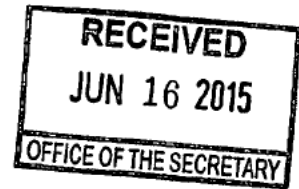


**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**  
**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 72186 / May 19, 2014**  
**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 31049 / May 19, 2014**  
**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15874**



**In the Matter of**

**Michael H. Johnson**

**Respondent.**

**DIVISION OF ENFORCEMENT'S**  
**RESPONSE TO MICHAEL H. JOHNSON'S**  
**MOTION TO MODIFY THE BAR ORDER**

**Introduction**

In May 2014, the Commission accepted Michael H. Johnson's ("Johnson") offer to consent to an order finding that he willfully aided, abetted and caused Penson Financial Services, Inc.'s ("Penson's") violations of Rule 204 of Regulation SHO ("Rule 204"), and that he failed reasonably to supervise his subordinates. *See Michael H. Johnson*, Exch. Act Rel. No. 72186, 2014 WL 2038878 (May 19, 2014) (referred to herein as the "Johnson Order"). In accordance with Johnson's offer of settlement, the Commission barred Johnson from the securities industry with the right to apply for re-entry after five years. *See id.* The Commission did not find that Penson or Johnson profited from Johnson's misconduct, nor did the Commission order Johnson to pay any disgorgement. *See id.*

In a letter to the Commission dated April 3, 2015, Johnson asked that he be allowed to apply for re-entry into the securities industry after one year instead of five. The Commission deemed Johnson's letter (referred to herein as the "Johnson Motion") to be a motion to modify

the bar order. *See Michael H. Johnson*, Order Directing the Filing of Opposition and Reply Briefs, Exch. Act Rel. No. 75074 (May 29, 2015).

In order to prevail on his motion, Johnson must show that there are “compelling circumstances” for modification. *Stephen S. Wien*, Securities Exchange Act Release No. 49000 (Dec. 29, 2003) (“In the usual case, bars will remain in place; relief will be appropriate only in compelling circumstances.”).

Johnson does not directly address any of the factors the Commission considers in determining whether “compelling circumstances” exist.<sup>1</sup> Instead, Johnson focuses on a calculation error by the Division’s expert in a separate proceeding against other individuals concerning the amount of Penson’s potential profits from its Rule 204 violations and argues that, as a result of this error, the Division and Commission erred by attributing “motive” to Johnson in fashioning the length of his securities industry bar.

Johnson fails to demonstrate that “compelling circumstances” exist to support modifying the Commission’s settled order against him. The staff could not have relied on the expert’s miscalculation of profits because that calculation did not even exist until after the Commission entered the Johnson Order. More fundamentally, Johnson’s motion fails even the staff had relied on an erroneous view of profits from his misconduct. As set out in the Johnson Order, Johnson serially violated Rule 204 for three years while encouraging others, whom he was supposed to be supervising, to do the same. The Johnson Order is silent about motive or profits. Motive is irrelevant in a case such as this one, where Johnson engaged in “conscious misbehavior”—that is, he knew what he was doing was wrong and did it anyway, irrespective of whether it benefitted him directly. However, even if the Commission were to determine that Johnson’s

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<sup>1</sup> The factors are discussed in Section III, below.

motive is relevant, his motive was not solely limited to potential profits to Penson from the violations, but rather to avoid or reduce the costs of compliance with Rule 204. Finally, Johnson's bar is not appropriate for modification under the factors the Commission considers in its "compelling circumstances" review.

### **Argument**

#### **I. The Expert's Profit Calculation Did Not Exist at the Time the Commission Entered the Johnson Order and Was Not a Factor in Determining Johnson's Bar.**

Johnson assumes that, in connection with his settled order, the staff relied on an expert analysis from a separate administrative proceeding that calculated approximately \$6 million in profits to Penson from its Rule 204 violations. The expert has acknowledged the calculation was a mathematical error and that the actual calculation should have been approximately \$60,000 in profits.

But the expert's profit calculation had no bearing on Johnson's case. In fact, the expert did not have the raw data necessary to even begin his analysis until after the Commission entered the Johnson bar order. The staff and Johnson negotiated the terms of Johnson's settlement between August and December 2013, and Johnson submitted an offer of settlement (including his bar with a right to re-apply after five years) in December 2013. The Commission approved Johnson's offer and entered the bar in May 2014. Meanwhile, Apex Clearing Corp., Penson's successor, did not produce begin producing the data necessary for the expert's profit analysis until February 2014—after Johnson had submitted his offer of settlement—and did not finish production until July 2014, after the Johnson Order was entered. The expert did not complete his calculation and provide it to the staff until September 2014. Thus, the expert's profit calculation did not and could not have had any bearing on the Johnson negotiations or the Johnson Order.

Johnson attempts to backstop his assumption that the staff relied on the expert's calculation by claiming that, even if the staff was not relying on that specific calculation, the Johnson Order was driven by the staff's insistence that there was approximately \$6 million in profits from Johnson's conduct. *See* Johnson Motion at 2 and fn. 3. That claim also fails. As Johnson acknowledges, he "consistently insisted during [settlement] discussions that there was virtually no profit to Pension, and absolutely none to himself, as a result of the Regulation SHO problems." *Id.* at 2. The profit issue arose specifically in the context of negotiating a potential disgorgement claim. Contrary to Johnson's assertion that the staff "dismissed" his arguments, Johnson fully prevailed on this point: the Johnson Order does not impose any disgorgement.<sup>2</sup> Not is there any finding in the Commission's order against Johnson that he or Pension received any financial gain from the violations.

## **II. The Bar is Appropriate Based on Johnson's Misconduct.**

Johnson argues the lack of proof about profits shows he had no motive to violate the law and, absent that motive, the duration of his bar is unjustified. However, because Johnson engaged in conscious misbehavior, motive is irrelevant. And even if motive were relevant, Johnson's motive lies in his desire to avoid the costs of compliance. Finally, Johnson's bar is appropriate to protect the public interest regardless of how much or how little Johnson made from his misconduct.

### **a. The Commission Was Not Required to Make Findings Regarding Johnson's Motive to Support the Imposition of a Bar.**

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<sup>2</sup> Johnson acknowledges that, in entering into his settlement, he negotiated away the possibility that he may have obtained a better result through litigating his claims. *See* Johnson Motion at 3 (Johnson "fully understands that by settling with the Commission, he waived his rights to appeal the sanctions imposed by the order," and Johnson understands that "one risk of settling is that an adjudicator may find that the Division's case is incorrect. . ."). Johnson should not be allowed to seize on events in litigation involving other Pension personnel to re-raise factual points that were specifically-negotiated points of his settlement. In any event, as set out below, the findings regarding profits to Pension in the separate administrative proceeding, and the issue of motive Johnson asserts in his motion, are collateral points that have no bearing on the propriety of the Johnson bar order.

Johnson's aiding and abetting conduct alone was sufficient to support the imposition of a bar with the right to re-apply after five years. Motive is not an element of any of the claims against Johnson, including the scienter-based aiding and abetting claim.<sup>3</sup> Furthermore, analysis of motive adds nothing to a case such as this one, where it is indisputable that Johnson engaged in "conscious misbehavior" over the course of three years.<sup>4</sup>

The Johnson Order contains extensive findings of conscious misbehavior. The Commission found that Johnson met with other Stock Lending supervisors to discuss Penson's compliance with Rule 204. *See* Johnson Order at ¶ 13. Johnson and the other supervisors "agreed that, due to their view of industry practices, they would not close out Penson's CNS failures to deliver resulting from long sales of loaned securities by market open of T+6." *Id.* The Commission also found that Johnson and the other supervisors "further agreed that, in certain circumstances, they would allow the CNS failures to deliver to persist beyond close-of-business T+6." *Id.* The Commission then found that "Johnson knew the procedures the Securities Lending Department implemented as a result of these discussions did not comply with Rule 204." *Id.* at ¶ 14. Johnson does not dispute any of these factual findings.

The Commission also found that Johnson induced others at Penson to violate the law. Johnson was the direct supervisor of two Vice Presidents of Securities Lending at Penson, both

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<sup>3</sup> Courts have repeatedly held that motive is not an element of scienter-based securities laws claims. *See, e.g., SEC v. U.S. Environmental, Inc.*, 155 F.3d 107, 111-12 (2d Cir. 1998), *cert. denied sub nom. Romano v. SEC*, 526 U.S. 1111 (1999) (What is at issue is the fraudulent conduct itself, not its motivation.); *Graham v. SEC*, 222 F.3d 994, 1005 (D.C. Cir. 2000) (absence of motive does not relieve one of liability); *SEC v. Goldstone*, 952 F. Supp 2d 1060, 1242 (D. N.M. 2013) *citing SEC v. Int'l Chem. Dev. Corp.*, 469 F.2d at 20, 26 (10th Cir. 1972) ("The federal securities laws do not shield parties simply because a fraudulent statement did not pad their personal pocketbook: The federal securities laws protect 'investors from fraudulent practices.'"); *Piper Capital Mgmt., Inc.*, No. ID-175, 2000 WL 1759455, at \*44 (Nov. 30, 2000), *aff'd* Rel. No. 2163, WL 22016298 (August 26, 2003) (Motive is not an element the Division must prove.).

<sup>4</sup> In order to establish scienter for aiding and abetting liability in securities claims, a plaintiff may prove either motive or "conscious misbehavior." *Berman v. Morgan Keegan & Co., Inc.*, 2012 WL 147907, \*\*2 (2<sup>nd</sup> Cir. 2012) (a plaintiff may establish scienter for aiding and abetting claim through "either (a) . . . show[ing] that defendants had both motive and opportunity to commit fraud, or (b) by . . . [showing] strong circumstantial evidence of conscious misbehavior or recklessness") (emphasis added).

whom also “aided and abetted Penson’s Rules 204(a) violations by implementing procedures they knew or were reckless in not knowing would result in violations of Rule 204(a).” *Id.* at ¶ 25. As their supervisor, Johnson was responsible to supervise them with an eye towards detecting and preventing their misconduct. *See id.* at ¶ 26. Instead of fulfilling that responsibility, Johnson “fostered and encouraged their misconduct by participating in it with them.” *Id.*

The Commission further found that Johnson implemented procedures that he knew, or absent recklessness must have known, caused Penson to violate the “penalty box” requirements of Rule 204(b). *See id.* at ¶¶ 17-19.

Finally, the Commission found that Johnson engaged in his misconduct over a three-year period, from October 2008 through November 2011. *See id.* at ¶¶ 16, 17, and 24. Again, Johnson does not dispute these findings.

Significantly, the Johnson Order says nothing about profits as a possible motive for Johnson’s violations, not as basis to support the bar and not for any other reason. Ultimately, for the purpose of bar that the Commission imposed, it does not matter why Johnson engaged in this misconduct. Johnson’s conscious decision to follow perceived industry practice rather than what he knew the law required constitutes conscious misbehavior, and establishes Johnson’s scienter. His misconduct is compounded by the fact that he fostered and encouraged similar misconduct by those he was supposed to be supervising and by the fact that he engaged in the misconduct over the course of three years. In light of these findings, Johnson’s arguments about motive are irrelevant.

**b. Johnson Consciously Decided to Violate the Law in Order to Avoid the Costs of Compliance with Rule 204.**

Even if Johnson's motive were relevant to the question of how long a bar the Commission should impose, his argument still fails. Johnson assumes that potential profit to Penson was the only incentive he may have had to violate Rule 204. However, this assumption ignores the fact that violating Rule 204 allowed Johnson to avoid or reduce significant costs to the firm of complying with Rule 204. This cost avoidance has nothing to do with the profit calculation Johnson points to in his motion. The fact that he could avoid costs by avoiding compliance was well known to Johnson while he was engaging in his misconduct. Penson's former VP of Operations has provided a sworn declaration regarding a meeting with Johnson in late 2009 or early 2010 in which they discussed Johnson's non-compliance with Rule 204 and different ways Johnson could change procedures to come into compliance. *See* Exh. 1 (Declaration of Brian Gover). One of the options for compliance was to purchase securities on Penson's own account. *See id.* Johnson refused to take that approach because he did not want to incur the associated costs. *See id.* Johnson's conscious decision to violate the law in order to avoid the costs of compliance proves his motive and confirms his lack of fitness for the securities industry.<sup>5</sup>

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<sup>5</sup> Rule 204 is straightforward. If a clearing firm has a CNS fail resulting from a long sale, it must close out that fail by purchasing or borrowing securities by market open T+6. *See* Rule 204(a)(1). The potential complexity arises when clearing firms attempt to pass along the cost of complying with Rule 204 to someone else—then they must sift through potentially large volumes of transactions on their books and records to identify a correspondent causing the CNS fail and charge them for the purchase or borrow. The effort to pass along the cost of compliance to someone else becomes impossible where, such as in the present case, the clearing firm's own conduct causes the fail. Indeed, in the relevant transactions, Penson incurred CNS fails because Johnson and the Securities Lending Department had loaned the securities needed for delivery to third parties. *See* Johnson Order at ¶¶ 6-7. The bottom line is that Johnson chose to violate Rule 204 because he did not want to pay for the cost of compliance and he could not figure out a way to pass that cost on to anyone else.

**c. The Bar is Appropriate to Protect the Public Interest Regardless of Any Profits.**

Johnson's current arguments about profits and motives have no bearing on the analysis the Commission undertakes in determining the appropriateness of a bar. In that context, the Commission typically considers the factors set out in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). Those factors are: (1) the egregiousness of the respondent's actions; (2) whether the violations were isolated or recurrent; (3) the degree of scienter; (4) the sincerity of the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations.

As discussed above, the egregiousness of Johnson's misconduct, its recurring nature, and his high degree of scienter all justify the bar. Ironically, under the fifth of the *Steadman* factors, Johnson's present motion serves to further justify the bar. His attempt to minimize his misconduct by pointing to an irrelevant profits analysis shows that he continues to fail to recognize the wrongful nature of his conduct.

**III. Johnson Cannot Meet His Legal Burden of Showing "Compelling Circumstances."**

Johnson may be entitled to some sympathy for the consequences that have befallen him and his family as the result of his violations coming to light and his removal from the industry. But these are not "compelling" reasons to alter the Commission's order against him. The standard for modifying bar orders is "compelling circumstances." *Stephen S. Wien*, Securities Exchange Act Release No. 49000 (Dec. 29, 2003) ("In the usual case, bars will remain in place; relief will be appropriate only in compelling circumstances."). The Commission has established specific factors it weighs in determining whether such "compelling circumstances" exist. In addition to considering the Division's position regarding the request for modification, which in



this case is squarely against, the Commission considers the following factors: the nature of the conduct at issue in the underlying matter; time passed; the compliance record of, and any regulatory interest in, the petitioner since issuance of the administrative bar; age and securities industry experience of the petitioner, and the extent to which the Commission has granted prior relief from the administrative bar; whether the petitioner has identified verifiable, unanticipated consequences of the bar; and any other circumstance that would cause the requested relief from the administrative bar to be inconsistent with the public interest or the protection of investors.

*See id.*

Under these factors, the Commission should deny Johnson's motion to modify the bar.<sup>6</sup> The Division has addressed the most important factor—the nature of Johnson's misconduct—above. That factor weighs strongly, decisively, against Johnson's motion. Most of the remaining issues—namely the amount of time passed since entry of the bar; the post-entry compliance record and regulatory interest in the petitioner; the age and experience of the petitioner along with any incremental relief from the bar; and the identification of verifiable, unanticipated consequences of the bar—relate to an analysis of what has happened since the bar was imposed. Those factors are not particularly relevant here, as Johnson has only been barred from the industry for one year. He cannot point to any unforeseeable, unintended consequences of the bar; it has functioned the way it was designed. None of these factors weigh in favor of modifying the bar from five years to one year.

There are no other circumstances weighing in favor of modifying Johnson's bar order. To the contrary, the egregious nature of his misconduct establishes that the final consideration—

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<sup>6</sup> Johnson does not directly address any of these factors in his motion. In light of that fact, the Division respectfully requests the opportunity to respond if Johnson raises new arguments about these factors in his reply brief.

the public interest and the protection of investors—will be best served by keeping Johnson out of the securities industry.

### **Conclusion**

Johnson's motion is misguided from its outset. The mistaken profits calculation at the center of his motion did not exist until after the Commission barred him from the securities industry. Nor did the Commission order against Johnson make any findings about profits or motive as a basis for the bar. The issue of profits also is irrelevant to both the factors the Commission applies in determining the appropriateness of a bar and to the factors the Commission applies in assessing motions to amend bars. The duration of the bar as entered was appropriate based on Johnson's intentional misconduct, and the Commission should deny Johnson's motion to modify the bar.

DATED: June 15, 2015.



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**EXHIBIT 1**

## DECLARATION OF BRIAN STUART GOVER

I, BRIAN STUART GOVER do hereby declare under penalty of perjury, in accordance with 28 U.S.C. § 1746, that the following is true and correct, and that I am over 18 years of age and I am competent to testify to the matters stated herein:

1. From approximately April 2007 through at least December 2011, I was a Vice President of Operations at Penson Financial Services, Inc. ("Penson"). From approximately the third quarter of 2009 through at least December 2011, I was responsible for overseeing Penson's Buy Ins Department.

2. From at least the third quarter 2009 through December 2011, Penson's Buy Ins Department and the Stock Loan Department were responsible for complying with certain aspects of Penson's obligations under Rule 204 of Regulation SHO ("Rule 204"). The Buy Ins Department had primary responsibility for Rule 204 close outs of Continuous Net Settlement ("CNS") failures to deliver for long sales when the failure to deliver resulted from Penson's failure to receive the shares from the seller.

3. When the CNS failure to deliver resulted from open stock loans, however, the Stock Loan Department had primary responsibility for the Rule 204 close out. The Stock Loan Department loaned securities held in customer margin accounts to third parties. When the customer sold those securities, Stock Loan typically recalled the loans in order to deliver on the customer sale. (I will refer to such circumstances throughout this Declaration as "long sales of loaned securities.") Depending on Penson's CNS position, if the recalled shares were not returned by settlement date, Penson sometimes incurred a CNS failure to deliver due to the open stock loans. From at least the third quarter 2009 through December 2011, the Stock Loan Department had primary

responsibility within Penson for Rule 204 close outs of such CNS failures to deliver relating to long sales of loaned securities.

4. Soon after I assumed responsibility for the Buy Ins Department in approximately the third quarter of 2009, Penson's Compliance Department conducted an internal audit of Penson's Rule 204 compliance. In the course of reviewing Buy Ins Department procedures as part of my new responsibilities as supervisor of the Buy Ins Department, and in the course of responding to the internal Rule 204 audit, I learned the Stock Loan Department was not consistently closing out failures to deliver resulting from long sales of loaned securities by market open T+6.

5. This practice appeared to be inconsistent with my understanding of Rule 204. Therefore, I requested a meeting with Michael Johnson ("Johnson"), the Senior Vice President of Stock Loan, and Thomas Delaney ("Delaney"), Penson's Chief Compliance Officer.

6. Shortly thereafter, Johnson, Delaney and I met face-to-face in Penson's offices in Dallas, Texas. In that meeting, Johnson confirmed that the Stock Loan Department did not consistently close out CNS failures to deliver relating to sales of loaned securities by market open T+6. He claimed that it was not industry practice to do so. He further claimed that nobody on the street bought in lending counterparties at market open T+6, and that the stock loan agreements did not allow for such buy ins.

7. In that meeting, Johnson and Delaney discussed whether Penson should purchase securities on Penson's own account by market open T+6 in order to comply with my understanding of Rule 204's obligation that long sales of loaned securities be closed out by market open T + 6. Johnson and Delaney rejected this option for

complying with Rule 204. My understanding is that they rejected this option because of the associated costs to Penson.

8. In that meeting, Johnson and Delaney also discussed whether Penson should close out failures to deliver on long sales of loaned securities at or before market open T+6 by recalling the loans on T+2 instead of on T+3. Johnson and Delaney rejected that option, and Johnson claimed this was not feasible because he could not project on T+2 which securities would incur failures to deliver.

9. It is my understanding that sometime after this meeting Johnson and Delaney had discussions with legal counsel, which I believe took place within days of the meeting, although I did not participate in any meeting or telephone call. I am not aware that Stock Loan made any changes to its practice of not closing out CNS failures to deliver resulting from long sales of loaned securities by market open T+6.

10. As set out above, the meeting with Johnson and Delaney occurred in the context of (1) my assumption of responsibilities relating to the Buy Ins Department in approximately the third quarter of 2009 and my related efforts to understand the Buy Ins Department's procedures; and (2) the internal audit of Penson's Rule 204 procedures. As shown by an email to me from Penson's Compliance Department (Exhibit A), the internal audit occurred in December 2009. The December 14, 2009 date of the email in Exhibit A is consistent with my recollection that the meeting with Johnson and Delaney regarding

Rule 204 close outs for long sales of loaned securities occurred by the end of 2009 or, at the latest, early 2010.



Brian Stuart Gover

Date: 1/7/2014

Certificate of Service

On June 15, 2015, the foregoing DIVISION OF ENFORCEMENT'S RESPONSE TO MICHAEL H. JOHNSON'S MOTION TO MODIFY THE BAR ORDER was sent to the following parties and other persons entitled to notice as follows:

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By

