

1992

Johnson-Bowles Company and Marlen V. Johnson v. Division of Securities and the Utah Department of Commerce : Brief in Opposition to Certiorari

Utah Supreme Court

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UTAH SUPREME COURT

BRIEF

920145

IN THE UTAH SUPREME COURT

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 IN OPPOSITION TO PETITION
FOR WRIT OF CERTIORARI

Case # 900558-CA

920145

Rule 29 Priority # 15

Brief in Opposition to Petition for Review of an Amended
Decision of the Utah Court of Appeals Issued on
February 19, 1992, Case # 900558-CA

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UTAH

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STATEMENT OF THE CASE

Nature of the Case, Course of Proceedings, and Dispositions in Lower Courts:

This is a case where Johnson-Bowles, a securities broker-dealer, and Marlen Johnson, a securities agent (collectively referred to as "the Johnsons"), were sanctioned by the Utah Division of Securities (the "Division") for dishonest and unethical practices in the securities business. Following a formal hearing and administrative review, the Division suspended the Johnsons' licenses for one year and placed the Johnsons on an additional two years probation. The Johnsons appealed to the Utah Court of Appeals, which upheld the Division's actions. Following a petition for rehearing by the Johnsons, the Court of Appeals issued an Amended Opinion on February 19, 1992, which differed in a few respects from the original opinion, but which likewise upheld the Division's actions. The Johnsons' current petition for writ of certiorari is from that February 19th Amended Opinion of the Court of Appeals.

Statement of the Facts:

The Division basically agrees with the facts and procedural history as stated in the Amended Opinion of the Court of Appeals on pages 1-6 and as found by Securities Advisory Board and the Director of the Division in the Division's Findings of Fact, Conclusions of Law and Order of August 10, 1990.

Put simply, the Johnsons engaged in a "short sale"¹ of U.S.A. Medical stock at a time when they knew or should have known that the stock was being manipulated.² They misjudged the situation, and the price of the stock continued to rise rapidly. This meant that the Johnsons would have to cover their short sale with much more expensive stock. The entities to whom the Johnsons owed stock then began the process of "buying-in"³ the stock that the Johnsons owed to them. The Johnsons next went to the United States District Court and sought a preliminary injunction from Judge Green to prevent any buy-ins of stock to cover their short position. The preliminary injunction was denied because Judge Green, instead of viewing the Johnsons as innocent victims of stock manipulation, ruled that the Johnsons knew or should have known of the

¹A "short sale" occurs when a person sells stock, to be delivered at a particular future date, that the person does not currently own. The person must then buy an equivalent amount of stock before the delivery date. If the price of the stock drops during the interim between the sale date and the delivery date, then the person makes money, while an increase in the stock price before the delivery date causes the person to lose money. If the person fails to deliver the stock on time, then the party who originally purchased the short sale stock is allowed to "buy-in" enough stock from some third party to cover the amount of stock owed, and the cost of the buy-in stock is then charged to the person who made the short sale.

²When stock is being manipulated, its price will tend to rise, often as a result of phony press hype and artificial trades between nominee owners of the stock who are really controlled by the manipulators. Once the price is deemed high enough, the manipulators sell their stock to the public, after which the price usually nosedives rapidly. If an individual suspected manipulation, and believed that the price had reached its peak, that individual could sell short in the hopes of making a large profit by purchasing the stock to cover the short sale after its price had plummeted.

³See, footnote 1, *supra*.

manipulation at the time they engaged in the short sale.

In part in response to the evidence introduced at the hearing before Judge Green, the Division placed a Stop Trading Order on the stock of U.S.A. Medical, Inc. The Johnsons then purchased U.S.A. Medical stock that they knew could not legally be sold due to the Stop Trading Order. They purchased the stock for over \$506,000 less than they believed the stock would have cost before the Stop Trading Order made sales of the stock illegal. Because the Johnsons' acts of knowingly helping others to violate the Stop Trading Order constituted dishonest and unethical practices in the securities business, the Division undertook a formal administrative proceeding and sanctioned the Johnsons by suspending their licenses for one year and placing them on two years probation.

ARGUMENT

At its Heart, the Johnsons' Petition for Writ of Certiorari is Nothing More than an Attempt to Reargue the Facts of the Case:

There are basically two views as to the facts in this case. One view is the view summarized in the preceding section of this brief. That view has been adopted by every person and body who has reviewed this matter (except, of course, for the Johnsons and their counsel). Based on this view of the evidence, the Court of Appeals' Amended Opinion is eminently rational.

The other view is the view argued for by the Johnsons in their petition. Under this view, the Johnsons are merely innocent

victims to a fraud, who after uncovering the fraud were further victimized by the Division when the Johnsons attempted to honor their contracts by purchasing stock. Most importantly, the Johnsons, under this theory, were placed in an irreconcilable conflict between the Divisions' Stop Trading Order and the NASD's requirement that the Johnsons honor their contracts.

Every argument raised by the Johnsons in their petition hinges, either directly or indirectly, on the Utah Supreme Court reviewing the facts and accepting the Johnsons' view over the view of Judge Green, the Division, and the Court of Appeals. Such a fact finding exercise is not an appropriate basis for an appeal by writ of certiorari. That is particularly the case here, where the Johnsons' central tenant, that they were placed in an irreconcilable conflict between the Division and NASD, is simply not true.

The Johnsons were never Required to Choose Between Violating NASD Rules or Assisting in the Violation of the Division's Stop Trading Order:

As recognized by the Division in its Findings of Fact, Conclusions of Law, and Order, pages 8-9, "[t]he proper scope and operative effect of the [Stop Trading] Order entered by the Division was to prohibit any trading of U.S.A. Medical Corporation securities within this state." Thus, the Division's Stop Trading Order prevented the Johnsons from engaging in transactions in U.S.A. Medical stock in Utah. At the very least, the Stop Trading Order prevented any Utah resident from selling U.S.A. Medical stock to the Johnsons, and the Johnsons' participation in such a sale

would be unethical even if it were not illegal.

NASD rules require that a member honor all trades, including short sales. But, as the Johnsons readily admit, the NASD recognizes buy-ins as a legitimate way to settle accounts when a broker who sold short cannot make timely delivery of the stock owed. See, Petition for Writ of Certiorari at 9, footnote 1.

It would therefore have been perfectly legal and proper for the Johnsons, who were prohibited from purchasing stock in Utah to cover their short positions, to have allowed buy-ins by the parties to whom they owed the stock. The Johnsons would then have owed those parties for the price of the buy-ins. (Of course, if the Johnsons felt that they were victims of manipulation, they could then sue those who were manipulating the stock for the losses incurred by the Johnsons.) The only problem with that scenario is that the Johnsons assert that they could not have afforded the price of the buy-ins. Even assuming that the Johnsons would have been driven out of business by having to pay for the buy-ins, that error in business judgment⁴ does not constitute a conflict between

⁴At its core, the Johnsons' decision to buy so much of the highly volatile U.S.A. Medical penny stock was a bad business decision. Before becoming a market maker in the stock, Johnson-Bowles was required to do extensive due diligence into the stock's background. As a result, the Johnsons either knew or should have known that the stock was being manipulated, as Judge Green found. If the Johnsons knew that the stock was being manipulated, then they are of course culpable themselves. If they did not know of the manipulation, then they were negligent in their due diligence review. In either case, the Johnsons apparently bought far more U.S.A. Medical stock than was prudent in light of Johnson-Bowles' financial condition. U.S.A. Medical was a high technology start up company that was actively developing (and beginning to market) certain medical devices. Any number of events, such as receiving a patent, receiving an offer of merger from a large medical

the Division saying, on the one hand, that you cannot trade in a security that is the subject of manipulation and NASD saying, on the other hand, that you must honor your short sale contract by paying for necessary buy-ins of the stock.

This Case does not meet the Criteria for Supreme Court Review by Writ of Certiorari:

Rule 46 of the Utah Rules of Appellate Procedure sets forth the considerations that govern Supreme Court review by writ of certiorari. Certiorari should only be granted "for special and important reasons." Of the four examples given in Rule 46, three are clearly not relevant: There is no need to reconcile a conflict between two Court of Appeals decisions with respect to the same issue of law, there is no conflict between the Court of Appeals decision and a decision of the Supreme Court, and the Court of Appeals decision does not so far depart from the usual course of judicial proceedings as to call for an exercise of the Supreme Court's supervisory power.

Likewise, the Amended Opinion by the Court of Appeals, while it will have some general usefulness in the area of securities law, does not decide important new questions that require the Supreme Court's review. Instead, the analytical portion of the decision is largely an application of the somewhat unusual facts of this case

equipment manufacturer, or developing a new breakthrough product, could have easily legitimately driven up the price of the stock tenfold or more in a very short period of time. If the price of the stock had shot up under those legitimate circumstances, Johnson-Bowles apparently would have been unable to cover its short positions and would have been forced out of business. It was foolhardy of the Johnsons to have put so much money into a short sale of stock in such a company.

to fairly well established existing law, albeit law that has not always been previously applied in a securities case. For example, much of the Amended Opinion is given over to a case specific analysis of basic principles of due process, the sufficiency of the evidence, and the application of the law to the facts. The only parts of the Amended Opinion that really addresses a "new" issue are the parts about federal preemption and the scope of the commerce clause. The Court of Appeals deals with those issues in entirely predictable ways. There is no federal preemption where the federal legislation clearly expressly allows for state regulation, which is consistent in purpose with the federal regulation. There is no commerce clause problem where a state regulates the sale of securities within its borders. There is no need for the Supreme Court to review those nearly inevitable conclusions.

What is really being sought here is not a review of some shocking new legal theory, but rather a review of the facts of this case and how those facts ought to apply to the law. In that sense, the Johnsons seek nothing more than a second bite at the appellate apple, which is not the purpose of a certiorari review.

If a Writ of Certiorari is Granted, it Should be Carefully Limited:

The Johnsons have had a tendency to raise every conceivable issue, whether well founded or not, at every conceivable juncture of this litigation. For example, they raises over thirty distinct grounds for reversal in their Court of Appeals brief, which ran eighty-three pages, exclusive of addendum. Most of those arguments

were simply deemed by the Court of Appeals to be without merits and not worthy of analysis. Likewise, the thirty-five page Petition for Writ of Certiorari spends four pages simply listing a plethora of possible issues for review on certiorari. Needless to say, it is practically impossible to adequately and fully respond to such a shotgun-type appeal in a reasonable time or within reasonable page limits.

The Division does feels that this case does not warrant a writ of certiorari. If the Supreme Court, in its discretion, feels that a writ of certiorari is appropriate, then the Division would request that the Court take it upon itself to carefully define and limit the issues to be reviewed. Given the procedural history of this case, appropriate guidance from the Court in limiting the scope to the review to the issues that concern the Court will result in a much better focuses set of briefs and oral arguments.

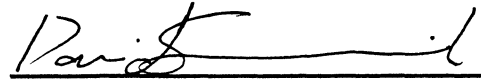
CONCLUSION

The Supreme Court should deny the Johnsons' Petition for Writ of Certiorari. The Petition is primarily a diatribe against factfinding with which the Johnsons disagree. The key premise of the Petition, that the Johnsons were placed in an irreconcilable conflict between their duties to the Division and to NASD, is simply not true. If the Court decides that it wishes to review this case, it should limit the writ to the specific question or questions that concern the Court. Under no circumstances should

the writ be granted *carte blanc* on the multitude of possible issues suggested in the Johnsons' Petition.

Respectfully submitted this 20th day of April, 1992.

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CERTIFICATE OF SERVICE

I hereby certify that on this 20th day of April, 1992, I caused to be [] hand delivered ☒ mailed, postage prepaid, four true and correct copies of the foregoing Memorandum in Opposition to Petition for Writ of Certiorari to:

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