complaints and conducted an analysis of that information to determine if violations of the Montana Securities Act occurred.

7. The Department was only able to conduct an analysis of the accounts involved in the complaints for the period May 2001 to the date the accounts were closed due to the statute of limitations.

8. In May 2001 one complainant was 85 years old and the value of this customer's two accounts totaled approximately \$3,000,000. According to Squire, one of this customer's accounts, a charitable trust, was originally funded in 1998 with \$2 million in ConAgra stock. The account was intended to generate enough income annually to provide the customer with an annual distribution of \$180,000, the majority of this amount to be used to pay for the customer's \$130,000 annual life insurance premium. This account had investment objectives of quality

income² and quality growth³. Additionally, according to documentation provided by D.A. Davidson, the trust “instrument incorporated nearly verbatim the prudent man investment standard.”⁴

9. In May 2001, the value of this account was approximately \$1,400,000. During the time period analyzed, May 2001 to September 2003, the economic loss on the account was approximately \$757,679.13. On at least two occasions, the account was listed on D.A. Davidson’s “Declining Account Value” exception report.

10. During the period analyzed, May 2001 to September 2003, there were over 400 transactions in the account. The average annual turnover rate⁵ for the account was approximately 2.55. This high volume of trading was unsuitable based on the customer’s age and the purposes of the account, including the investment objectives and the trust’s prudent man standard.

2 The term “income” in the securities industry implies that the customer needs to supplement their income with investments that return dividends or interest.

3 The term “growth” in the securities industry implies that the customer is seeking an increase in value over time through appreciation in value of their investment, typically a diversified portfolio of seasoned, quality stock and/or mutual funds with reinvestment of dividends and capital gains.

4 *Harvard College v. Amory*, 26 Mass. (9 Pick) 446 (1830). The prudent man standard requires “in investing, reinvesting, purchasing, acquiring, exchanging and selling property for the benefit of my trust, my Trustee shall exercise the judgment and care, under the circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.”

5 According to PIABA, the turnover rate is the number of times the average net equity is used to purchase securities. Volume, rather than cost, is being measured. A turnover rate of 2 creates an inference of churning, a turnover rate of 4 creates a presumption of churning and a turnover rate of 6 is conclusive of churning. PIABA, is the Public Investors Arbitration Bar Association, whose mission is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process and creating a level playing field for the public investor in securities and commodities arbitration. Courts and arbitrators often rely upon PIABA expertise in cases involving excessive trading.

11. The majority of the securities held in this account were technology stocks. Many of the securities Squire solicited were highly speculative and volatile and had a beta ratio⁶ greater than 3. These securities included companies such as Broadvision, Cirrus Logic, Digital Lightware, ESS Technology, Genesis Microchip, Invision Technology, International Rectifier, Power-One, and Storage Networks, Inc. These recommendations were unsuitable based on the customer's age and the purposes of the account, including the investment objectives and the trust's prudent man standard.

12. Further, some of the securities Squire recommended had little or no financial history or track record, including Storage Networks, Palm, Inc. and Digital Lightware. These recommendations were unsuitable based on the customer's age and the purposes of the account, including the investment objectives and the trust's prudent man standard.

13. In July 2001, the account was moved from a commission account to a fee-based account, and was charged a quarterly fee based on assets under management rather than on a commission basis. Commissions prior to this change were substantial. The D.A. Davidson commission exception report dated June 29, 2001, indicates commissions for the prior three months in this

⁶ Beta ratio is a measure of a security's sensitivity to market movements as represented by the following formula: $\beta_p = R_{pm} (\tilde{\sigma}_p / \tilde{\sigma}_m)$,

β_p = security beta (i.e., slope of the regression line);

R_{pm} = the correlation coefficient between the security and the market index (or benchmark). (The correlation coefficient is the signed square root of R-squared.);

$\tilde{\sigma}_p$ = the observed standard deviation of the security's TWRs over a particular time horizon and compounding interval; and

$\tilde{\sigma}_m$ = the standard deviation of the market index over the same time horizon and compounding interval.

A security's beta ratio measures the expected change in its return per one percent change in the return on the market. By definition, the beta of a benchmark index is 1.00. Accordingly, a security with a 1.10 beta is expected to perform 10% better than the index in up markets and 10% worse in down markets, assuming all other economic factors remain constant. A low beta means that the security's market-related risk is low.

account totaled \$41,862, representing a CEMR of 13.99%⁷. After this change in the account the trading activity was still excessive based on the age of the customer and the purposes of the account, including the investment objectives and the trust's prudent man standard.

14. This 85 year old customer's second account was originally a Transfer on Death account (TOD) with primary investment objectives of quality growth and quality income. In May 2001 the account value was approximately \$1,627,000. In November 2001 this account was changed to a living trust. The living trust account retained the primary investment objective of quality income. During the time period analyzed, the account suffered a trading loss of approximately \$142,863.27.

15. There were approximately 82 transactions that occurred in this second account during the period analyzed. Commissions and fees for this account totaled \$19,580.73 during the period. There were at least nine times between January 2002 and September 2003 that this account was listed on the D.A. Davidson "Top 50 by Commission" exception report. On two occasions Squire was required to provide comments to managers regarding the commissions in the account. On both occasions he indicated that the commissions were low based on the monetary value of the account. For example, on May 16, 2003, Squire stated, "Since when is an annualized (commission) rate of .65% to .70% too much?"

16. During the time period analyzed, there were approximately 500 transactions in the two accounts. The two accounts combined had an economic loss of approximately \$744,049.13.

⁷ CEMR is calculated by dividing the average account equity by the total commissions during a 12-month period. According to PIABA, a CEMR of 4% in an investment account indicates there is an inference of churning; a CEMR of 8% indicates there is a presumption of churning; and a CEMR of 12% is conclusive that excessive trading is occurring.

Total commissions and fees paid in the two accounts during this time was approximately \$66,921.

17. The other customer complaint against Squire was regarding an account that belonged to a married couple who are both physically disabled. One of the couple was disabled in 1989 due to a motor vehicle accident. Since the accident, this individual has undergone 36 surgeries and has been unable to work a full-time job. The other individual was disabled as a result of an accident to this individual's hands, causing a severe limitation on the person's ability to work. As a result of the hand accident, the couple received a settlement check in the amount of \$654,000 and invested the majority of the proceeds with Squire.

18. On October 3, 2001, the couple opened an account with Squire. The couple's primary investment objectives listed on their new account form were quality income and quality growth. Annual income for the couple was disclosed as being between \$0-\$50,000. The couple opened a fee-based account with a management fee of 1.00% for assets under management.

19. In early October 2001, the couple deposited approximately \$572,169 into their account. Squire developed a 20-year financial plan for them assuming the majority of their income would come from investments. The couple required extra income because they did not have health insurance and were raising two young children.

20. In the financial plan, Squire recommended the purchase of two bonds, two unit investment trusts, two mutual funds, one real estate investment trust (REIT), and nineteen stocks. Most of the securities recommended were well-known companies and included blue chip stocks. These securities were purchased between October 11 and October 17, 2001. However, within thirty days of these purchases, Squire solicited the sale of a majority of these positions, contrary to the financial plan he developed, as well as the couple's investment objectives.

21. Beginning in November 2001, Squire solicited transactions in the couple's account that were mostly speculative technology stocks. Many of the securities Squire solicited were volatile and had a beta ratio greater than 3. These companies included Broadvision, Cirrus Logic, Digital Lightware, ESS Technology, Genesis Microchip, Invision Technology, International Rectifier and Pixelworks. Some of these securities had little or no financial history or track record. Further, the speculative technology stocks Squire recommended provided little or no dividend income. This trading was contrary to the couple's stated investment objectives and contrary to Squire's recommended financial plan.

22. In February 2002, the couple saw their portfolio decline from approximately \$574,209 to \$529,833. As a result, they called Squire many times during the month to tell him they wanted out of the market and to have their money put in a safer place.

23. On February 19, 2002, Squire responded to these calls by sending the couple an email stating that if they closed their account with him he would have to tell their home mortgage lender that it was the lender's responsibility to monitor their income because they were no longer employed. The couple interpreted this email as a threat that if they closed their D.A. Davidson account they could lose their home mortgage. Because of this the couple continued to maintain their account with Squire.

24. On March 8, 2002, Squire sent the couple an email stating that their account was doing better and stating "I will make you money".

25. By the end of August 2002, the account had a cumulative net economic loss of approximately \$152,606. The couple told Squire they wanted out of the market and he suggested putting their money in a money market account held outside of D.A. Davidson. In late September 2002, they sold their securities and closed the account.

26. In October 2002, the couple decided to get back into the stock market, and reopened their account with Squire. On their updated new account form the couple again listed quality income and quality growth as their primary investment objectives.

27. On October 14, 2002, when the couple reopened their account, Squire sent them an email recommending nineteen blue chip stocks that they might consider buying. One member of the couple began to make unsolicited trades in the account in an attempt to recoup some of the realized losses. The couple stated that this trading upset Squire and that their relationship with him continued to disintegrate. In November the couple contacted Tim Owen, the Bozeman branch office manager, and told him they wanted a new broker. Shortly after this meeting, the account was transferred from Squire to Tim Owen.

28. On December 9, 2002, Squire sent the couple an email that said "I know you are shopping for a new broker but I'm afraid what you will find is nothing but fee based money managers or mutual funds in this office, no one will let you trade penny stocks like I have."

29. There were 55 transactions in the account that involved "penny stocks."⁸ These types of investments are highly speculative and provide no income. D.A. Davidson's documentation relevant to this account failed to reveal any of the required written approval by the customer to engage in trading penny stocks, nor was there any indication of the required disclosure regarding

⁸ According to BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 412 (4th ed. 1995), "penny stock" is "stock that typically sells for less than \$1 a share although it may rise to as much as \$10 a share after the initial public offering, usually because of heavy promotion. Penny stocks are issued by companies with a short or erratic history of revenues and earnings, and therefore such stocks are more volatile than those of large, well-established firms traded on the New York or American stock exchanges. . . . [T]he Securities and Exchange Commission (SEC) requires that brokers implement suitability rules in writing and obtain written consent from investors."

the risks inherent in this type of trading. These positions were contrary to the investment objectives of quality income and quality growth.

30. During the time the account was open there was a total of approximately 286 transactions in the account. The average hold period for the positions in this account was 88 days. On at least seventeen occasions Squire opened and closed a position within 30 days. The account experienced an annualized turnover rate of 3.58 and suffered an economic loss of approximately \$191,214. This trading was contrary to the customers' stated investment objectives.

31. The 20-year financial plan Squire recommended to the couple established a portfolio that would have generated approximately \$30,192 in income over the eighteen month life of the account. Rather, due to Squire's complete reversal of the recommended plan, the couple's account earned only \$14,444 in income over the eighteen month period. Thus, were Squire to have followed the recommended financial plan, the couple would have had a monthly income of approximately \$1,677, as compared to the approximately \$802 monthly income they received due to Squire's unsuitable trading in this account.

CONCLUSIONS OF LAW

1. The Montana State Auditor is the ex-officio Commissioner of Securities pursuant to § 30-10-107 MCA.

2. The Commissioner has jurisdiction over this matter pursuant to §§ 30-10-102, 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, and 30-10-309, MCA.

3. The administration of the Securities Act of Montana, § 30-10-101, *et seq.*, MCA, is under the supervision and control of the Securities Commissioner pursuant to § 30-10-107, MCA.

4. The Commissioner shall administer the Securities Department to protect investors, pursuant to § 30-10-102, MCA.

5. Squire was a Montana registered salesperson pursuant to § 30-10-103 (20), MCA, and was so registered during the relevant time period.

6. Squire violated § 30-10-301 (1) (b), MCA, by misrepresenting the material facts relevant to the securities transactions he made for these customers in their D. A. Davidson & Co. accounts including, but not limited to, failing to inform the customers that the trading strategy he recommended was excessive and unsuitable based on their stated investment objectives, age, income, and the purpose of their accounts.

7. Squire violated § 30-10-301 (1) (c), MCA by engaging in an act, practice, and course of business that acted as a fraud on the customers when he performed the following acts:

- a. Executing hundreds of trades for the customers resulting in tens of thousands of dollars in commissions and fees to himself;
- b. Executing hundreds of unsuitable transactions in the accounts of customers, contrary to the customers' stated investment objectives, ages, incomes, and the purposes of their accounts;
- c. Trading excessively in the customers' accounts based on their stated investment objectives and the other relevant information revealed in their new account forms with D. A. Davidson & Co.

8. Squire violated § 30-10-201 (13) (g), MCA and ARM 6.10.126 (2) (f), by guaranteeing his customers' investments.

9. Squire violated § 30-10-201 (13) (g), MCA and ARM 6.10.126 (2) (f), by recommending unsuitable investments in his customers' accounts.

10. Squire violated § 30-10-201 (13) (g), MCA and ARM 6.10.126 (2) (f), by effecting excessive trading in his customers' accounts.

PUBLIC INTEREST

For any and all of the reasons set forth above, it is in the public interest and will protect Montana investors to:

1. Immediately issue a cease and desist order barring Russell Millard Squire, III, from further violations of the Montana Securities Act.
2. Order denial of Russell Millard Squire, III's application for registration as a securities salesperson in Montana.
3. Order Russell Millard Squire, III, to pay an administrative fine in an amount and upon such terms and conditions as supported by the evidence and determined at a hearing of this matter;
4. Order Russell Millard Squire, III, to pay restitution, plus statutory interest of 10% from the date of wrong-doing, in an amount and upon such terms and conditions as supported by the evidence and determined at a hearing of this matter; and
5. Take such other actions which may be in the public interest and necessary and appropriate for the protection of Montana investors.

RELIEF REQUESTED

WHEREFORE, the Departments seek the following relief:

1. Pursuant to § 30-10-201, MCA, denial of Respondent Squire's application for registration as a securities salesperson in Montana.
2. Pursuant to § 30-10-305, MCA, imposition of an administrative fine upon Respondent Squire not to exceed \$5,000 for each violation of §§ 30-10-301, and 30-10-201, MCA.

3. Pursuant to § 30-10-309, MCA, imposition of restitution to be paid by Respondent Squire, plus 10% interest from the date of wrongdoing, for each violation of § 30-10-301, MCA.

4. Issuance of a finding that all sanctions and remedies detailed and described here are in the public interest and necessary for the protection of Montana investors.

5. Issuance of an immediate Order to cease and desist from committing further violations of the Act.

6. Any further action as deemed just and appropriate for the protection of Montana investors.

STATEMENT OF RIGHTS

You are entitled to a hearing to respond to this notice and present evidence and arguments on all issues involved in this case. You have a right to be represented by an attorney at any and all stages of this proceeding. You may demand a formal hearing before a hearing examiner appointed by the Commissioner pursuant to the Montana Administrative Procedure Act, §§ 2-4-601, MCA, *et seq.*, including § 2-4-631, MCA. If you demand a hearing, you will be given notice of the time, place and the nature of the hearing.

If you want to contest the proposed action under the jurisdiction of the Commissioner, you must advise the Commissioner within fifteen days of the date you receive this notice. You must advise the Commissioner of your intent to contest the proposed action by writing to Roberta Cross Guns, Special Assistant Attorney General, State Auditor's Office, 840 Helena Avenue, Helena, Montana 59601. Your letter must clearly indicate whether you demand a hearing, or whether you waive formal proceedings and, if so, what informal proceedings you prefer for disposition of this case. Pursuant to § 2-4-603(2), MCA, you may not request to proceed informally if the action could result in suspension, revocation or any other adverse

proceed informally if the action could result in suspension, revocation or any other adverse action against a professional license.

Should you request a hearing, you have the right to be accompanied, represented, and advised by counsel. If the counsel you choose has not been admitted to practice law in the state of Montana, he or she must comply with the requirements of *Application of American Smelting and Refining Co.*, (1973), 164 Mont. 139, 520 P.2d 103.

CONTACT WITH SECURITIES COMMISSIONER'S OFFICE

If you have questions or wish to discuss this matter, please contact Roberta Cross Guns, legal counsel for the State Auditor, at 840 Helena Avenue, Helena, MT, 59601, (406)-444-2040 or, within Montana, (800)-332-6148. If an attorney represents you, please make any contacts with this office through your attorney.

POSSIBILITY OF DEFAULT

Failure to give notice or to advise of your demand for a hearing or informal procedure within fifteen days will result in the entry of a default order imposing the disciplinary sanctions against you and your license, without further notice to you, pursuant to ARM 6.2.101, and the Attorney General's Model Rule 10, ARM 1.3.214.

DATED this 23rd day of June 2006.

JOHN MORRISON
State Auditor and ex-officio
Commissioner of Securities and Insurance

By: Roberta Cross Guns
Roberta Cross Guns
Special Assistant Attorney General