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Hon. Mari Jo White, Chair
Hon. Luis A. Aguilar, Commissioner
Hon. Daniel M. Gallagher, Commissioner
Hon. Kara M. Stein, Commissioner
Hon. Michael S. Piwowar, Commissioner
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

3-15874

Re: *In the Matter of Michael H. Johnson*, File No. 34-72186

Dear Chair White and Commissioners:

We represent Michael Johnson in the above-referenced matter. We write to convey Mr. Johnson's request that the Commission reevaluate the sanctions included in a settled order against Mr. Johnson based on an error in the staff's factual analysis of the case, and presumably in the Commission's analysis of the appropriateness of the terms of Mr. Johnson's settlement. Because all parties agree that the staff was working under materially incorrect facts in connection with its enforcement action, Mr. Johnson believes that the Commission should exercise its discretion and modify its administrative order.

On May 19, 2014, the Commission issued a settled administrative order against Mr. Johnson based on a finding that Mr. Johnson aided and abetted Penson Financial Services, Inc.'s ("Penson's") violations of Regulation SHO, and failed reasonably to supervise two Penson employees in connection with their activities related to Regulation SHO. In that settlement, Mr. Johnson agreed, without admitting or denying the Commission's findings, to a bar from the securities industry with a right to apply for reentry after a period of five years, and to payment of a $125,000 civil money penalty. Mr. Johnson has complied with all aspects of that order since it was entered nearly a year ago. Specifically, Mr. Johnson timely paid the penalty, and left the industry to open a restaurant.

During the Wells process and throughout settlement discussions with the staff concerning the case against Mr. Johnson, the staff consistently took the position that the violations of Regulation SHO were the result of intentional conduct by Penson employees in order for Penson to earn millions of dollars in profits by allowing stock to remain out on loan past

market open on the date (T+6) that it was required to be returned. As a result, according to the staff, Mr. Johnson's activities were particularly egregious given the motivation he purportedly had to substantially profit both Penson and himself. Mr. Johnson consistently insisted during these discussions that there was virtually no profit to Penson, and absolutely none to himself, as a result of the Regulation SHO problems, and that, in fact, no profit could have been derived because the stock was almost always returned on T+6.[1] The staff, citing data it received from Penson during the investigation and its own analysis of that data, dismissed Mr. Johnson's argument. Unfortunately, Mr. Johnson did not have available to him either the trading data, or the resources to analyze it, in order to prove to the staff that profit could not have been a motive. As a result, Mr. Johnson did not have the ability to counter the staff's position that the sanctions the staff was seeking to impose were reasonable given the egregiousness of the violations as shown, in large part, by the millions of dollars of ill-gotten gains purportedly obtained by Penson. Mr. Johnson therefore agreed to settle the matter on the terms demanded by the staff, as he was not in the position to litigate the matter.[2]

The staff's position that the Regulation SHO violations were motivated by profit was featured in the litigated action also brought on May 19, 2014. On that date, the Commission entered an Order Instituting Cease-and-Desist Proceedings ("OIP") against Thomas Delaney and Charles Yancey in connection with Penson's violations of Regulation SHO. In the OIP, various allegations were made against Messrs. Delaney and Yancey including that the violations of Regulation SHO were intentionally undertaken in order to financially benefit Penson "by keeping stock out on loan rather than recalling it so that it could be delivered in a timely fashion" (OIP, at par. 23.)

In order to prove its allegation of millions in profits to Penson, the Division offered the expert report and testimony of Lawrence Harris ("Harris"), a Professor of Finance at USC Marshall School of Business. Harris calculated in his report that the profit to Penson based on the Regulation SHO violations was approximately $6.2 million.[3] However, as noted on page 26 of the Initial Decision in that matter, "the $6.2 million figure resulted from a calculation error that caused Harris to overstate the purported benefit by a factor of 100." Harris himself acknowledged the error was "quite embarrassing."

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[1] As discussed on page 24 of Mr. Johnson's Wells Submission, because the stock was outstanding only a few hours past market open on T+6, and not overnight, there was no interest or other profit to Penson for the late return. Moreover, also on page 24 of the Wells Submission, Mr. Johnson continued to argue to the staff that profits were virtually non-existent as a result of the Regulation SHO violations ("Penson calculated the additional revenue from violations at $2,810.24 for a representative month." *Wells Submission*, at 24.)

[2] Among other things, Mr. Johnson has for years suffered from [redacted], a debilitating disease which is greatly exasperated by stress.

[3] Although Mr. Johnson does not know if the staff had retained Harris prior to or during the Wells and settlement conversations Mr. Johnson had with the staff as described above, Harris' "ill-gotten gains" calculation is similar to the amount the staff propounded during those conversations.

Rather than the $6.2 million alleged by the Division, the ALJ found, and the Division agreed[4], that as a result of Penson's violations of Regulation SHO over a three-year period, it profited by a mere $59,000, or less than $20,000 per year.[5] Over the same time period, Penson's Stock Loan Department had earned approximately $77 million in revenue. (*Initial Decision*, at 8.) Thus, rather than accounting for 8% of Stock Loan's revenue as argued by the Division at the hearing and during discussions with Mr. Johnson, the revenues potentially attributable to the Regulation SHO violations accounted for only 0.008% of its revenue. (*Initial Decision*, at 62.)

As noted above, the staff's belief that Penson's, and Mr. Johnson's, violations were motivated by outsized profits was a significant factor in the terms of the settlement demanded by the staff. Without profit as the motive for the violations, this matter would have been recognized as significantly less egregious than understood by the staff and, presumably, the Commission. As a result, Mr. Johnson believes that it is appropriate, albeit unusual, to ask for relief from one of the terms of his settlement.

Specifically, Mr. Johnson requests that the Commission reevaluate the appropriateness of the five-year bar imposed on him pursuant to his settlement, and reduce the bar to one year.[6] Mr. Johnson was forced out of the industry nearly two years ago as a result of receiving the staff's Wells notice. He has, as a result, sold his home, relocated from St. Louis to Dallas, and moved his family into a smaller, more affordable home while he tries to start a restaurant. And while we will not repeat all of the unique and severe difficulties that the bar has placed on Mr. Johnson and his family (*Wells Submission*, at 28-29), having lost his ability to properly care for the medical conditions both he and his wife endure has been particularly difficult since leaving the industry.

Modifying the bar would also be consistent with, though still in excess of, the sanctions imposed in many other Regulation SHO matters. For example, the SEC has not imposed remedial sanctions against individuals even when the individuals knew or should have known that their acts would contribute to Rule 204 violations. See, eg., *In the Matter of Peter J. Bottini et. al*, Securities Exchange Act Rel. 66814 (Apr. 16, 2012).

Moreover, the SEC has limited severe sanctions – such as a bar – to those Rule 204 cases that involve egregious misconduct and "naked" short selling. For example, the SEC ordered

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[4] See *Initial Decision*, at 26.

[5] *Id.* In addition, although the staff also alleged in the OIP that Penson had "thousands" of Regulation SHO violations, in fact the 1500 violations over the relevant three-year period only amounted to only .0018% of long sales associated with loaned shares (1500 violations divided by 83.6 million long sales transactions associated with loaned shares)(See *Initial Decision* at 7).

[6] Mr. Johnson is not requesting a reconsideration of the civil money penalty imposed by the settlement order.

remedial sanctions against Gary Bell, the sole proprietor of broker-dealer GAS I, L.L.C. The SEC found that Bell willfully engaged in sham transactions and false claims to market making activity, in order to "earn profits while subject to minimal risk" through "naked" short-selling. *In the Matter of Gary S. Bell*, Securities Exchange Act Rel. 65941 at ¶ 5 (Dec. 13, 2011). Similarly, in *In the Matter of Jeffrey A. Wolfson et al.*, the SEC imposed remedial actions against a trader and his firm who engaged in "naked" short sales through sham transactions and improper utilization of the market maker exception: "[t]hese transactions enabled the Respondents to circumvent Reg. SHO, allowed them to generate hundreds of thousands of dollars in profits . . . and caused their clearing broker to have large persistent fail to deliver positions in these threshold securities, thus undermining one important purpose of Reg. SHO." Securities Exchange Act Rel. 67450 at ¶ 7. And in *In the Matter of Hazan Capital Management, LLC*, the SEC imposed remedial sanctions against Steven Hazan and Hazan Capital Management, LLC. Hazan, the majority owner and managing member of Hazan Capital Management, was found to have engaged in "naked" short selling by using sham reset transactions and improperly claiming the market maker exception. Securities Exchange Act Rel. 60441 (Aug. 5, 2009).[7]

Mr. Johnson fully understands that by settling with the Commission, he waived his rights to appeal the sanctions imposed by the order. Moreover, Mr. Johnson also understands that it would be highly unusual for the Commission to modify sanctions that have been agreed to by settlement. Finally, Mr. Johnson understands that one risk of settling is that an adjudicator may find that the Division's case is incorrect, as happened in this matter.

Nevertheless, Mr. Johnson believes that this case is unique, and should be reviewed for fairness. Specifically, in this case the Division has conceded that a fundamental fact on which it based its case, and presumably on which it based its recommendation to the Commission, was little more than a "quite embarrassing" error. This is not a matter where the ALJ simply disagreed with the Division's position that Penson profited by $6.2 million. Rather, this is a case where the Division has acknowledged that any argument it may have made that Penson had profited by more than a few thousand dollars was based on the staff's own mistake.

Had the staff been aware of this mistake when it was discussing settlement with Mr. Johnson, and when it was recommending settlement to the Commission, there is little doubt that the case would have been viewed as much less egregious than it was. In fact, there would have been no argument that profit or greed could have motivated Penson or its employees, including Mr. Johnson. Having no such motive to violate Regulation SHO, there would be

[7] For a more complete discussion of appropriate precedent, please see pages 25-27 of Mr. Johnson's Wells Submission.

no reason to impose the unprecedented sanctions that were demanded by the staff in settlement.

As noted in his Wells Submission, Mr. Johnson went above and beyond in cooperating with the staff during its investigation. In fact, he provided much of the information on which the staff built its case. After leaving Penson, Mr. Johnson went to Scottrade where he assisted the firm in its stock lending business, using his experience to help Scottrade remain compliant with Regulation SHO. Mr. Johnson fully understands, and has always acknowledged his mistakes in connection with Penson's stock lending activities, and has learned valuable lessons as a result of this matter including that when he does not get approproiate guidance from his compliance officer, he should take the opportunity to raise issues with the regulators. Given all of that, and the errors which the staff has acknowledged concerning this matter, Mr. Johnson is asking that his bar be limited so that he may apply for reentry into the securities industry after one year, rather than the five years as the settlement order currently requires.[8]

For all the reasons set forth above, Mr. Johnson respectfully asks that the Commission consider his request for a modification of his settlement order to allow him to apply for reentry into the securities industry after a period of one year from the date of the order against him.

[redacted]

cc: John Warner
Jay Scoggins

[8] Mr. Johnson also understands that various procedural steps may need to be taken in modifying the bar as he has requested. He is, of course, more than willing to undertake any such steps as necessary. However, Mr. Johnson believed that raising his request in this form was the most effective way to appeal to the Commission's sense of fairness.