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**STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION**

IN THE MATTER OF DETERMINING
whether there has been a violation of the
Securities Act of Washington by:

JOHN D. FAGAN,

Respondent.

S-02-284-03-SC01

STATEMENT OF CHARGES AND NOTICE
OF INTENT TO ENTER AN ORDER TO
DENY REGISTRATIONS AND IMPOSE
FINES AND COSTS

Case No. S-02-284

THE STATE OF WASHINGTON TO:

John D. Fagan, CRD #719914

STATEMENT OF CHARGES

Please take notice that the Securities Administrator of the State of Washington has reason to believe that the Respondent, John D. Fagan, has violated the Securities Act of Washington by engaging in dishonest and unethical practices in the securities business while employed as a registered securities salesperson for D.A. Davidson. The Securities Administrator believes those violations justify the entry of an order against John D. Fagan imposing fines and costs, and denying future registrations, pursuant to RCW 21.20.110. The Securities Administrator finds as follows:

TENTATIVE FINDINGS OF FACT

RESPONDENT

1. John D. Fagan ("Fagan") was continuously registered in the State of Washington as a securities salesperson from October 1984 until January of 2003. From October 1999 to January 2003, Fagan was employed by D.A. Davidson & Co. ("D.A. Davidson") as a securities salesperson. Prior to that, from September 1984 to October 1999, Fagan was employed by U.S. Bancorp Piper Jaffray Inc. ("Piper Jaffray") as a securities salesperson. Fagan currently resides in Lake Stevens, Washington.

1 **NATURE OF RESPONDENT'S CONDUCT**

2 **Barbara G.**

3 2. Barbara G.¹ ("Barbara") is a retired seventy-five year old Washington resident.

4 3. Barbara inherited an investment account from her mother in 1989. The account was held
5 at Piper Jaffray and handled by Fagan. Barbara also held two accounts at another brokerage firm, an
6 investment account, hereinafter referred to as "Account I," and an individual retirement account or
7 "IRA," hereinafter referred to as "Account II." In late 1998, Barbara wanted to consolidate her accounts
8 at one firm and transferred these accounts to Piper Jaffray. Fagan handled the accounts after they were
9 transferred. At this point, the account she had inherited from her mother was merged with Account I.

10 4. Barbara decided to transfer her accounts to D.A. Davidson in November 1999 after Fagan
11 began working there. At the time of the transfer, the accounts were collectively worth approximately
12 \$277,000.

13 5. Fagan sent new account documents to Barbara at the time she transferred the accounts to
14 D.A. Davidson. The new account documents included information about Barbara's investment
15 objectives and other personal financial information such as her net worth and income. The documents
16 were filled out at the time Barbara received them. Fagan had designated her primary investment
17 objective as "Quality Growth" on one of the accounts, and as "Quality Growth" and "High Growth
18 (Speculative)" on the other. Fagan did not discuss the meaning of these investment objectives with
19 Barbara. Barbara signed the documents and returned them to D.A. Davidson as instructed.

20 6. At the time the accounts were transferred to the D.A. Davidson, they represented the
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majority of Barbara's assets. Barbara's only source of income was her Social Security benefits of \$600 per month.

7. Barbara's investment objective for both accounts was to supplement her minimal income. Due to her age and financial situation, she wanted her funds to be secure and did not want to purchase high-risk investments.

8. Barbara had little understanding of investments and had never invested on her own. As a result, she completely relied on Fagan's advice throughout the time he managed the accounts. Barbara did not direct any of the trades in the accounts at any time, and Fagan did not discuss individual trades with her prior to making them. She would learn of the trades by checking her monthly statements.

9. From the time Barbara's accounts were transferred to D.A. Davidson in November 1999 through February of 2002, Fagan purchased approximately \$389,363 worth of securities in Account I and approximately \$329,081 worth of securities in Account II. Virtually all of the securities purchased were equities. Further, the majority of the equities purchased were companies in the technology sector.

10. In approximately January 2000, Fagan began to utilize margin in Account I to purchase the securities.² By April 2000, the account had a margin debit balance of over \$75,000, and a margin to equity percentage of 39%, putting her account at risk for a margin call. Barbara did not understand margin trading and was unaware that Fagan was making transactions in her account using margin. Fagan did not disclose to Barbara that her account was being margined and never explained the risks of using

¹ The full names of customers are omitted to protect their privacy.

² When a customer buys stock on margin, he or she obtains a loan from the brokerage that is secured by his or her brokerage account. A customer pays interest on the amount borrowed. Margin allows a customer to leverage his or her investments by increasing the amount of stock he or she can purchase. Leverage is a form of speculation, since the customer borrows the money in the hopes that the value of the securities purchased will appreciate. If the value of the stock in the account declines, the customer may receive a "margin call" from the brokerage. In order to satisfy a call, the customer must either transfer cash into the account

(footnote continued on next page)

1 margin.

2 11. Fagan engaged in a heavy volume of trading in both accounts, evidenced by the turnover
3 ratio in the accounts.³ During this time period, Account I had a turnover ratio of approximately 5.17, and
4 Account II had a turnover ratio of 3.64. This volume of trading generated excessive commissions given
5 the size of the accounts. Barbara paid approximately \$8,352 in commissions from November 1999
6 through February 2002 for the two accounts. In addition, Barbara paid approximately \$3,279 in margin
7 interest. During that same time period, Barbara would have needed rates of return on her investment
8 capital in Accounts I and II of 11.22% and 3.52%, respectively, merely to cover the commissions and
9 margin interest she was paying.

10 12. Barbara transferred her accounts to another brokerage firm in February of 2002.

11 13. During the twenty-nine months Fagan controlled Barbara's accounts at D.A. Davidson,
12 Account I lost approximately \$103,000 and Account II lost approximately \$73,000. Collectively, these
13 losses were equal to approximately 64% of the funds Barbara entrusted to Fagan at D.A. Davidson.

14 14. On or about June 2, 2003, D.A. Davidson agreed to pay Barbara \$130,000 in settlement of
15 the complaint she had filed with them regarding Fagan.

16 **Marion B.**

17 15. Marion B. ("Marion") is an eighty-year old widow and Washington resident. Her husband
18 Donald died in 1992. She has not worked since approximately 1947.

19 16. Marion and her husband initially set up two primary investment accounts at Piper Jaffray
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21 or sell securities to cover the call. Margin is very risky because a stock price may drop so much that even if a customer sells all of his or her shares, the money
22 raised will not be sufficient to repay the loan to the brokerage.

1 severally years ago, hereinafter referred to as "Account I" and "Account II." They had begun using
2 Fagan as their securities salesperson because he was a friend of Marion's eldest son. In November 1999,
3 Marion transferred the accounts to D.A. Davidson so that Fagan could continue to handle them. At the
4 time the accounts were transferred, they were collectively worth approximately \$325,484.

5 17. Fagan sent new account documents to Marion at the time her accounts were transferred to
6 D.A. Davidson. The new account documents included information about Marion's investment objectives
7 and other personal financial information such as her net worth and income. The documents were filled
8 out at the time Marion received them. Only her signature was required. Marion suffers from macular
9 degeneration and could not read the back of the documents because the print was too small. Marion
10 signed the documents and returned them to D.A. Davidson as instructed. Marion's primary investment
11 objective had been designated by Fagan as "Quality Growth" on both accounts. Fagan did not discuss
12 the meaning of this investment objective with Marion.

13 18. At the time the accounts were transferred to the D.A. Davidson, they represented the
14 majority of Marion's assets. Her monthly income consisted of her Social Security benefits and her late
15 husband's pension, which collectively amounted to less than \$2,000 per month.

16 19. Marion's investment objective as to both accounts was the purchase of quality stocks and
17 other investments that would supplement her income. Marion wanted her money to be invested
18 conservatively and did not want risky investments.

19 20. After her husband's death in 1992, Marion completely relied on Fagan's recommendations
20 with regard to the accounts. Marion had developed a trust in Fagan over the several years he had
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22 ³ The turnover ratio is the number of times during a given period of time that securities in an account are replaced by new securities.

1 managed the accounts. She had never invested on her own and felt she could depend on Fagan to invest
2 her money appropriately. Fagan would call Marion periodically to tell her what he was doing with the
3 accounts, but did not speak with her prior to making trades.

4 21. From the time Marion's accounts were transferred in November of 1999 through May of
5 2002, Fagan purchased approximately \$223,636 worth of securities in Account I and approximately
6 \$1,073,703 worth of securities in Account II. All or substantially all of the securities purchased were
7 equities. Further, the majority of the equities purchased were companies in the technology sector.

8 22. In approximately February 2000, Fagan began to utilize margin to purchase securities in
9 Account I. By February 2002, the account had a margin debit balance of over \$45,000, and a margin to
10 equity percentage of 42%, putting her account at risk for a margin call. Marion did not understand
11 margin trading and was unaware that her account was being margined. Fagan did not disclose to Marion
12 that her account was being margined and never explained the risks of using margin.

13 23. During this time period, Fagan also engaged in a high volume of trading, as evidenced by
14 the turnover ratio on both accounts. Account I had a turnover ratio of approximately 2.36, and Account
15 II had a turnover ratio of 43.42. This volume of trading generated excessive commissions given the size
16 of the accounts. Marion paid approximately \$13,445 in commissions from November 1999 through May
17 2002 for the two accounts. In addition, Marion paid approximately \$8,519 in margin interest. During
18 that same time period, Marion would have needed rates of return on her investment capital in Accounts I
19 and II of 10.89% and 44.65%, respectively, merely to cover the commissions and margin interest she was
20 paying.

21 24. Fagan controlled Marion's accounts through at least May 2002.

22 25. During the first thirty-one months Fagan controlled Marion's accounts at D.A. Davidson,

1 the Account I lost approximately \$110,000 and Account II lost approximately \$88,000. Collectively,
2 these losses were equal to 61% of the funds Marion entrusted to Fagan at D.A. Davidson.

3 26. On or about August 18, 2003, Marion filed an arbitration claim naming Fagan and D.A.
4 Davidson, NASD Docket No. 03-05825.

5 Based upon the above Tentative Findings of Fact, the following Conclusions of Law are made:

6 **CONCLUSIONS OF LAW**

7 1. John D. Fagan, as described above, has willfully violated RCW 21.20.702 by
8 recommending the purchase and sale of securities to Barbara G. and Marion B. without reasonable
9 grounds to believe that the transactions were suitable for those customers. Such practice is grounds for
10 the denial of registrations pursuant to RCW 21.20.110(1)(b), and for the imposition of fines pursuant to
11 RCW 21.20.110(1).

12 2. John D. Fagan, by knowingly effecting transactions in the accounts of Barbara G. and
13 Marion B. that were excessive in size and frequency in view of the financial resources and character of
14 the accounts, and that were effected by reason of Barbara G. and Marion B.'s trust and confidence in
15 Fagan, was able to influence the volume and frequency of the trades, in violation of RCW 21.20.035.
16 Such practice is grounds for the denial of registrations pursuant to RCW 21.20.110(1)(b), and for the
17 imposition of fines pursuant to RCW 21.20.110(1).

18 3. John D. Fagan, as described above, engaged in one or more dishonest and unethical
19 practices in the securities business, as defined by WAC 460-22B-090(6), by inducing trades in customer
20 in the accounts of Barbara G. and Marion B. that were excessive in size and frequency in view of the
21 financial resources and character of the accounts. Such practice is grounds for the denial of registrations
22 pursuant to RCW 21.20.110(1)(g), and for the imposition of fines pursuant to RCW 21.20.110(1).

1 **AUTHORITY AND PROCEDURE**


2 This Order is entered pursuant to the provisions of RCW 21.20.110, and is subject to the
3 provisions of RCW 21.20.120 and Chapter 34.05 RCW. The Respondent may make a written request for
4 a hearing as set forth in the NOTICE OF OPPORTUNITY TO DEFEND AND OPPORTUNITY FOR
5 HEARING accompanying this Order. If the Respondent does not request a hearing, the Securities
6 Administrator intends to adopt the foregoing Tentative Findings of Fact and Conclusions of Law as final,
7 and enter a final order against the Respondent imposing fines and costs, and denying future registrations,
8 as described above.


9 DATED this 24th day of October, 2003.

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13 DEBORAH R. BORTNER
14 Securities Administrator

14 Approved by:

Presented by:

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16 
17 Michael E. Stevenson
18 Chief of Enforcement

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17 Chad C. Standifer
18 Staff Attorney