

1990

Johnson-Bowles Company INC., and Marlen Vernon Johnson v. The Division of Securities and the Utah Department of Commerce, the State of Utah : Brief of Respondent

Utah Court of Appeals

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UTAH COURT OF APPEALS
BRIEF

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900558CA

IN THE UTAH COURT OF APPEALS

JOHNSON-BOWLES COMPANY, INC.,
a Utah corporation, and MARLEN
V. JOHNSON,

Petitioners,

v.

The DIVISION OF SECURITIES
and the UTAH DEPARTMENT OF
COMMERCE, STATE OF UTAH,

Respondents.

BRIEF OF RESPONDENTS

Case # 900558-CA

Rule 29 Priority # 15

Consolidated appeal from Final Agency Actions by the
Division of Securities, Department of Commerce, State of Utah
Case # SD-89-46BD and Case # SD-89-47AG

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ATTORNEYS FOR THE APPELLANTS

FILED

APR 30 1991

IN THE UTAH COURT OF APPEALS

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| V. JOHNSON, |) | |
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BRIEF OF RESPONDENTS

STATEMENT OF JURISDICTION:

The Court of Appeals has appellate jurisdiction over the final agency action in this case pursuant to Utah Code Annotated sections 78-2a-3(2)(a) (Supp. 1990) (Court of Appeals Jurisdiction), 63-46b-16 (1989) (Administrative Procedures Act - Judicial Review - Formal Adjudicative Proceedings), and 61-1-23 (Supp. 1990) (Utah Uniform Securities Act - Review of Orders).

STATEMENT OF THE ISSUES AND THE STANDARDS OF REVIEW:

The Respondents¹ believe that the Statement of the Issues contained in the Brief of Petitioners (hereinafter "Petitioners' Brief") is impermissibly vague² and contains erroneous standards of review. The Respondents therefore offer the following statement of the issues and the standards of review:

Issue I: Based upon the record as a whole, was there

¹The Division of Securities (hereinafter the "Division") and the Department of Commerce (hereinafter the "Department of Commerce") of the State of Utah (hereinafter collectively referred to as the "Respondents").

²Rule 24(a)(5) of the Utah Rules of Administrative Procedure does not specify any requirements for the statement of the issues, but it stands to reason that the issues should be at least as well defined in the brief as they are in the docketing statement. Rule 9(c)(5) states, with regard to docketing statements, that "[g]eneral conclusions . . . are not acceptable," yet the Statement of Issues contained in the Petitioners' Brief consists of nothing but general conclusions. See, Petitioners' Brief at 1-3.

substantial evidence to support the Division's Findings of Fact and Conclusions of Law?

Standard of review: Agency determinations of fact are only overturned if, after marshalling all of the evidence supporting the findings, the party challenging the findings can establish that the findings are not supported by substantial evidence, which is such evidence as a reasonable mind might accept as adequate to support a conclusion. Grace Drilling v. Board of Review of the Industrial Commission of Utah, 776 P.2d 63, 68 (Utah App. 1989). This court should not substitute its judgment as between two reasonably conflicting views, but rather should uphold the agency's findings. *Id.* An agency's conclusions of law concern the application of findings of fact to the law, and are therefore mixed questions of fact and law, which should not be disturbed on appeal unless the agency's "determination exceeds the bounds of reasonableness and rationality." Pro-Benefit Staffing v. Board of Review of the Industrial Commission of Utah, 775 P.2d 439, 442 (Utah App. 1989).

Issue II: Is there an unconstitutional conflict between the Divisions' enforcement of its U.S.A. Medical Stop Trading Order and the Johnson's obligations under NASD³ rules?

Standard of review: This is a mixed question of law and fact, requiring a factual determination of the Johnsons' situation and how that situation is affected by Utah law and NASD rules. Due to the technical nature of the question, this court should uphold the

³The National Association of Securities Dealers, a self-regulating organization that governs over the counter stock brokerages. It is monitored by the Securities and Exchange Commission ("SEC").

agency's position if that position is reasonable and rational. Hurley v. Board of Review of the Industrial Commission of Utah, 767 P.2d 524, 527 (Utah 1988) ("Issues of mixed law and fact are often illuminated by an agency's expertise, and special technical knowledge may be of particular help in determining whether the facts fall within the meaning of statutory terms.") *See also*, Vali Convalescent and Care Institutions v. Division of Health Care Financing, 797 P.2d 438, 443 (Utah App. 1990) ("For 'ultimate facts,' mixed questions of law and fact, interpretations of 'special law' or the agency's own regulations, and a host of other matters between the 'pure fact' and 'general law' extremes, we apply an 'intermediate standard,' according the agency decision some deference and affirming the disposition if it is reasonable and rational"); Pro-Benefit Staffing, 775 P.2d at 442 ("reasonable and rational" standard applies to mixed questions of law and fact under the Utah Administrative Procedures Act).

Issue III: Did the Respondents err procedurally with regard to the Petitioners' (hereinafter referred to collectively as the "Johnsons"⁴) many motions?

Standard of review: The narrow question of whether the agency erred procedurally is a straight question of law, and is governed by the correction-of-error standard. In resolving this issue, however, the Court will have to review a number of conclusions of

⁴There is often little reason to distinguish between the two Petitioners for purposes of this brief, hence the term "Johnsons" is used to refer to both Petitioners. Where reference to a specific Petitioner is necessary, Marlen Vernon Johnson is referred to as "Marlen Johnson," while Johnson-Bowles Company, Inc. is referred to as "Johnson-Bowles."

law and other mixed questions of law and fact, which are correctly reviewed under the "reasonable and rational" standard. Hurley, 767 P.2d at 527. See also, Vali Convalescent and Care Institutions, 797 P.2d at 443; Pro-Benefit Staffing, 775 P.2d at 442.

Issue IV: Was the Division's U.S.A. Medical Stop Trading Order valid at the time when the Johnsons purchased U.S.A. Medical stock?

Standard of review: This is a mixed question of law and fact, requiring a factual determination of status of the Stop Trading Order and the application of federal laws to the state. Due to the technical nature of the question, this court should uphold the agency's position if that position is reasonable and rational. Hurley, 767 P.2d at 527. See also, Vali Convalescent and Care Institutions, 797 P.2d at 443; Pro-Benefit Staffing, 775 P.2d at 442.

Issue V. Was an Order that suspended the Johnsons' registration with the Division for one year and placed the Johnsons' on probation for two years thereafter unreasonable in light of the severity and willful nature of the Johnsons' conduct?

Standard of review: This is an issue of agency discretion, and this court should limit its review to the question of abuse of discretion. Utah Code Ann. § 63-46b-16(h)(i) (1989).

LIST OF CONSTITUTIONAL PROVISIONS, STATUTES, ORDINANCES, REGULATIONS AND RULES:

For the sake of consistency, all constitutional provisions,

statutes, ordinances, regulations, rules and materials from NASD or NASAA⁵ have been reproduced as Exhibit "A" in the addendum to this brief.

STATEMENT OF THE CASE:

The Nature of the Case:

This is a case where Johnson-Bowles, a securities broker-dealer, and Marlen Johnson, a securities agent, encouraged the Division of Securities to place a Stop Trading Order on the stock of U.S.A. Medical, and then knowingly violated, and helped others to violate, that Stop Trading Order by purchasing U.S.A. Medical stock from Utah residents for over \$506,000 less than the Johnsons believed the stock would have cost before the Stop Trading Order made sales of the securities illegal. Because the Johnsons' acts of knowingly violating, and helping others to violate, the Stop Trading Order constituted dishonest and unethical practices in the securities business, the Division, after a complete formal administrative procedure, suspended the Johnsons' licenses for one year and placed the Johnsons on an additional two years probation.

The Facts of the Case:

⁵The North American Securities Administrator's Association, an organization comprised of securities regulators at the state level (including people from the Utah Division of Securities).

The Respondents believe that the Petitioners have conveniently ignored a number of key facts, including admissions by the Petitioners and findings by Federal Judge J. Thomas Greene, that influenced the Division's decision in this matter. Therefore, the Respondents will set forth a complete set of facts that they deem relevant to this case:

1. At all times relevant to this case, Johnson-Bowles was registered with the Division as a broker-dealer, and Marlen Johnson was registered as an agent. (Stipulation of Facts for Purposes of Hearing, R.1154-1158, ¶ 1 at R.1154 (hereinafter "Stipulation of Facts"); Findings of Fact, Conclusions of Law and Order In re: Johnson-Bowles and Marlen Johnson, R.1129-1142, ¶ 1 at R.1129-1130 (hereinafter "Findings, Conclusions and Order")).

2. As of January 22, 1989, Johnson-Bowles was "short"⁶ exactly 53,500 shares of U.S.A. Medical stock. (Stipulation of Facts, ¶ 2 at R.1155; Findings, Conclusions, and Order, ¶ 2 at R.1130.)

3. Of the 53,500 shares, 38,500 shares were deliberately purchased "short" by Johnson-Bowles, with the remaining 15,000 shares representing a sell order placed by a customer through Johnson-Bowles but not covered by the customer. (Complaint for Securities Fraud and Declaratory Relief in the case of Johnson-Bowles Company v. U.S.A. Medical Corporation, et al., #89-C-157-G

⁶Being "short" means that Johnson-Bowles had been paid by other people for stock that it had not delivered. In order to cover the "short" position, Johnson-Bowles would have to buy an equal amount of stock and deliver it to the parties that had already paid Johnson-Bowles.

(D. Utah Feb. 16, 1989) (hereinafter "Johnsons' Federal Complaint" and "Johnsons' Federal Lawsuit"), at 9.⁷)

4. On January 23, 1989, U.S.A. Medical stock underwent a 10 for 1 forward split⁸, and thereafter the price per share increased approximately tenfold, to approximately \$1.00 per share of post-split stock. (Stipulation of Facts, ¶¶ 3-4 at R.1155; Findings, Conclusions and Order, ¶ 2 at R.1130)).

5. At a price of approximately \$1.00 per share, the Johnsons would have had to pay approximately \$535,000 to purchase enough stock to clear their short position.

6. On or about February 6, 1989, Otra Clearing House, one of the parties to whom Johnson-Bowles owed stock, informed the Johnsons that it had "bought-in"⁹ the 150,000 shares Johnson-Bowles owed it, at a price of 10¢ per share. On February 15, 1989, the Johnsons wrote a letter to Otra Clearing House that said "Johnson-Bowles Company, Inc., considers U.S.A. Medical Corp., common stock

⁷Johnsons' Federal Complaint, and a complete transcript of the preliminary injunction hearing in that case, were entered as exhibits in the instant administrative hearing, see Reporter's Transcript of Proceedings Before the Securities Division In Re Johnson-Bowles and Marlen Johnson (July 16, 1990) (hereinafter "Hearing Transcript"), R.860-1111, at R.861, were relied upon by the Division in its decision making process, and are a part of the record in this case, although not separately numbered (the documents are in a manila file folder, along with other documents that were entered into evidence at the Division's Hearing).

⁸Meaning that each old share of U.S.A. Medical was replaced by 10 new shares of post-split stock. After the split, Johnson-Bowles was short 535,000 shares of new U.S.A. Medical stock.

⁹"Buying-in" is a normal practice in the securities industry. When party "A" fails to deliver stock that it owes to party "B" within a given period of time, then party "B" may "buy-in" the stock by purchasing it from some other source "C" and charging party "A" the purchase price.

to be unregistered securities. We choose not to engage or participate in an unlawful distribution of unregistered securities." (Letter of 15 February 1989, Hearing Before the Securities Division of the Department of Commerce of the State of Utah (hereinafter "Hearing") Exhibit P-2¹⁰; Findings, Conclusions, and Order, ¶¶ 3-4 at R.1130.)

7. The next day, on February 16, 1989, Johnson-Bowles filed the Johnsons' Federal Lawsuit. See, Johnson-Bowles Company v. U.S.A. Medical Corporation, et al., #89-C-157-G (D. Utah Feb. 16, 1989). In the Complaint, Johnson-Bowles alleges that it "believes and asserts that there is no exemption for any U.S.A. Medical shares trading in interstate commerce," that it "is fearful of honoring its commitments with the numerous Broker-Dealer Defendants, including either taking delivery of stock or otherwise delivering such itself, as it does not want to aid and abet, or otherwise participate or engage in an unlawful distribution of unregistered securities, namely, the securities of U.S.A. Medical," and that "there is no exemption for the shares of U.S.A. Medical trading in interstate commerce." (Johnsons' Federal Complaint, at 13, 13, and 26 respectively; Findings, Conclusions and Order, ¶ 5 at R.1131.)

8. On February 17, 1989, United States District Court Judge J. Thomas Greene granted Johnson-Bowles motion for a temporary restraining order preventing Midwest Clearing from buying-in U.S.A.

¹⁰This document, like the Johnsons' Federal Lawsuit documents and all of the other documents that were introduced into evidence at the Hearing, is part of the record in this case, is in the manila file folder, and has not been separately paginated.

Medical stock on Johnson-Bowles' account. (Stipulation of Facts, ¶ 6 at R.1155; Findings, Conclusions and Order, ¶ 6 at R.1131.)

9. Judge Greene held a preliminary injunction hearing on February 27 and 28 concerning Johnson-Bowles' motion to enjoin further buy-ins against it. At that hearing, a number of witnesses testified for Johnson-Bowles, including Marlen Johnson. At the conclusion of the hearing Judge Greene ruled from the bench against Johnson-Bowles and subsequently entered, on March 1, 1989, a Findings of Fact, Conclusions of Law, and Order, which read in part, as follows:¹¹

2. The Court finds that the stock of U.S.A. Medical was unlawfully issued, has never been registered with any proper regulatory authority, is not exempt from such requisite registration and has been and is continuing to be traded illegally.

3. The stock of U.S.A. Medical has been and continues to be traded as part of a fraudulent scheme and device to manipulate and artificially inflate the price of that stock in violation of the securities laws.

4. The Court finds, however, that the plaintiff, Johnson-Bowles, knew or should have known about the alleged irregularities as to non-registration, non-exempt status and illegal trading in the stock after it became a market maker, and is charged with knowledge of these irregularities.

5. The Court finds that relative burden between Johnson-Bowles and other parties as well as damage to the public interest has not been shown by a preponderance of the evidence and that there is a failure of burden of proof to establish those elements.

(Judge Greene's Findings of Fact, etc., Hearing Exhibit R-3, at 6; Findings, Conclusions and Order, ¶ 6 at 1131-1132.)

10. Judge Greene did not rule on the issue of whether

¹¹The order was apparently prepared from a transcript of Judge Green's oral ruling; the two are almost identical. See, Johnsons' Federal Lawsuit transcript at 2-263 through 2-264.

Johnson-Bowles was required to buy-in U.S.A. Medical stock, though he did rule that the stock lacked either registration or exemption and was being traded illegally. Judge Greene stayed the case as to all NASD members, and he ordered that all NASD members submit their claims to arbitration. (Judge Greene's Findings of Fact, etc., Hearing Exhibit R-3, at 7.)

11. On the same day that Judge Greene entered his Order, the Division of Securities entered its Summary Order Denying Availability of Exemptions from Registration (hereinafter the "Temporary Stop Trading Order"). (Temporary Stop Trading Order, R.290-294; Stipulation of Facts, ¶ 9 at 1156; Findings, Conclusions and Order, ¶ 7 at 1132.) That Order was made final by the Division's Findings of Fact, Conclusions of Law and Default Order of March 27, 1989 (hereinafter the "Permanent Stop Trading Order"). (Permanent Stop Trading Order, R.1164-1168; Stipulation of Facts, ¶ 9 at R.1156; Findings, Conclusions and Order, ¶ 9 at R.1133.) (Because the two operate together, with no gap in coverage, the Temporary and Permanent Stop Trading Orders are collectively referred to herein as the "Stop Trading Order.") The Stop Trading Order denied U.S.A. Medical stock the benefit of any exemptions from Utah stock registration requirements, thereby making trading in the stock illegal in Utah.¹² The Johnsons had actual knowledge of both the Stop Trading Order and the Default Order at the time of issuance. (Stipulation of Facts, ¶ 11 at R.1156; Findings,

¹²This was the conclusion of law reached by the Securities Advisory Board. See, Findings, Conclusions and Order, at 8-9, R.1136-1137.

Conclusions and Order, ¶ 9 at 1133.)

12. On March 1, 1989, Otra Clearing House completed its buy-in of 150,000 shares of U.S.A. Medical stock, but at a price of 70¢ per share. (Letter of Marlen Johnson to Ken Schaeffer of NASD, Hearing Exhibit P-1, at 4; Findings, Conclusions and Order, ¶ 7 at R.1132.) There is nothing in the record that clearly establishes whether Otra Clearing House made its buy-in before the Division issued its Stop Trading Order (or before Otra became aware of the Order).

13. On March 6, 1989, the United States Securities and Exchange Commission issued a ten day Order of Suspension of Trading, which stopped trading in U.S.A. Medical stock nationwide. That order, by its terms, expired at 11:59 p.m. EST on March 15, 1989. (SEC Order of Suspension of Trading, R.1169; Stipulation of Facts, ¶ 10 at R.1156; Findings, Conclusions and Order, ¶ 8 at R.1132.)

14. During the month of March, 1989,¹³ at a time when the Johnsons were aware of the U.S.A. Medical Stop Trading Order, the Johnsons purchased 397,900 shares of U.S.A. Medical stock from six Utah Residents and one New York resident. (Stipulation of Facts, ¶¶ 12-14, 16, at R.1156-1157; Findings, Conclusions and Order, ¶ 10, R.1133.) The Johnsons engaged in this transaction even though

¹³Or perhaps mid-April. Although the parties stipulated to the March date, R.1156, on the witness stand Marlen Johnson was unable to pinpoint a date, and had to admit that the transactions may not have closed until mid-April, based on when Johnson-Bowles paid for the stock. Hearing Transcript at 171-174. The Respondents argued at the hearing, and argue now, that the Johnsons waited long enough for the Division's Stop Trading Order to have the effect of severely depressing prices before illegally purchasing the stock.

they had been advised by legal counsel that it was illegal for them to do so. (Hearing Transcript, at 151-153; Johnsons' Federal Lawsuit Transcript, at 2-219 through 2-220.) Further, Marlen Johnson later admitted to an employee of the Division that he knew at the time he made them that the purchases would be in contravention of the Stop Trading Order. (Hearing Transcript, at R.890, R.893.)

15. The difference in price between the price at which the Johnsons sold the stock short and the price at which they illegally purchased the stock yielded the Johnsons a net profit of \$6,538. (Hearing Transcript, at R.1045; Findings, Conclusions and Order, ¶ 13 at R.1134-1135.) According to the Johnsons' own accountant, if the stock had been bought-in at the pre-Stop Trading Order price of 70¢ per share, the Johnsons would have lost approximately \$500,000. (Hearing Transcript, at R.1139.) Thus, the Johnsons benefitted by approximately \$506,538 as a result of illegally purchasing shares in violation of the Stop Trading Order.

16. On March 21, 1989, Marlen Johnson, on behalf of Johnson-Bowles, wrote a letter to Ken Schaeffer of the National Association of Securities Dealers ("NASD"), in which he reiterated Judge Greene's findings "that the stock in U.S.A. Medical was unlawfully issued, has never been registered with any proper regulatory authority, is not exempt from such requisite registration and has been and is continuing to be traded illegally." (Letter of March 21, 1989, Hearing Exhibit P-1, at 1.) The Johnsons' letter went on to complain about the March 1st Otra buy-in, and explained the Johnsons' position as to the legality of trading in U.S.A. Medical

stock:

It is Johnson-Bowles Company, Inc.'s position that these buy-ins were illegal. First, shares of stock in U.S.A. Medical Corp. were unlawfully issued, were never lawfully registered and do not qualify for any valid exemption under federal or state law. As such, any trading of or transaction involving U.S.A. Medical stock has been, would have been and is unlawful under Section 5 of the Securities Act of 1933, 15 USC § 77e, and Section 10 of the Securities and Exchange Act of 1934, 15 USC § 78j(b).

Second, all open trades or outstanding contracts for the purchase or sale of shares of stock in U.S.A. Medical Corp. are illegal contracts and therefore unenforceable. The enforcement or performance of any and all such open trades or contracts would constitute and serve to complete illegal trades and unenforceable contracts. This would violate securities laws.

(Hearing Exhibit P-1, at 4; Findings, Conclusions and Order, ¶ 8 at R.1132-1133.)

The Course of Proceedings and Disposition Below:

The Division instigated this action by filing two Notices of Agency Action with attached petitions, one against Johnson-Bowles (R.280-289) and one against Marlen Johnson (R.263-273). An Amended Petition, consolidating and simplifying the actions, was subsequently filed (R.161-169.) Thereafter, there were numerous motions filed, several of which were cited as grounds for appeal and are discussed at length below. A hearing was held on July 16, 1990, before the Securities Advisory Board (Hearing Transcript, R.860-1115). On August 10, 1990, the Securities Advisory Board issued its Findings of Fact, Conclusions of Law and Order. (Findings, Conclusions and Order, R.1129-1142.) That order suspended the Johnsons' registration for one year and placed them

on an additional two years of probation. After an agency review, the Director of the Department of Commerce, David Buhler, issued an Order on Review on October 29, 1990, which affirmed the Division's Order. (Order on Review, R.830-842.) This appeal follows.

A SUMMARY OF THE ARGUMENT:

This is a simple license suspension case masquerading as a complex securities law case. The Division of Securities lawfully issued an order stopping all Utah trading in the stock of U.S.A. Medical Corporation. Johnson-Bowles, a Utah broker-dealer, and Marlen Johnson, a Utah registered agent, violated the Stop Trading Order by purchasing U.S.A. Medical stock from six Utah sellers. That direct, willful violation of the Division's order by the Johnsons constituted dishonest and unethical conduct, for which the Johnsons were properly suspended, following a lawful and correct administrative proceeding. Despite the Johnsons' assertions to the contrary, the Division's enforcement of its stop trading order was not in conflict with NASD rules, and the Johnsons could have abided by the Division's order without risking NASD sanctions for failure to purchase stock (in part because there are no sanctions for failing to purchase stock).

THE ARGUMENT:

Point I: Based Upon the Record as a Whole, There is More than

Substantial Evidence to Support the Division's Findings of Fact and Conclusions of Law:

The Findings of Fact are supported by substantial evidence.

As noted in the issues and standards of review section of this brief, the Johnsons have the burden in this case to "marshall all of the evidence supporting the findings and show that despite the supporting facts, and in light of the conflicting or contradictory evidence, the findings are not supported by substantial evidence." Grace Drilling, 776 P.2d at 68 (emphasis in original). Instead of meeting their burden, the Johnsons carefully selected the facts that they felt supported their case, and conveniently neglected to marshall many of the key facts relied upon by, and often even quoted in, the Findings of Fact. For example, the Petitioners' Brief fails to mention many of the admissions that the Johnsons made that they knew trading in U.S.A. Medical stock was illegal. Because the Johnsons failed to marshall all of the evidence, this Court should ignore their claims that the Findings of Fact are flawed.

If the Johnsons had marshalled all of the evidence, it would be clear that all of the key Findings of Fact are supported by sufficient evidence. The following table references each important Finding of Fact and shows some of the evidence that supports each Finding:¹⁴

¹⁴This list is not meant to be exclusive. A more thorough listing of the evidence can be found in the Facts of this Case section of the brief. The Stipulation of Facts can be found at

| Finding # | References to Supporting Evidence |
|-----------|---|
| 1 | Stip. of Facts, ¶ 1 |
| 2 | Stip. of Facts, ¶ 2 |
| 3 | Stip. of Facts, ¶ 8; Hearing Exhibit P-2 |
| 4 | Hearing Exhibit P-4 |
| 5 | Johnsons' Federal Complaint, at 13, 26 |
| 6 | Stip. of Facts, ¶ 6; Hearing Exhibit R-3, at 6 |
| 7 | Stip. of Facts, ¶ 9; Hearing Exhibit P-1, at 4 |
| 8 | Stip. of Facts, ¶ 10; Hearing Exhibit P-1, at 4 |
| 9 | Stip. of Facts, ¶¶ 9, 11 |
| 10 | Stip. of Facts, ¶¶ 12-14, 16 |
| 13 | Hearing Transcript, R.1045 |

The foregoing table, and the Facts of the Case section of this brief, conclusively show that there was more than substantial evidence to support each Finding of Fact.

The Conclusions of Law are Reasonable and Rational.

The Findings of Fact, Conclusions of Law and Order in this case was entered by the Securities Advisory Board, a body that is expert in the area of securities law,¹⁵ and approved by the then

R.1154-1158. Findings of Fact 11, 12, 14, and 15 are not included in the table because the Respondents do not believe that they are very important for purposes of upholding the Division's Order. Respondents assert that there is adequate evidence to support those four findings, however, and that the Petitioners, having failed to marshall the evidence (or even assert any flaw) with regard to those findings should be estopped from challenging them.

¹⁵The Securities Advisory Board is composed of five members: Two from the securities brokerage community with at least five years experience in securities, one member of the securities section of the Utah State Bar, one officer or director of a

Director of the Division of Securities, John Baldwin, and then affirmed by the Director of the Department of Commerce, David L. Buhler. The Conclusions of law require the application of facts to the law in the highly specialized area of securities law. As mixed questions of fact and law, the Conclusions of Law should be upheld unless they are unreasonable. Hurley, 767 P.2d at 527 ("Issues of mixed law and fact are often illuminated by an agency's expertise, and special technical knowledge may be of particular help in determining whether the facts fall within the meaning of statutory terms.").

The Johnsons have failed to show that the Conclusions of Law are unreasonable. Indeed, they have failed to directly analyze and critique the Conclusions of Law, other than to say that the finding of fact on which they are based lack substantial evidence, a point which was disposed of above.¹⁶ The Court should therefore summarily affirm the Conclusions of Law.

While the Respondents refuse to do the Johnsons' work for them

corporation affected by Utah securities laws, and one member of the public at large. Utah Code Ann. § 61-1-18.5(2) (1989).

¹⁶The Johnsons do assert, in cursory style, that the Division offered no evidence that the Johnsons' sellers lacked exemption from registration. Nonsense. The Stop Trading Order, which denied the availability of all transactional exemptions, constitutes *prima facie* evidence that no exemption existed, as did Judge Greene's findings. In light of the Stop Trading Order and Judge Greene's findings, it was the Johnsons' burden to show what exemption they relied upon; needless to say, they have never identified any such exemption. In light of the numerous assertions by the Johnsons that no exemption existed, the Johnsons should now be estopped from claiming that one did. Indeed, even if an exemption did exist that made the trades legal, the Johnsons would still be guilty of dishonest and unethical conduct if they traded in stock that, by their own repeated admissions, they fully believed was not exempt.

by analyzing every statement in the Conclusions of Law against every possible attack, there are a few key conclusions that warrant the Court's attention.

The Conclusions of Law begin (after identifying the Johnsons' alleged defenses) by reviewing the Division's statutory authority. *See, Findings, Conclusions and Order*, at R.1136. Utah Code Annotated section 61-1-6(1) (1989) is quoted for the proposition that the Division may suspend the registration of a broker-dealer or agent who has "engaged in dishonest or unethical practices in the securities business." Utah Code Ann. § 61-1-6(1)(g) (1989). Section 61-1-7 is quoted to show that "[i]t is unlawful for any person to offer or sell any security in this state unless it is registered under this chapter or the security or transaction is exempted under Section 61-1-14." Utah Code Ann. § 61-1-7 (1989). Although the point apparently baffles the Johnsons, common sense dictates that willfully purchasing a security that you know cannot legally be sold constitutes a dishonest or unethical practice in the securities business.¹⁷

¹⁷The Johnsons assert that they were found to have "aided and abetted" in a legal sense, and then assert that they could not have done so. That is not the case. The Johnsons were sanctioned for having participated in, and encouraged (by buying the stock) a securities transaction that they knew was illegal.

Even if the Divisions' case rested solely on the "aiding and abetting" theory, there is ample support for that theory. Utah Code Ann. § 76-2-202 (1990) states that "[e]very person, acting with the mental state required for the commission of an offense who directly commits the offense, who solicits, requests, commands, encourages, or intentionally aids another person to engage in conduct which constitutes an offense shall be criminally liable as a party for such conduct." Contrary to the Johnsons' assertions, as the following paragraphs of this brief demonstrate, the Stop Trading Order did not merely seek to protect the Johnsons (or other purchasers) from themselves; the order was entered to protect the

The Securities Advisory Board then entered a key Conclusion of Law with regard to the proper scope of a Stop Trading Order:

The proper scope and operative effect of the March 1, 1989 Order entered by the Division was to prohibit any trading of U.S.A. Medical Corporation securities within this state. Since those securities were neither registered nor exempt from registration and had been traded in a fraudulent scheme designed to manipulate the price of those securities, the just-stated order was duly entered to protect the public interest. It is specious to argue, as [the Johnsons] assert, that the order only prohibited the sale of U.S.A. Medical Corporation securities. Given the unlawful issuance of those securities and that the subsequent trading of those securities was tainted by fraudulent and manipulative practices, the proper scope of the March 1, 1989 Order must be broadly interpreted and in a manner consistent with the purpose for the issuance of that order.

Findings, Conclusions, and Order, at R.1136-1137. Given the expertise of the Securities Advisory Board, including two experienced members of the Utah brokerage community, this Court should defer to the reasonable and rational conclusion that an order denying the effectiveness of exemptions from registration is clearly interpreted by the Utah brokerage community as a Stop Trading Order that prohibits any trading whatsoever.

The next key conclusion of law states that the Johnsons

. . . purchased U.S.A. Medical Corporation Securities after March 1, 1989 with knowledge that a sale of those securities would constitute a violation of the March 1, 1989 Order. Such conduct clearly constitutes a "dishonest or unethical practice" within the meaning of Section 61-1-6(1)(g) and provides a sufficient basis upon which to enter a disciplinary sanction as to [the

public at large and to prohibit any more trades in tainted stock. The Johnsons, by willfully encouraging and aiding others to sell stock to them in violation of the Stop Trading Order and Utah Code Ann. § 61-1-7 (1989), aided and abetted those violations, and under Utah law is liable as a principle. (Willfulness is the mental state required for a criminal prosecution under the Utah Uniform Securities Act. Utah Code Ann. § 61-1-21 (1989).)

Johnsons'] registration.

Findings, Conclusions and Order, at R.1137-1138. This Conclusion of Law is again a result of the application of expertise in the area of securities law to the facts of this case. It is reasonable and rational. If the conduct was not of a type that is viewed as clearly and unambiguously dishonest and unethical in the industry, it is hard to imagine how two members of the brokerage community and a member of the securities section of the Utah Bar could feel comfortable signing their names to the Findings of Fact, Conclusions of Law and Order.

While a number of other Conclusions of law could be similarly reference, only one more will be addressed briefly here. The Securities Advisory Board found that "the [Johnsons'] dishonest and unethical conduct was driven by a desire to realize monetary gain and/or avoid financial loss and that [the Johnsons'] willingness to engage in trading the securities shifted over time, depending upon whatever would promote [the Johnsons'] economic interests." Findings, Conclusions and Order, at R.1139. The Board therefore concluded that "[b]y reason of the serious nature of [the Johnsons'] misconduct, an appropriately severe sanction should be entered." *Id.*, at R.1140. Once again, based upon the facts as set forth in the Findings of Fact and in the Facts of the Case portion of this brief, there is ample evidence that the Johnsons asserted that any trading in U.S.A. Medical was illegal whenever they were concerned about high buy-in prices, but gladly purchased the stock in defiance of the Divisions' Stop Trading Order when doing so would save them some \$506,538.

Every significant Conclusion of Law is supported by ample evidence, and the Conclusions of Law should be affirmed in their entirety.

Point II: The Petitioners Have Failed to Meet Their Burden of Establishing that there is an Unconstitutional Conflict between the Division's Enforcement of its U.S.A. Medical Stop Trading Order and the Petitioners' Obligations Under NASD Rules:

The heart of the Johnsons' appeal in this case is an argument that the Divisions' Stop Trading Order, as applied to the Johnsons, unconstitutionally conflicts with federal law in the form of NASD Rules. This was the basis for the Petitioners' Rule 12(b)(1), Rule 12(b)(6) and Rule 56 Motions, and most of the points raised in the Petitioners' Brief go to this argument, by focusing on various alleged constitutional defects.¹⁸

The Johnsons' argument rests on two basic assumptions: First, that the Johnsons, under the facts of the case, were required to violate the Stop Trading Order in order to fulfill their NASD requirements; and second that NASD rules have the force of federal law and therefore preempt the Division's Stop Trading Order. If the Johnsons fail to establish the validity of either of these assumptions, then most of the constitutional arguments raised in their brief are inapplicable.

The Petitioners' Brief cites Article III, section 1 of the

¹⁸Specifically, the following points in the Petitioners' Brief are dependent on this argument to the degree that they cannot be successfully raised if the argument is invalid: 2(A); 2(B); 2(C); 2(D); 2(E); 3; 4(A); 4(C); 4(D); 4(F); 4(H); and 4(N).

NASD Rules of Fair Practice, and Paragraph 1401 of the NASAA Statements of Policy for the proposition that broker-dealers and agents are required by both NASD and NASAA to "observe high standards of commercial honor and just and equitable principles of trade." NASD Manual, (CCH) ¶ 2151 (1990); NASAA Reports, (CCH) ¶ 1401 (1987).¹⁹ The Johnsons assert, without authority, that those general standards required that they violate the Divisions' Stop Trading Order by purchasing U.S.A. Medical shares from Utah residents in order to cover their "short" position. More specifically, they contend that they could have been sanctioned by NASD, or even expelled from NASD, for failing to cover their "short" position by purchasing from Utah sellers.

The Johnsons have utterly failed to prove that they ran the risk of any sanction by NASD if they did not purchase the U.S.A. Medical stock. They offered not one single case in which a member of NASD has been similarly sanctioned.²⁰ Even the Johnsons' expert witness at the administrative hearing, David King, had to admit

¹⁹The Respondents agree that the Johnsons are held to those standards; indeed, the Division suspended the Johnsons because their dishonest and unethical behavior failed to comply with those standards.

²⁰Indeed, the only evidence in the entire record that the Johnsons were faced with NASD sanctions is Marlen Johnson's self-serving hearsay statement that Ken Schaeffer of NASD told him "that we had to honor the contracts under any circumstances, or the NASD would take charge and we would be fined." Hearing Transcript at 93. Even assuming that Marlen Johnson correctly quoted Ken Schaeffer, all NASD was requiring was that the Johnsons "honor the contracts," which could be done by paying for stock bought-in on their behalf. Given the total lack of evidence that the NASD had any intention of trying to sanction the Johnsons for abiding by the Division's Stop Trading Order, this entire issue should be summarily resolved in favor of the Respondents.

that he knew of no case where NASD had sanctioned a member for a failure to deliver securities. Hearing Transcript, at 213-214.

There is a self-evident reason for this: Failure to deliver a security, by itself, is not sanctionable by NASD.²¹ To the contrary, the NASD Uniform Practice Code contains a lengthy and detailed "buy-in" procedure, which is specifically designed to be followed in the event that a seller fails to deliver a security. NASD Manual (CCH) ¶ 3559, *et. seq.* (1987). As the Petitioners' Brief concedes, "[b]uy-ins are regular occurrences in the securities brokerage business when a broker has not made timely delivery" of stock to cover a short position. Petitioners' Brief, at 12 n.11. All that the Johnsons had to do was allow buy-ins by the parties that they had shorted, and the Johnsons could not have been sanctioned by NASD; likewise, they would not have violated the Divisions' Stop Trading Order.²²

The Johnsons assert that they could not have allowed the buy-ins because the price of the buy-ins would have caused them to fall

²¹There is another, equally self-evident reason. It is preposterous to presume that the NASD would sanction a member for failing to purchase stock that could only be purchased illegally. For example, if the Johnsons' position is correct, and no state law can interfere with their overarching federal obligation to deliver stock, and if the Johnsons knew of some stock that could only be obtained by violating a probate order, or even by stealing pre-endorsed stock certificates, then under the Johnsons' reasoning, federal law would require that the Johnsons violate the probate order or steal the stock.

²²Johnson-Bowles owed the stock to out of state persons and entities, who would not have been violating the Stop Trading Order if they had purchased from out of state sellers.

below minimum capital requirements,²³ which in turn would have caused the NASD to have put them out of business. This is what the Johnsons really mean when they refer to the threat of NASD sanctions. The Johnsons' argument is flawed in three respects.

First, the evidence suggests that the price of the buy-ins would not have been excessive. The Johnsons purchased from at least one New York resident at an acceptable price, and there is no evidence in the record that buy-ins from other out of state residents were not possible at similarly favorable prices. See, Stipulation of Facts for Purposes of Hearing, at R.1155.

Second, if buy-ins were made at a price that the Johnsons felt was too high, they could have sought NASD arbitration²⁴ as to the reasonableness of that price, using the New York purchase to establish the proper fair market price.

Third, and most importantly, even if the buy-in prices would have been so high that they would have driven Johnson-Bowles out of business, the Johnsons still would not have been entitled to violate the Stop Trading Order. The penny stock market is a volatile place, and more than one brokerage house has gone out of business because it found itself on the losing end of a major price

²³All broker-dealers are required to meet minimum capital requirements in order to remain in business. See, 17 CFR 240.15c3-1 (1990); Utah Admin. Code R177-4-4 (1990). If a broker-dealer falls below the allowed minimum, that broker-dealer will generally be forced to shut down.

²⁴Which they were engaged in anyway as a result of Judge Green's orders, with regard to the issue of whether they could rescind their original short sales. It would not have been difficult to have also arbitrated the correctness of the price paid for buy-in stock.

fluctuation.²⁵ The law does not allow broker-dealers and agents to violate Stop Trading Orders merely to avoid economic loss, however severe.

In short, there is no reason to believe that the Johnsons risked being sanctioned by NASD if they had refused to violate the Stop Trading Order, but had agreed to allow the buy-ins. The Johnsons only faced NASD sanctions because of their poor economic situation, which was not caused by the Division's order. There is no conflict between enforcement of the Division's order and NASD rules.

Finally, even if there were a conflict between the Stop Trading Order and the NASD rules, the Johnsons have failed to establish that the conflict must be resolved in favor of the NASD rules and at the expense of state law.²⁶ The NASD is not an agency of the federal government; it is merely a self-regulating industry organization that is authorized by federal law and subject to monitoring by the SEC. NASD rules are not promulgated by the

²⁵If the Johnsons' loss was due to fraud or market manipulation by persons affiliated with U.S.A. Medical, the Johnsons' proper remedy would be to sue those persons, not to violate the Division's Stop Trading Order.

²⁶Section 28 of the Securities and Exchange Act of 1924, 15 U.S.C.A. § 78bb(a), states that "[n]othing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any security or person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." Thus, no implied preemption or comity argument is possible with regard to security laws. Federal law only expressly preempts directly conflicting state law; all other state law is valid. In this case, at most, the Johnsons are claiming an indirect conflict based upon the specific nature of the facts in this case. Such an incidental conflict is not sufficient to raise a question of federal preemption under 15 U.S.C.A. § 78bb(a).

federal government, although the SEC can monitor those rules. The Johnsons have failed to cite even one federal case that says that NASD rules have the force of federal law for purposes of conflict of laws analysis. By contrast, the Divisions' Stop Trading Order is specifically authorized by Utah statute. See, Point IV of this brief. It is a clear exercise of the state's police power to prevent fraud and chaos in the state's penny stock market; the state's powers are essentially identical to powers that the SEC has at the federal level. *Id.* The Johnsons have simply failed to show that there is a basis for federal pre-emption, even assuming that there was a real conflict between the NASD rules and state law.

Point III: The Respondents did not Err in Denying the Petitioners' Many Motions:

The ALJ's order converting the administrative procedure from informal to formal was correct.

This case began as an informal agency action, as defined by the Utah Administrative Procedures Act²⁷, on April 27, 1989. On May 24, 1989, the Division made a motion to convert the proceeding from informal to formal under the Administrative Procedures Act. (R.260.) The Johnsons objected to the conversion, (R.251.) and a hearing was held on June 5, 1989. (R.242.) The motion was granted on July 14, 1989. (R.174.)

The Johnsons object to the conversion on three grounds:

²⁷Utah Code Ann. § 63-46b-1, *et seq.* (1989).

First, that the Division's own rules designate all adjudicative proceedings as informal; second, that the conversion is not in the public interest; and third, that conversion unfairly prejudiced the Johnsons.

It is true that Utah Administrative Code Rule R177-46b-6B (1990) states that "[a]ll adjudicative proceedings under the Act, enumerated in this Rule, are designated as informal adjudicative proceedings." Nothing in that rule, however, prohibits a motion to convert to formal proceedings. By contrast, the Administrative Procedures Act specifically provides for conversion:

Any time before a final order is issued in any adjudicative proceeding, the presiding officer may convert . . . an informal adjudicative proceeding to a formal adjudicative proceeding if:

- (a) conversion of the proceeding is in the public interest; and*
- (b) conversion of the proceeding does not unfairly prejudice the rights of any party.*

Utah Code Ann. § 63-46b-4(3) (1989) (emphasis added). Under the express terms of that statute, the Division had a clear right to seek conversion before a final order was issued.

The Divisions' motion was based upon a belief that conversion of such a complex matter from an informal to a formal proceeding was in the public interest. Administrative Law Judge J. Steven Eklund specifically found that:

Given the relative complexity of securities regulation, expertise in the application and interpretation of the statutes and rules which govern the securities industry could prove to be invaluable to any fact finder charged with the responsibility to determine whether certain conduct is violative of the governing statutes and rules in that regard. In fact, the existence and effectiveness of agency adjudicative proceedings is primarily predicated upon the exercise of such specialized skills by boards and commissions similar to the Securities

Advisory Board. In light of the proposed agency action incident to these proceedings, it is in the public interest to conduct these cases on a formal basis.

(R.173.) Judge Eklund's findings are reasonable and rational, and should not be disturbed by this court.²⁸

The Johnsons' claim that they were unfairly prejudiced because they lost the right to a trial *de novo* in District Court is without foundation. Once again, Judge Eklund's findings are reasonable and rational:

[The Johnsons'] concern with costs which could be incurred on appeal and the nature of judicial review from any order entered in this forum implies that [the Johnsons] believe the outcome of these proceedings is a foregone conclusion. Although the division has undertaken proceedings which could prompt entry of a disciplinary sanction against [the Johnsons], there is no basis to conclude that [the Johnsons] will not be accorded due process in these proceedings, whether conducted on a formal or informal basis.

(R.173.) Further, because the motion to convert was brought in the first month of this adjudicative process, Judge Eklund found that the conversion "would not adversely affect the substantial rights of either party." *Id.*

The law allows conversion of an administrative action from informal to formal, and the conversion in this case was in the public interest and did not unfairly prejudice the Johnsons. Therefore, the ALJ acted correctly in granting the Division's motion to convert the proceedings to a formal status.

²⁸Although most of the issues raise under Point III of this brief are subject to the "correction-of-error" standard of review, the questions of whether conversion is in the public interest or would unfairly prejudice the Johnsons are mixed questions of fact and law, and should be subject to the "reasonable and rational" standard of review.

The ALJ properly denied the Petitioners' Rule 12(b)(1) Motion.

On July 3, 1989, the Johnsons filed a motion to dismiss due to a lack of subject matter jurisdiction, pursuant to Rule 12(b)(1) of the Utah Rules of Civil Procedure, as referenced by section 63-46b-1(4)(b) (1989) of the Administrative Procedures Act. (R.239-241.) The motion was denied by ALJ Eklund on August 27, 1989, after full briefing and oral argument. (R.149-153.)

The Johnsons have argued, on pages 25-36 of there brief, that the motion should have been granted. In support of that argument they assert five closely related grounds, all of which go to the question of whether the Division can sanction the Johnsons for violating the Stop Trading Order in light of the alleged conflict between that order and NASD requirements. Point II of this brief has already analyzed the substance of Johnsons claims of alleged conflict between the Division's order and NASD requirements, and has shown that the conflict exists solely in Johnsons' mind.²⁹

Even assuming every argument in pages 25-36 of the Petitioners' Brief were valid, however, they still do not add up to a lack of subject matter jurisdiction. Even if the Johnsons were entirely right as to their theory of the case, the Division would still have jurisdiction to bring an administrative proceeding.³⁰

²⁹Judge Eklund did address the substance of the Johnsons' claims in his conclusions of law denying the Rule 12(b)(1) motion. See, R.150-152.

³⁰The case of Davis v. Rio Rancho Estates, Inc., 401 F. Supp. 1137 (D.C.N.Y. 1975), is illustrative. In that case the defendant argued that the land deal over which it was being sued did not involve a security under federal law and hence there was no subject

The Johnsons have moved to dismiss on the basis of a lack of jurisdiction, where the allegation is merely one of lack of merit. The issue of whether a court or agency has jurisdiction to decide a matter and whether the specific claims of the case against a defendant have merit are entirely severable and distinct issues. See Wright & Miller, Federal Practice Civil 2d Section 1350 (1990).

This is a license suspension case. Utah Code Annotated section 61-1-6(1) (1989) allows the executive director, with the approval of the Securities Advisory Board, to suspend broker-dealer or agent licenses. Utah Code Annotated section 61-1-18.6 (1989) says that the Division will comply with the Administrative Procedures Act in its adjudicative proceedings. Utah Code Annotated section 63-46b-3 (1989) establishes the procedure for commencing administrative proceedings under the Administrative Procedures Act. Notices of Agency Action were served on the Johnsons in accordance with the requirements of section 63-46b-3. (R.263-295.) Those are the statutes and facts upon which subject matter jurisdiction is based. The claims raised by the Johnsons have nothing to do with the basis for subject matter jurisdiction.

The ALJ properly denied the Petitioners' Rule 12(b)(6) Motion.

Petitioners offer a quiver-full of constitutional arguments in

matter jurisdiction in the federal court. The court rejected that argument, informing the defendant that the merits of the claim were properly raised in a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) and not in a claim that the court lacked subject matter jurisdiction.

Point 4 of their brief, which claims that Judge Eklund erred in denying their Rule 12(b)(6) Motion. Most of the claims of constitutional error raised in that section are redundant, unsupported with any authority and just plain a waste of this Court's time and the Petitioners' paper. That having been said, the Respondents address the issues raised in Point 4 of Petitioners' brief as follows. The equal protection and due process arguments raised in Points 4(A) and (B) will be addressed in Point IV of this brief. The comity argument raised in Point 4(D) of Petitioners' brief has been addressed in Point II of this brief, *supra*. The arguments raised in Points 4(H) and (K) of Petitioners' brief have been addressed in Section I of this brief, *supra*. The substance of the arguments raised in Points 4(I), (J), and (L) will be addressed in Point IV of this brief. brief.

The remaining issues raised in Point 4 will be addressed here. Those issues concern whether the Division's actions: deprived the Johnsons of their "privileges and immunities," Point 4(C); made the statute an *ex post facto* law, Point 4(E); interfered with the Johnsons' right to contract, Point 4(F); or were based on an unconstitutionally vague statute, Point 4(G). Respondents contend that this Court should not even consider any of these issues, however, because the Johnsons have failed to make legally sufficient arguments, including citations to relevant authorities, on each point. Instead, the Petitioners' Brief simply raises bald and cursory allegations. Since the Petitioners' Brief does not meet the standard required under Rule 24(a)(9) of the Utah Rules of Appellate Procedure, this Court should summarily reject each of the

Johnsons' arguments cited at the outset of this paragraph. See, State v. Reiners, 151 Utah Adv. Rep. 17, 22-23 n.2 (Utah App. Dec. 28, 1990); State v. Wareham, 772 P.2d 960, 966 (Utah 1989). That said, the Respondents offer the following analysis on each point. Petitioners have not had their privileges and immunities violated.

In so far as Respondents can fairly discern it, Petitioners' argument in Point 4(C) of their brief is that by suspending their licenses, the Division violated their rights as federal citizens.

The Fourteenth Amendment to the United State's Constitution states: "No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States."

That language has been given its clear meaning: any state law that purports to take away an inherent right of federal citizenship is invalid. See, Twining v. New Jersey, 211 U.S. 78 (1908). The rights inherent in federal citizenship are as follows: the right to pass freely from state to state; the right to petition Congress for the redress of grievances; the right to vote for federal officers; the right to be protected against violence while in the custody of federal marshals; the right to inform federal authorities of violations of law; and the statutory right to hold property. See *Id.*, at 97; Oyama v. California, 332 U.S. 633 (1948).

Of course, since Johnson-Bowles is not a citizen, the privileges and immunities clause offers its no protection. Nor does it aid Marlen Johnson, since there is no inherent right to sell securities that attaches to federal citizenship.

Petitioners also appear to claim that their privileges and immunities under Article IV, Section 2 of the United States

Constitution have been violated. That argument is, if such a thing is possible, even less meritorious than their Fourteenth Amendment claim.

Article IV, Section 2 provides: "[the] Citizens of each state shall be entitled to all the privileges and immunities of Citizens in the several States." That language creates a concept of national citizenship under which a citizen of state "A" who moves to state "B" cannot be treated more harshly than citizens of state "B" in general. See, Toomer v. Witsell, 334 U.S. 385 (1948).

Again, the provision is entirely inapplicable to Johnson-Bowles, a corporate person but not a citizen, and inapplicable to Marlen Johnson because he makes no claim even colorably close to a valid argument under Article IV, Section 2.

The Order Suspending Petitioner's Licenses was not an *ex post facto* Law.

In Point 4(E), Petitioners argue that the order suspending their licenses was an illegal *ex post facto* law under Article I, section 10 of the United States Constitution. Again, Petitioners reveal a lack of even a basic familiarity with Constitutional concepts.

First, the prohibition against *ex post facto* laws applies only to the imposition of criminal penalties. See, Calder v. Bull, 3 U.S. 386 (1798) (*ex post facto* law prohibition inapplicable to legislative act setting aside probate order); Galvan v. Press, 347 U.S. 522 (1954) (*ex post facto* prohibition has no application in deportation proceedings since they are civil); Garrett Freight Lines, Inc v. State Tax Commission, 135 P.2d 523 (Utah 1943)

(neither Utah nor Federal Constitutions' prohibition against *ex post facto* laws prohibited after the fact taxation of lawful business activity).

Moreover, even if the Johnsons had a liberty rather than a property interest suspended by the Division, there still would have been no violation of the prohibition against *ex post facto* laws. The Division suspended the Johnsons' licenses because they committed a dishonest and unethical practice when they bought stock in violation of a stop trading order. Since it was illegal to participate in dishonest or unethical practices and to trade in the face of a stop trading order before Johnsons undertook to sell the U.S.A. Medical shares short, and before they bought the stock in violation of the order, their claim that they were the victims of an *ex post facto* law is simply silly.

Petitioners' right to freedom from interference with contract was not violated.

Since the Petitioners have not favored the Respondents or this Court with any analysis or authority on Point 4(F) of their brief, it is difficult to discern their argument on the point, let alone refute it. It appears to the Respondents that the Petitioners are claiming that they had a constitutional right to sell U.S.A. Medical stock after the Division placed a stop trading order on it because they had sold the shares short prior to the stop trading order being entered.

That argument is frivolous. The freedom from interference to contract guaranteed by Article 1, Section 18 of the Utah Constitution and Article 1, Section 10 of the United States

Constitution does not deprive state administrative agencies of the right to use the state's police power to regulate business. See, United States Smelting v. Utah Power and Light Company, 197 P. 902 (Utah 1921) (regulation of the rates charged by a utility company permissible even it interferes with contract rights).

There was nothing vague about the Division's Command that Petitioners Not Trade shares covered by a stop trading order.

In reading Petitioners' argument in Point 4 (G) of their brief it is easy to loose sight of what Petitioners did to warrant the suspension of their licenses. Petitioners had their licenses suspended because, after they successfully convinced a federal court judge that it was illegal to trade in shares of U.S.A. Medical (on the theory that they were unregistered securities and fraudulently issued) and after the Division had entered an order to the same effect, and after the price of the securities had plummeted, they purchased over 300,000 U.S.A. Medical shares.

Petitioners now come before this Court with straight faces and assert that Utah Code Annotated section 61-1-6(1)(g) (1989), the section that allows the Division to suspend the licenses of agents and brokers who participate in "dishonest or unethical practices," and the rules promulgated thereunder, are unconstitutionally vague as applied to them. In their brief, Petitioners assert that the standard under which the statute should be measured is one of whether a "reasonably intelligent person" would have been able to discern that his conduct was dishonest or unethical. Petitioners' Brief, at 48. That is not the correct standard. In Brewster v. Maryland Securities Commissioner, 548 A.2d 157 (Md. App. 1988), a

case the Petitioners have tried in vain to distinguish, the court held that in deciding whether the phrase "dishonest and unethical practices" was unconstitutionally vague, the phrase's reference in business practice, custom and usage must be considered. *Id.* at 160. The record in this case fully establishes that all reasonable people in the securities industry knew that the Division's Order was a total prohibition on the trading of U.S.A. Medical stock and that violating it could result in a license suspension. Findings of Fact, Conclusions of Law and Order, at R.1136-1137 ("The proper scope and operative effect of the March 1, 1989 Order entered by the Division was to prohibit any trading of U.S.A. Medical Corporation Securities within this state"). That being the case, there was nothing vague about the Division's interpretation that Utah Code Annotated section 61-1-6(1)(g) (1989) prohibits violating stop trading orders as an unethical or dishonest practice.

Moreover, even if the vagueness test is applied using a reasonable person rather than a reasonable securities broker standard, there is still nothing vague about the statute and rules as applied to the Johnsons by the Division. The Johnsons knew that the stock in U.S.A. Medical was not exempt from registration and indeed successfully convinced Judge Greene of the same. Hence they knew that neither they nor any one else should be trading in it. If that were not enough, the Petitioners were specifically told by the Division's order that they were forbidden to trade in it. It does not take a person of any more than average ability to discern that trading in the stock under those conditions would be deemed a dishonest or unethical thing to do.

The ALJ properly denied the Petitioners' Rule 56 Motion.

The Johnsons filed a motion for summary judgment pursuant to Rule 56 of the Utah Rules of Civil Procedure. That motion was denied, and the Johnsons claim that the denial was error.

The Johnsons complain that the only facts asserted to be in dispute went to the question of "solicitation," which is immaterial to the case, and they further complain that the issue of "solicitation" was not raised by competent affidavit, as required under Rule 56.³¹

Rule 56 allows for summary judgment in cases where two criterion are met: First, that there are no disputed issues of material fact; and, second, that the movant is entitled to judgment as a matter of law. See, Geneva Pipe Co. v. S & H Insurance Co., 714 P.2d 648 (Utah 1986); Snyder v. Merkley, 693 P.2d 64 (Utah 1984).³² The Johnsons' motion failed to meet either criterion. As the rest of this brief amply demonstrates, the Johnsons were not entitled to judgment as a matter of law. Further, the key issue in the case, whether the purchases by the Johnsons of U.S.A. Medical

³¹The Division's memorandum opposing the summary judgment motion contained evidence of solicitation in the form of an affidavit by Dorothy Akin, an investigator for the Division, and in the form of her memorandum to the file. Admittedly, the affidavit is based on hearsay, and the memorandum is hearsay, but hearsay is allowed in formal administrative proceedings and should therefore be allowed in summary judgment motions. See, Utah Code Ann. § 63-46b-8(1)(c) (1989).

³²Summary judgment should only be granted when it is clear from the undisputed facts that the opposing party cannot prevail. Conder v. A.L. Williams & Associates, 739 P.2d 634 (Utah App. 1987); Bray Lines v. Utah Carriers Inc., 739 P.2d 1115 (Utah App. 1987).

stock after the Division imposed its Stop Trading Order constituted "dishonest or unethical conduct" was certainly not undisputed. Thus, the ALJ acted correctly in denying the Johnsons' motion for summary judgment.

The Petitioners' remaining procedural objections are either frivolous or moot.

The Johnsons assert in point 3 of the Petitioners' Brief that then Division Director John Baldwin's Order on Agency Review of October 30, 1989, with regard to Judge Eklund's order denying the Johnsons' motion to dismiss under rule 12(b)(1) was erroneous and prejudicial. This was the central issue in the case of Johnson-Bowles Company v. Baldwin, No. 900210-CA (Utah App. January 29, 1991). The Court held that the issue was moot, and the Court specifically denied the Johnsons' motion to consolidate that case with the case currently before the Court. Therefore, this issue has been resolved and no longer needs addressed.

The Johnsons claim, in point 6 of the Petitioners' Brief, that then Division Director John Baldwin erred in issuing his Order on Agency Review of April 9, 1990. That order denied further agency review of the Johnsons' Rule 56 Motion on the grounds that denial of that motion did not constitute a final agency action. Even if the Johnsons are right, and Director Baldwin should have allowed further agency review at the time, the issue is now moot. The Johnsons received a full agency review by Executive Director David L. Buhler of the Department of Commerce after the Division of

Securities entered its final order, R.1129-1142. The Department of Commerce then issued a detailed Order on Review, R.830-842, which specifically reviewed the denial of the Johnsons' Rule 56 motion. See, R.840-841. Thus, the Johnsons' received the agency review that they sought, and this issue is moot on appeal.

Point 8 of the Petitioners' Brief alleges error because the Division ignored both the Johnsons' objection to the form and content of the Divisions' final order, and the Johnsons' "Demand for Disclosure of how and by whom the August 13, 1990, Findings of Fact, Conclusions of Law and Order was Prepared."³³ The Division rightly ignored both motions, which are nothing more than a spurious and frivolous attack on the integrity of the Security Advisory Board and Judge Eklund.³⁴ Further, the Johnsons waived their objections when they failed to raise them at the agency review before the Department of Commerce. Their request for review does not include a request for review of the Division's failure to act on either order. The Department of Commerce even invited the

³³Of course, no such motion has ever been recognized under the laws of this state or, to the best of counsel's knowledge, under the laws of any state. It is not provided for in any rule, and while courts have the right, in the furtherance of justice, to entertain a wide range of motions not specifically provided for by rule, there is no authority for requiring a court to entertain such dross as this.

³⁴Assuming, *arguendo*, that people other than the Securities Advisory Board, Judge Eklund, and former Director Baldwin were involved in the process of drafting the Findings of Fact, Conclusions of Law, and Order (an assumption that is entirely lacking in evidence, since the document may very well have been drafted by a member of the Securities Advisory Board on a word processor different from the one usually used by Judge Eklund), that does not change the fact that the members of the Securities Advisory Board, and Mr. Baldwin, approved the wording of the document and signed their names to it.

Johnsons to supplement their request for review, but the Johnsons "declined the invitation and filed no more memoranda." Department of Commerce Order on Review, R.832.

Point 9 of the Petitioners' Brief alleges that the Department of Commerce's Order on Review is flawed simply because it failed to overturn the final order of the Division of Securities. This argument adds nothing to the case; either the Division's final order was correct, in which case so was the Order on Review, or it was flawed, in which case so was the Order on Review. There is no independent error claimed on the part of Executive Director Buhler, the author of the Order on Review.

Point IV: The Divisions' U.S.A. Medical Stop Trading Order was valid at the time when the Petitioners purchased U.S.A. Medical stock:

This Court should not even consider challenges to the validity of The Division's Stop Trading Order. The order was entered in large part as a result of prompting by the Johnsons and because of the Johnsons' evidence, put on in the Johnsons' Federal Lawsuit, that U.S.A. Medical stock lacked trading exemptions and was fraudulently issued. The Johnsons received a copy of the Divisions summary stop order as soon as it was entered, and that copy stated that "notice is hereby given that within fifteen (15) days after receipt of a written request, this matter will be set down for hearing." R.294. Not surprisingly, the Johnsons, who were

benefiting from the stop trading order's existence,³⁵ did not request a hearing. When no hearing was requested, under the terms of Utah Code Annotated section 61-1-14(3) (1989) "the order will remain in effect until it is modified or vacated by the executive director." The Division then issued its default (permanent) version of the Stop Trading Order, and the Johnsons were again immediately provided with a copy. Again not surprisingly, the Johnsons did not take any action to try to lift the Stop Trading Order. Because the Johnsons were the parties who worked hard to get the Stop Trading Order issued, and because they were routinely admitting in both court and correspondence throughout the months of February and March of 1989 that the U.S.A. Medical stock lacked all exemptions and could not be legally traded, they should be estopped from attacking the validity of the order. Further, they waived their right to complain about the validity of the order when they failed to request a hearing, and again when they took no actions, not even a letter of protest, when notified that the order had become permanent by default.

The Johnsons argue that, at most, the Division's stop trading order could only have been valid for ten days, from March 1, 1989, through March 10, 1989, and therefore, purchases of stock made by them after March 10th could not have violated the order, or constituted dishonest or unethical behavior on their part. Of course, that argument is only relevant if the Johnsons can show

³⁵Without the stop trading order it is highly improbable that the price of U.S.A. Medical stock would have fallen to a fraction of its pre-order value, thereby making it attractive for the Johnsons to buy the stock.

that all of their purchases took place after March 10th; if even one purchase took place on or before that date, that purchase would have been a sufficient basis for the Division's order.³⁶ The evidence, however, merely shows that all of the purchases took place during March of 1989; there is no evidence as to the exact dates in March. It is therefore reasonable to assume that some of the purchases may have taken place on or before March 10th. Because the Johnsons have utterly failed to meet their burden of introducing evidence that all of their purchases were begun and completed after March 10th, this court should not even consider the issue of whether the Division's Stop Trading Order could lawfully last more than ten days.

Turning to the substance of the Johnsons' argument, it is clear that they have confused two types of stop trading orders, namely the ten day "suspension of trading" type of order and the potentially permanent "denial of exemption from registration" type of order.

The SEC can issue a "suspension of trading" type of stop trading order under the authority of Section 12(k) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 781(k), which reads in part as follows:

If in its opinion the public interest and the protection of investors so require, the Commission is authorized summarily to suspend trading in any security (other than an exempted security) for a period not exceeding ten days, or with the approval of the President, summarily to

³⁶Actually, the S.E.C.'s suspension order expired on March 16, 1989. Since it would obviously have been dishonest or unethical to violate that order, the Johnsons' must show that all of their purchases took place after March 16th.

suspend all trading on any national securities exchange or otherwise, in securities other than exempted securities, for a period not exceeding ninety days.

This suspension of trading type of stop trading order has several unique characteristics, the most noteworthy of which is that it may be entered by the SEC any time that "the public interest and the protection of investors so require." Thus it may be used in an almost unlimited variety of circumstances. For example, if the president and guiding force of a high-tech company suddenly dies, the SEC could use its power to suspend trading and give the market some cooling off time in order to prevent wild price instability. Because the SEC's authority under this provision is so broad, and essentially unreviewable, it is limited to ten days (or ninety, with the President's concurrence).

By contrast, SEC Rule 261, Suspension of Exemption, under the Securities Act of 1933, 17 CFR § 230.261 (1990) provides for potentially permanent stop trading orders based upon the suspension of exemptions from registration requirements. It operates in much the same manner as Utah Code Annotated section 61-1-14 (1989), which is the section relied upon by the Division in this case.³⁷ Each provision operates to stop trading in a stock by denying the availability of exemptions to the stock registration requirements. Under each provision the order is originally temporary, but becomes

³⁷Rule 261 is very similar to the other stop order provision in the Utah Uniform Securities Act, Utah Code Ann. § 61-1-12 (1989). The primary difference between sections 61-1-12 and 61-1-14(3), is that the former section is limited to denying the effectiveness of registration statements, while the latter section is used for stop trading orders based upon the denial of exemptions from registration.

permanent if no hearing is requested within a set period of time. See, Rule 261(b) ("If no hearing is requested . . . the order shall become permanent on the thirtieth day after it entry and shall remain in effect unless or until it is modified or vacated by the Commission.")

Thus, under a provision that is extremely similar to the provisions of the Utah Uniform Securities Act, the SEC does have authority to stop trading in a stock permanently. Obviously, Utah Code Annotated section 61-1-14(3) does not conflict with the federal law, and the Petitioners' claim that the Stop Trading Order could not lawfully last for more than ten days is meritless.³⁸

Point V: The Divisions' Order Suspending the Johnsons' Registration with the Division for One Year and Placing the Johnsons' on Probation for Two Years Thereafter was Reasonable in Light of the Severity and Willful Nature of the Johnsons' Conduct:

The facts of this case, and the analysis contained in the prior portions of this brief, should be sufficient to establish

³⁸So is the related argument that a permanent stop trading order constitutes an unlawful taking of property, an argument that should be rejected out of hand because the Petitioners have failed to support it with any authority or more than the most general argument. State v. Reiners, 151 Utah Adv. Rep. 17, 22-23 n.2 (Utah App. Dec. 28 1990); State v. Wareham, 772 P.2d 960, 966 (Utah 1989). Of course, under a stop trading order there is only a suspension of the right to trade the stock, not a "taking" of the right to own the stock (and to receive dividends, vote at shareholders' meetings, etc.). Further, the Johnsons waived their right to object to the propriety of the alleged taking when they failed to request a hearing. Finally, even a permanent stop trading order is subject to modification or vacation, something that the Johnsons have never sought in this case. See, Utah Code Ann. § 61-1-14(3) (1989).

that the Division did not abuse its discretion in placing the Johnsons on one year's suspension followed by two year's probation. The Johnsons' behavior constituted as direct and willful a violation of a Division order as can be imagined. Not only did the Johnsons know about the order, they were largely responsible for its issuance. They also profited handsomely from violating the order, to the tune of more than \$500,000. As the Securities Advisory Board and John Baldwin put it in the Divisions' Conclusions of Law:

[E]ntry of a disciplinary sanction in this proceeding is in the public interest and clearly warranted due to [the Johnsons'] non-compliance with the March 1, 1989 Order which was duly entered to regulate the trading of U.S.A. Medical Corporation Securities. The record reflects that Respondents' dishonest and unethical conduct was driven by a desire to realize monetary gain and/or avoid financial loss and that [the Johnsons'] willingness to engage in trading the securities shifted over time, depending upon whatever would promote [their] economic interests. Adherence to orders duly entered by the Division which govern the practices of broker-dealers and against engaged in the securities business should not be a matter dictated by the potential for monetary gain. By reason of the serious nature of [the Johnsons'] misconduct, an appropriately severe sanction should be entered.

Findings of Fact, Conclusions of Law, and Order, at R.1139-1140. Under the circumstances of this case, the penalty meted out was not an abuse of discretion by the Division.³⁹

³⁹Likewise, the Johnson's claim that the Division's actions violated the Equal Protection Clause of the United States Constitution, Fourteenth Amendment, section 1, is baseless. That argument, which like so many others cites no legal authority (and should therefore be summarily dismissed) is premised on the belief that the Division singled out the Johnsons for punishment. In fact, two of the masterminds behind U.S.A. Medical, Jim Averett and Roger Coleman have pled guilty to related crimes (Averett received probation; Coleman will be sentenced soon, and prison time is expected). Paul Jones is still facing disciplinary action (the

CONCLUSION: THE COURT OF APPEALS SHOULD AFFIRM THE RESPONDENTS' ACTIONS IN ALL REGARDS:

Under the facts of this case, looking at the record as a whole, the Division acted reasonably and rationally in suspending the licenses of Johnson-Bowles and Marlen Johnson for one year and placing them on a two year suspension. This Court should uphold the Division's actions.

Respectfully submitted this 29th day of April, 1991.

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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of April, 1991, I caused to be mailed, postage prepaid, two true and correct copies of the foregoing BRIEF OF RESPONDENTS to

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only reason his case has been inactive so long is the lack of resources to pursue it, caused largely by the many frivolous motions and grounds for appeal raised by the Johnsons). As for the parties that transacted trades in U.S.A. Medical on March 1, 1989, there is no clear evidence that they knew of the Division's order before they executed their trades. Of course, the Johnsons were unique in that they originally urged the Division to issue the Stop Trading Order, and then proceeded to violate that order once the price of U.S.A. Medical stock had fallen dramatically.