

1990

Johnson-Bowles Company INC., and Marlen Vernon Johnson v. The Division of Securities and the Utah Department of Commerce, the State of Utah : Response to Petition for Rehearing

Utah Court of Appeals

Follow this and additional works at: https://digitalcommons.law.byu.edu/byu_ca1



Part of the [Law Commons](#)

Original Brief Submitted to the Utah Court of Appeals; digitized by the Howard W. Hunter Law Library, J. Reuben Clark Law School, Brigham Young University, Provo, Utah; machine-generated OCR, may contain errors.

John Michael Coombs; Craig F. McCullough; Attorneys for the Appellants.

R. Paul Van Dam; Attorney General; David N. Sonnenreich; Assistant Attorney General; Attorneys for the Appellees.

Recommended Citation

Legal Brief, *Johnson-Bowles Company v. The Division of Securities and the Utah Department of Commerce*, No. 900558 (Utah Court of Appeals, 1990).

https://digitalcommons.law.byu.edu/byu_ca1/2987

This Legal Brief is brought to you for free and open access by BYU Law Digital Commons. It has been accepted for inclusion in Utah Court of Appeals Briefs by an authorized administrator of BYU Law Digital Commons. Policies regarding these Utah briefs are available at http://digitalcommons.law.byu.edu/utah_court_briefs/policies.html. Please contact the Repository Manager at hunterlawlibrary@byu.edu with questions or feedback.

UTAH COURT OF APPEALS
BRIEF

UTAH
DOCUMENT
KFU
50
A10
DOCKET NO.

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.

RESPONSE TO PETITION
FOR REHEARING

Case # 900558-CA

Rule 29(b) 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

R. PAUL VAN DAM, #3312
Attorney General
DAVID N. SONNENREICH, #4917
Assistant Attorney General
Fair Business Enforcement Unit
115 State Capitol Building
Salt Lake City, Utah 84114
Telephone (801) 538-1331

ATTORNEYS FOR THE APPELLEES

John Michael Coombs, #3639
72 East 400 South, Suite 220
Salt Lake City, Utah 84111
Telephone (801) 359-0833

Craig F. McCullough, #2166
10 East So. Temple, Suite 800
Salt Lake City, Utah 84133
Telephone (801) 530-7307

ATTORNEYS FOR THE APPELLANTS

FILED

JAN 2 1992

Mark E. Noonan
Clerk of the Court
Utah Court of Appeals

IN THE UTAH COURT OF APPEALS

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

) RESPONSE TO PETITION
) FOR REHEARING

Case # 900558-CA

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

) Rule 29(b) 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

R. PAUL VAN DAM, #3312
Attorney General
DAVID N. SONNENREICH, #4917
Assistant Attorney General
Fair Business Enforcement Unit
115 State Capitol Building
Salt Lake City, Utah 84114
Telephone (801) 538-1331

ATTORNEYS FOR THE APPELLEES

John Michael Coombs, #3639
72 East 400 South, Suite 220
Salt Lake City, Utah 84111
Telephone (801) 359-0833

Craig F. McCullough, #2166
10 East So. Temple, Suite 800
Salt Lake City, Utah 84133
Telephone (801) 530-7307

ATTORNEYS FOR THE APPELLANTS

RESPONSE TO PETITION FOR REHEARING

This RESPONSE TO PETITION FOR REHEARING is submitted by the Division of Securities (hereinafter the "Division") and the Department of Commerce of the State of Utah, Respondents in this appeal, pursuant to Rule 35 of the Utah Rules of Appellate Procedure and at the specific request of the Court.

The Respondents believe that the Court made a minor error in citing Utah Code Annotated section 61-1-12 on page 8 of its opinion of November 29, 1991 (hereinafter the "Opinion"). The Respondents believe that the Court meant to cite to Utah Code Annotated section 61-1-14(3). Otherwise, the Respondents believe that the Opinion correctly resolves all of the issues raised in this appeal.

I. THE COURT INCORRECTLY CITED TO UTAH CODE ANNOTATED SECTION 61-1-12 ON PAGE 8 OF THE OPINION, BUT THAT ERROR DOES NOT AFFECT THE VALIDITY OF THE OPINION BECAUSE A STOP TRADING ORDER UNDER UTAH CODE ANNOTATED SECTION 61-1-14(3) IS FUNCTIONALLY THE EQUIVALENT OF ONE UNDER SECTION 61-1-12.

The second paragraph of page 8 of the Opinion includes two references to Utah Code Annotated section 61-1-12 (1989).¹ The Court implies that the stop trading order was issued under section 12. That is incorrect. The stop trading order in this case was

¹Contrary to the Petitioners' assertions in their Petition for Rehearing, the remainder of the Opinion appears to be based correctly on section 14(3). The only references to section 12 are those contained on page 8; other references in the Opinion to the stop trading order correctly identify it as a section 14(3) order. See, e.g., Opinion at 16, 18 (quoting the Division's March 1, 1989 stop trading order).

issued under Utah Code Annotated section 61-1-14(3)(1989).² The Court's mistaken reference to section 12, rather than section 14(3), on page 8 of the Opinion does not affect the analysis of the case, however. The Opinion states that

Utah Code Ann. § 61-1-12 (1989) grants the executive director blanket authority to issue a stop order in several enumerated circumstances. In addition, Utah Code Ann. § 61-1-12(2)(C)(i) (1989) states: "If no hearing is requested and none is ordered by the division or executive director, the order shall remain in effect until it is modified or vacated by the executive director." By its plain language, the statute grants broad discretionary powers to the executive director to either call for a hearing, modify or leave in effect the stop trading order that has been entered.

The same can be said for stop trading orders issued under section 14(3). Section 14(3) gives the director the authority to stop trading in an unregistered security by revoking or denying the effectiveness and availability of exemptions from the registration requirements. (As the Opinion correctly notes on page 14, "[s]ince the stock was unregistered and was not eligible for any exemptions to registration, it could not lawfully be the subject of any transaction.") Likewise, section 14(3) includes the following language, which is almost identical to the language from section 12 quoted in the Opinion: "If no hearing is requested and none is ordered by the executive director or division, the order will

²There are a number of differences between section 12 and section 14(3) stop trading orders, as explained in the Brief of Respondents at pages 42-44, but the main difference is that section 12 stop trading orders are issued when a company has registered with the Utah Division of Securities, while section 14(3) stop trading orders are issued when a company has not registered, but is trading on the basis of an alleged exemption from the registration requirements.

remain in effect until it is modified or vacated by the executive director." U.C.A. § 61-1-14(3)(1989). Thus, the Opinion's analysis on page 8 that section 12 "grants broad discretionary powers to the executive director to either call for a hearing, modify or leave in effect the stop trading order that has been entered" applies equally well to section 14(3) stop trading orders.³

In short, while a minor amendment to the Opinion would be appropriate, replacing the page 8 references to section 12 with references to section 14(3) and slightly altering the quote, the analysis contained in the Opinion remains valid with respect to section 14(3) stop trading orders such as the one in this case.

II. THE JOHNSONS CONTINUE TO FAIL TO UNDERSTAND THAT THEY WERE SANCTIONED FOR ENGAGING IN DISHONEST AND UNETHICAL PRACTICES IN THE SECURITIES BUSINESS.

The arguments raised in the remaining points of the Petition for Rehearing show that the Johnsons have never quite understood that they were administratively sanctioned for violating industry norms by engaging in dishonest and unethical practices in the securities business. The Johnsons continually try to shift burdens of proof, raise non-issues, and apply incorrect legal standards, leading the Respondents to wonder, *inter alia*, whether the Johnsons

³For the record, it should be noted that while the Johnsons have made numerous arguments in their original briefs and in the Petition for Rehearing to the effect that the stop trading order is invalid or unconstitutional, they lack standing to raise those arguments. Although they were aware of the stop trading order on the day it was issued, they failed to either (1) object to it becoming permanent or (2) seek to have it modified or vacated.

think that they have been convicted of felonies, rather than having been temporarily denied the privilege of professional licensure.

For example, Point II of the Petition for Rehearing, concerning whether a section 14(2) exemption is required for purchasing a security, fails to recognize that this is an administrative action based on unethical conduct. The scope of unethical conduct encompasses much more than merely that conduct which is not illegal. As this Court recently noted in Heinecke v. Dept. of Commerce, 810 P.2d 459, 466 (1991):

In contrast to the unfairness in imposing criminal liability on a run-of-the-mill citizen under a statute which does not clearly proscribe the conduct complained of, as a result of their training, testing, and licensure, members of a profession are properly charged with knowledge of what conduct is inconsistent with their responsibilities as professionals notwithstanding some lack of precision or comprehensiveness in the statutes and rules governing their licensure."

The record provides substantial evidence that the Johnsons knowingly engaged in conduct that was inconsistent with their responsibilities as professionals, even if the conduct was not civilly or criminally actionable. Among other things, the Securities Advisory Board had no trouble concluding that the Johnsons' purchase of U.S.A. Medical stock after the Division's March 1, 1989 stop trading order "frustrated the Division's appropriate efforts to preclude trading in those securities and thus partially emasculated the effect of the March 1, 1989 Order." Record, at page 1138. Such conduct by a professional, designed to subvert the professional's regulatory agency, is *prima facie* unethical. Thus, even assuming, *arguendo*, that the Johnsons were

to show that their purchases of stock were not illegal, they have not met their burden of showing that the Securities Advisory Board acted irrationally in determining that their behavior was unethical.⁴

Likewise, the Johnsons are obsessed with attempting to prove (in Point III of the Petition for Rehearing) that they did not "aid and abet" a violation of the securities act, even though they were not sanctioned for having aided and abetted in the narrow legal sense of the term. While Count One of the Amended Petition brought against the Johnsons contains an assertion that the Johnsons' actions encouraged or aided violations of the law,⁵ Count Two contains no language about aiding. Record, at 165-167. The Findings of Fact, Conclusions of Law, and Order entered by the Securities Advisory Board against the Johnsons is based solely on the theory that the Johnsons had acted dishonestly and unethically by willfully violating the Division's stop trading order; there is not one mention of the Johnsons being censured for having "aided and abetted" a violation of law. Record, at 1129-1142. Thus, Point III of the Petition for Rehearing, concerning whether a mere

⁴Of course, the Respondents do not concede for a second that the Johnsons' behavior was lawful. The Court's Opinion is correct when it states that "[s]ince the stock was unregistered and was not eligible for any exemptions to registration, it could not lawfully be the subject of any transaction." Opinion, at page 14.

⁵The Johnsons have utterly failed to recognize, and therefor address, the fact that encouraging a violation of the securities laws could be deemed a dishonest and unethical practice even if it did not rise to the level of technical "aiding and abetting."

purchase of non-exempt stock⁶ is "aiding and abetting," is irrelevant.⁷

In Point IV of the Petition for Rehearing, the Johnsons show that they do not understand their duty to first "marshall the evidence" before attacking the Division's administrative ruling. They assert that they did marshall the evidence because "all of the facts were stipulated to with the exception of Finding No. 14 . . ." Petition for Rehearing, at page 6. Not true. At least two of the most important facts supporting the Division's action were not contained in the Stipulation of Facts for Purposes of Hearing. Those facts are: (1) Judge Green's finding that Johnson-Bowles knew or should have known (and was chargeable with knowledge) of the illegal trading of the U.S.A. medical stock before the Johnsons sold short; and (2) the Johnsons' own damning letter of March 21, 1989 to the NASD in which they themselves argue that "any trading of or transaction involving U.S.A. Medical stock has been, would

⁶Of course, the Johnsons did more than merely purchase non-exempt stock. They purchased stock in violation of a stop trading order. The Respondents believe that such a purchase constitutes both a direct violation of the law and aiding and abetting a violation by the seller.

⁷Likewise irrelevant is the case of Jessup, Josephthal & Co. v. Piquet & Cie, cited in Counsel for Petitioners' letter to the Court of January 7, 1992. Even assuming, *arguendo*, that the present case involved an "aiding and abetting" theory, Jessup has nothing to do with whether a party can be administratively sanctioned for having aided another in violating the securities laws. Instead, it deals with the entirely different question of when a plaintiff in a civil action, who claims that the defendant was aiding and abetting a third party in committing securities fraud against the plaintiff, is barred by the doctrine of *in pari delicto* due to the plaintiff's own participation in the fraudulent scheme.

have been and is unlawful" even without reference to the Division's stop trading order. The Johnsons' briefs failed to marshal those facts or the other facts favorable to the Division before attacking the Division's actions.

In all of their briefs, the Johnsons have utterly failed in their duty of showing that the Division's actions were irrational in light of the facts, such as those just mentioned, that favor the Division. Thus the Court was correct in declining to analyze many of the claims by the Johnsons that required a factual determination of the reasonableness of the Securities Advisory Board's actions.

Point V of the Petition for Rehearing is a mere *ad hominem* attack on the Court, and as such it does not dignify any extended response.⁸

The Respondents must admit that they do not fully understand Point VI of the Petition for Rehearing, which seems to indicate that the Johnsons think that the Opinion holds that they are guilty of dishonest and unethical behavior simply because they failed to prevail on their Rule 12 motions. The Johnsons claim that the Opinion does not explain why their behavior is dishonest and

⁸Three brief points about selective enforcement with regard to the U.S.A. Medical stock fraud. First, several of the key participants have been convicted of federal or state felonies, and at least one is serving extended back to back federal and state prison sentences. Second, Susan Slattery's situation is factually very different from that of the Johnsons, and she obtained a specific "no action letter" from the division in advance which held that the Utah Division of Securities had no jurisdiction over the exclusively out of state transaction that she envisioned. Finally, as to other participants in illegal trades who have not yet been punished, the State has only limited resources to devote to any one case, and those resources were largely absorbed by the Johnsons' litigiousness.

unethical. As the Court correctly points out on page 16, the "if he finds" language in Utah Code Annotated section 61-1-6(1) (1989) gives the executive director great latitude in determining what constitutes "dishonest or unethical practices in the securities business." The Opinion never suggests that the executive director's discretion is absolute. The standard is one of reasonableness, and the Opinion's factual recitations set forth an ample basis for a finding that the Johnsons' actions were dishonest and unethical. Every fact finder who has looked at this case, from Judge Green, to Administrative Law Judge Eklund, to the Securities Advisory Board, to Division of Securities Director Baldwin, to Department of Commerce Executive Director Buhler, and finally to this Court, has come to the conclusion that far from being innocent victims of fraud, the Johnsons are clever actors who were chargeable with knowledge of the U.S.A. Medical fraud and who attempted to manipulate the system to their maximum benefit. As the Opinion so cogently puts it on page 17:

It would be difficult to imagine a more willful violation of an order than that presented in this case. The Johnsons sought relief in federal district court, and when such relief was not forthcoming, they went to the Division of Securities to seek such relief. Having been granted the relief they sought from the Division, in the form of the stop trading order, they immediately turned around and began violating the very order for which in large part they were responsible.

In short, it is impossible to read the Opinion (or, for that matter the full record in this case) and not understand that the decision to sanction the Johnsons for dishonest and unethical conduct was based upon ample evidence, and not the mere whim of the executive

director.

The Conclusion portion of the Petition for Rehearing is mostly an attempt to resuscitate many of the arguments that the Opinion correctly labeled as being without merit. For example, the Johnsons insist on revisiting SEC Exchange Act Release No. 34-7920, and have even attached another copy of that Release to the Petition. The Respondents never addressed the release in either their brief or oral argument because they felt that it was unambiguously irrelevant to this case. Release No. 34-7920⁹ states in part that

It is the position of the [SEC] that where the broker or dealer is himself acting in good faith, where he is not connected with the activity announced by the Commission as a basis for suspension pursuant to Section 15(c)(5) or Section 19(a)(4), and where he has no reason to believe that his customer is so connected, no objection need be raised under such sections because the broker-dealer completes his contractual obligations in the particular transaction (e.g. by payment or delivery) while the suspension is still in effect. . . .

A broker-dealer, in deciding whether to consummate such a transaction, must of course consider not only the provisions of Sections 15(c)(5) and (19)(a)(4) but also all other applicable provisions of the Federal securities laws.

Putting aside the fact that the Johnsons cannot rely upon the Release because they were "connected with the activity" at issue, at least in Judge Green's view, it is clear that the Release only concerns itself with whether completing a contractual obligation by payment or delivery violates certain specific federal securities

⁹Which, by the way, is nothing more than a statement by the SEC as to its policy in 1966, based on old law. By itself, the Release is not law, and it certainly is not binding on the Utah Division of Securities.

laws. If the Johnsons had both sold short and purchased the shares to cover the short sale before the stop trading order was in place, and if they were being sanctioned for merely finalizing delivery of already purchased securities, then the Release might be of some interest. The Release, however, stops considerably short of saying that a broker-dealer may (and much less that a broker-dealer must) purchase stock¹⁰ in blatant violation of a state stop trading order simply so as to cover a short position created before the stop trading order went into effect.

III. CONCLUSION

The Opinion should be amended so as to replace the references on page 8 to Utah Code Annotated section 61-1-12 with correct references to Utah Code Annotated section 61-1-14(3). Otherwise, the Opinion is a correct and accurate statement of the law as it applies to this case, and it should not be modified.

Respectfully submitted this 21st day of January, 1991.

R. PAUL VAN DAM
Attorney General



DAVID N. SONNENREICH
Assistant Attorney General

¹⁰While some argument could be made that the short sale was still open at the time of the stop trading order, and therefor could have been finalized by delivery under the terms of the Release, the purchase of new stock to cover the short sale was a separate transaction, and not merely the equivalent of payment or delivery.

CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of January, 1992, I caused to be ☐ hand delivered ☒ mailed, postage prepaid, a true and correct copy of the foregoing RESPONSE TO PETITION FOR REHEARING to:

John Michael Coombs, #3639
72 East 400 South, Suite 220
Salt Lake City, Utah 84111
Telephone (801) 359-0833

Craig F. McCullough, #2166
10 East So. Temple, Suite 800
Salt Lake City, Utah 84133
Telephone (801) 530-7307

