

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 56886 / December 3, 2007

SECURITIES INVESTOR PROTECTION ACT OF 1970  
Rel. No. 167 / December 3, 2007

Admin. Proc. File No. 3-12156

In the Matter of  
STEPHEN J. HORNING

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Failure to Supervise

Causing Violations of Net Capital, Customer Reserve, and Books and  
Records Requirements

Appointment of SIPC Trustee

President, director, registered financial and operations principal, and compliance officer of registered broker-dealer failed to exercise reasonable supervision over firm's head trader and its operations manager with a view to preventing their violations of the antifraud provisions and caused broker-dealer's violations of the net capital, customer reserve, and books and records requirements. A SIPC trustee was appointed to liquidate firm. Held, it is in the public interest to bar president, director, registered financial and operations principal, and compliance officer from association with any broker or dealer in a supervisory capacity and to suspend him for twelve months from association with any broker or dealer.

## APPEARANCES:

Thomas D. Birge and Carla B. Minckley, of Birge & Minckley, P.C., for Stephen J. Horning.

Jennifer A. Ostrom and Amy J. Norwood, for the Division of Enforcement.

Appeal filed: October 10, 2006

Last brief received: January 26, 2007

Oral argument: October 1, 2007

## I.

Stephen J. Horning appeals from the decision of an administrative law judge. Horning was a director and senior officer of Rocky Mountain Securities & Investments, Inc. ("Rocky Mountain"), a registered broker-dealer formerly located in Denver, Colorado. The law judge found that Horning failed reasonably to supervise two former employees of Rocky Mountain with a view to preventing their violations of Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5. 1/ The law judge also found that Horning was a cause of Rocky Mountain's inaccurate books and records and its filing of materially false reports with regulatory agencies in violation of Exchange Act Sections 15(c)(3), 17(a), and 17(e) and rules thereunder. 2/ The law judge barred Horning from association with any broker or dealer in a supervisory capacity and suspended him from association with any broker or dealer in any capacity for twelve months. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. 3/

## II.

A. Background

From 1981 until February 2003, when Rocky Mountain ceased operations, Horning was a director, president, registered financial and operations principal ("FINOP"), compliance director, and a registered representative at the firm. Horning directed the management, policies, and daily operations of Rocky Mountain. He had authority to hire and fire employees. He established

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1/ 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5.

2/ 15 U.S.C. §§ 78o(c)(3) and 78q(a), (e).

3/ Rule of Practice 451(d), 17 C.F.R. § 201.451(d), permits a member of the Commission who was not present at oral argument to participate in the decision of a proceeding if that member has reviewed the oral argument transcript prior to such participation. Commissioners Atkins and Casey conducted the required review.

Rocky Mountain's supervisory procedures and was responsible for assuring that they were implemented.

Horning was solely responsible for supervision of the Operations Department at the firm. Horning supervised Leslie Andrade, who became head of Rocky Mountain's three-person Operations Department in 1991. Andrade is a high school graduate. She does not hold any securities licenses and failed the examination for a Series 7, General Securities Representative, license. Rocky Mountain's Operations Department did not have a manual that described the policies and procedures to be followed.

Andrade was responsible for keeping and maintaining Rocky Mountain's books and records. Andrade also was responsible for preparing the monthly "Financial and Operational Combined Uniform Single Report," Form X-17A-5 ("FOCUS Report"), that contained the firm's financial statements and its net capital calculation. <sup>4/</sup>

Horning reviewed all of Rocky Mountain's net capital calculations for accuracy and reviewed and signed Rocky Mountain's FOCUS Reports. Horning testified that it took him approximately "two minutes" to review each FOCUS Report. Horning assumed that Andrade made the calculations in the FOCUS Reports correctly because "[s]he had been doing it since 1991 without ever anyone complaining about how she did it."

Rocky Mountain also filed annual FOCUS Reports signed by Horning as president. The financial statements in these annual reports were audited by Mortland & Co., P.C., a one person firm run by Herbert Mortland. Mortland had repeatedly found weaknesses in the firm's internal controls. In August 2000, Mortland reported that the firm's "plan of organization did not include adequate separation of duties related to daily cash receipt and cash disbursement activities." The audit further found that "[a]ppropriate supervisory review procedures were not instituted to provide reasonable assurance that adopted policies and prescribed procedures were adhered to." Similar warnings had appeared in all of Rocky Mountain's audited reports since 1981. Horning testified that he had discussed the weaknesses in Rocky Mountain's internal controls when Mortland had first identified the weaknesses in the early 1980s. However, Horning did not change Rocky Mountain's organization or internal structure because the firm did not have funds to hire additional personnel and "the system worked fine as it was."

Horning also was responsible for supervising Rocky Mountain's Trading Department. Judy Clarke, who had joined Rocky Mountain at its inception, was the firm's head trader. In that position, Clarke bought and sold equities in Rocky Mountain proprietary accounts and she also executed trades on behalf of the firm's customers. Clarke was supposed to record these transactions on trade tickets for Horning's approval.

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<sup>4/</sup> Broker-dealers are required to file FOCUS Reports with regulators who use them to monitor firms to ensure that they are financially sound. See Exchange Act Rule 17a-5, 17 C.F.R. § 240.17a-5.

B. 2001 Unrecorded Trading

In early 2001, Commission staff conducted a routine examination in which they discovered more than \$800,000 in purchases by Clarke for Rocky Mountain accounts that were not reflected on the firm's books and records. As a result, the firm had suffered more than \$600,000 in unreported trading losses. Clarke had not received Horning's approval of the trade tickets as she was required to do. Moreover, because she had not submitted her trade tickets to the accounting department, the trades never appeared on the firm's books. Andrade and Tammy Steffen, Rocky Mountain's assistant director of compliance from 2000 until May or June 2001, knew about Clark's unrecorded trades from comparing data received from the two national clearing houses, National Securities Clearing Corporation ("NSCC") and Depository Trust and Clearing Corporation ("DTC"), with Rocky Mountain's books and records. Neither Andrade nor Steffen had notified Horning of these unrecorded trades.

On March 28, 2001, as a result of the examination, Commission staff sent Rocky Mountain a letter in which they detailed numerous deficiencies including: (1) net capital computation errors and customer reserve requirement computation errors; (2) failure to maintain accurate books and records; (3) failure to file an accurate net capital computation in its FOCUS Reports and annual audited reports; and (4) inadequate written supervisory procedures.

In a letter dated April 27, 2001, Horning informed Commission staff that the deficiencies and concerns detailed in the March 28, 2001 deficiency letter had "all been remedied." In his letter, Horning disagreed that Rocky Mountain failed to detect the problem in reconciling the clearing house reports with Rocky Mountain's books and records. Rather, according to Horning, "[a]fter the differences were detected they were then ignored" in the "hope that the market would recover and help alleviate some of these problems." Horning also told NASD that he was putting in place certain unspecified procedures to ensure that Clarke's activities would not reoccur.

C. Horning's Response

Horning did not fire or fine Clarke, Andrade, or Steffen, nor did he make them repay the losses suffered by the firm. <sup>5/</sup> Instead, he warned them that they would be fired if they repeated their actions. Horning testified that he considered Clarke and Andrade "trusted" employees who had made a mistake and deserved a second chance, although he admitted on cross examination that their activities in 2000 and 2001 were "basically" dishonest.

Horning did implement certain additional supervisory procedures in April 2001. Although Horning continued to allow Clarke to make unlimited trades in Rocky Mountain's proprietary account, she no longer received eighty percent of the profits on those trades. Rather, sixty percent of the profits from proprietary trades went to Rocky Mountain and forty percent of the profits were divided among Clarke and the firm's two other traders, Randy Van Brocklin,

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<sup>5/</sup> Steffen left the firm around this time.

Clarke's brother, and Jeremy Sanchez. In addition, Horning required that all proprietary trades be made under a single account number. Horning also instituted a system whereby Clarke, Andrade, Van Brocklin, and Sanchez each would be fined one hundred dollars for every trade that Horning found had not been reconciled.

Horning also required Andrade to prepare a daily handwritten reconciliation of the NSCC and DTC clearing reports with Rocky Mountain's trading records ("Reconciliation Report"). The purpose of the Reconciliation Report was to show that all trades that occurred were recorded on Rocky Mountain's books, which did not happen in 2000 and 2001. Toni Carter-Hall, who worked in the Operations Department under Andrade, was responsible for preparing the Reconciliation Report three days a week, and Andrade was responsible for preparing it the other two days of the week. However, when Carter-Hall could not balance the reconciliation numbers, Andrade sent her home and when Carter-Hall returned to the office the numbers would be balanced.

The Reconciliation Reports consisted of a one-page, handwritten summary, the clearing house daily report, and Rocky Mountain's trading records. The one-page summary contained debit and credit columns that purportedly were derived from the clearing house reports and debit and credit columns that purportedly were derived from Rocky Mountain's trading records.

Horning reviewed the Reconciliation Reports one day a week, the day chosen on a random basis. Horning testified that he spent "ten seconds" reviewing the Reconciliation Reports. He looked only to see if the bottom line numbers balanced. He did not add up the columns on the summary sheet to check that the totals were accurate or review the documents attached to the summary sheet to determine if the figures on those documents matched the figures on the summary sheet.

The record includes Reconciliation Reports initialed by Horning for twelve dates between February 20, 2002 and December 27, 2002. Each of the one-page summaries initialed by Horning contained errors. A number of the one-page summaries contain errors in adding the amounts in columns that resulted in erroneous bottom-line totals. For example, the one-page summary for November 5, 2002 that Horning initialed contains a column for NSCC/DTC debits

and credits that when added should have totaled over \$1 million; however, the ending balance is listed as only \$563,193.94:

Rocky Mountain Reconciliation Report for November 5, 2002

	NSCC/DTC	
	Debit	Credit
Balance forward	421,864.86	
Settling Trades	<u>502,217.00</u>	
Subtotal	924,063.86	
NSCC/DTC Collect/Pay	144,874.08	
Miscellaneous Adjustment		5,745.33
Dividends/Interest	<u>1.33</u>	
Ending Balance	563,193.94	

The one-page summary for November 25, 2005 that Horning initialed purports, in the first column labeled NSCC/DTC Debit, to add amounts of \$567,783.32 and \$953,821.54 to a subtotal of only \$521,614.86, a discrepancy of \$1 million:

Rocky Mountain Reconciliation Report for November 25, 2005

	NSCC/DTC	
	Debit	Credit
Balance forward	567,783.32	
Settling Trades	<u>953,831.54</u>	
Subtotal	521,614.86	
NSCC/DTC Collect/Pay		37,075.40
Dividends/Interest	<u>169.19</u>	
Ending Balance	484,708.65	

Horning admitted that he did not notice these errors when he reviewed the one-page summaries and had he noticed the errors, he would not have initialed the summaries. Moreover, the numbers on the one-page summaries did not correspond to the information provided by the clearing house, which was attached as part of the Reconciliation Report. For example, the one-page summary for March 25, 2002 that Horning initialed shows almost a one million dollar discrepancy between the figure on the summary sheet and the attached information from NSCC.

Around this time, Horning also began to require Andrade to prepare a daily handwritten report on any trading errors or unreconciled trades. Andrade or Carter-Hall prepared the trade error reports. Andrade initialed the trade error reports, regardless of who prepared them, because she was responsible for correcting the errors. Horning reviewed the reports but did not review any underlying records or ask anyone to verify the information in the trade error reports or whether the reported errors in fact were corrected. Horning relied completely on Andrade to give

him an accurate report of trading errors. He claimed that he had no reason to believe she would give him inaccurate information.

During this period, Rocky Mountain maintained a money market account, an omnibus account, at Reich & Tang Services, Inc. ("Reich & Tang"), a brokerage firm in New York City. The Reich & Tang omnibus account contained funds that had been swept from the credit balances in the accounts of Rocky Mountain customers. Each day, Reich & Tang sent a facsimile to Rocky Mountain entitled "Daily Reconciliation & Summary Sheet" that summarized the transactions in the omnibus account. Joanne Wing, an employee in the Operations Department, initially was responsible for handling all deposits to and disbursements from the omnibus account. Rocky Mountain recorded the amounts in the omnibus account on a document entitled "Rocky Mountain Securities Cash Out of Balance Report" under an entry for "Type 6" accounts. Horning did not establish procedures for Rocky Mountain to verify that information in the "Daily Reconciliation & Summary Sheet" matched Rocky Mountain's records with respect to the amounts in the omnibus account.

D. The Present Violations

From April 2002 through January 2003, Clarke incurred trading losses of approximately \$6.5 million through her equities trading in Rocky Mountain's proprietary accounts. Instead of reporting the trading losses, Clarke concealed them by entering fictitious profitable trades in Rocky Mountain's computer system and omitting executed losing trades. Clarke also entered fictitious trades in the personal inventory accounts of Rocky Mountain's registered representatives.

Andrade used approximately \$4.5 million of customer funds from the Reich & Tang account, as well as funds belonging to the firm, to pay for Clarke's trading losses. Although Wing had been assigned the responsibility for handling all deposits to and disbursements from the omnibus account, Andrade took this responsibility away from Wing during the summer of 2002 and did not inform Horning.

Rocky Mountain's annual audit also did not reconcile the amount in the Reich & Tang omnibus account with Rocky Mountain's records. <sup>6/</sup> Horning admitted that it would have been easy to compare the figures provided by Reich & Tang with those maintained by the firm. From April 2002 through January 2003, the Reich & Tang report never matched the information in Rocky Mountain's internal records. By the second half of November 2002 and continuing

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<sup>6/</sup> The Commission instituted and settled an administrative proceeding against Mortland concerning Rocky Mountain's 2002 audit in which Mortland consented to be barred from appearing or practicing before the Commission with a right to reapply after three years. Herbert J. Mortland, CPA, Securities Exchange Act Rel. No. 53162 (Jan. 20, 2006), 87 SEC Docket 552.

through January 2003, Reich & Tang reported that the omnibus account had less than \$100,000, while Rocky Mountain's internal records showed a value of over \$4 million.

On January 21, 2003, Rocky Mountain's bank informed Horning that the firm's account was overdrawn by \$350,000. Rocky Mountain hired a forensic accounting expert who determined that the firm likely was out of net capital and that inaccuracies in the firm's books and records raised significant uncertainty as to Rocky Mountain's financial condition. Rocky Mountain ceased operations on February 3, 2003. An NASD examination in February 2003 confirmed that Rocky Mountain had executed buy transactions cleared through NSCC that were not shown on its books and records, that there were sales transactions on Rocky Mountain's books and records that had not been cleared through NSCC, and that Rocky Mountain had millions of dollars in trading losses that were not reported on its books and records.

Horning also learned, at or around the time that Rocky Mountain ceased doing business, that Andrade had taken responsibility for the Reich & Tang omnibus account away from Wing and had taken responsibility for balancing the Reconciliation Reports away from Carter-Hall. Horning subsequently discovered, in the course of testifying before Commission staff in this matter, that Clarke had entered fictitious trades in Horning's personal inventory account.

The Commission and the Securities Investor Protection Corporation ("SIPC") sued Rocky Mountain on February 5, 2003, in the United States District Court for the District of Colorado alleging that Rocky Mountain had violated the Exchange Act and that its customers needed protection. <sup>7/</sup> The district court appointed a trustee who initiated an action in the United States

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<sup>7/</sup> The Commission filed an injunctive action against Clarke and Rocky Mountain in the United States District Court for the District of Colorado and obtained a default judgment against Clarke. The court found that Clarke violated Exchange Act Sections 10(b), 15(c)(3), and 17(a) and Exchange Act Rules 10b-5, 15c3-1, 15c3-3, and 17a-3. The court enjoined Clarke from violating Exchange Act Section 10(b) and Exchange Act Rule 10b-5 and from aiding or abetting violations of Exchange Act Sections 15(c)(3) and 17(a) and Exchange Act Rules 15c3-1, 15c3-3, and 17a-3. The court also ordered Clarke to disgorge \$5743.38 and to pay a civil penalty of \$120,000. SEC v. Clarke, 03-MK-0228 (D. Colo. 2005).

On May 18, 2006, Andrade was indicted and charged with one count of wire fraud in connection with the scheme to defraud Rocky Mountain and its customers. Andrade pleaded guilty to the wire fraud charge and, on February 20, 2007, the district court sentenced her to twenty-four months imprisonment and three years supervised release, and ordered her to make restitution in the amount of \$6,922,774.00. United States v. Andrade, No. 06-CR-00196 (D. Colo. 2006).

(continued...)

Bankruptcy Court for the District of Colorado to liquidate Rocky Mountain. Horning paid the estate of Rocky Mountain \$150,000 to settle a civil lawsuit by the SIPC trustee. As of February 28, 2006, SIPC had advanced \$5,402,891.18 to the estate to compensate customers for their losses. The estate paid 651 customer claims resulting in a total expenditure of \$5,388,273.15. The trustee expected that SIPC might have to contribute an additional \$100,000 to \$130,000 before the liquidation was complete.

A few days before Rocky Mountain ceased doing business, Horning made arrangements for himself and twenty-one associated persons of Rocky Mountain to become associated with Moloney Securities Co., Inc., a broker-dealer located in St. Louis, Missouri. Edward J. Moloney, the president and CEO of Moloney Securities, was Horning's college roommate. At the hearing in this matter, Horning testified that he still is employed with Moloney Securities. He is a director and a regional vice president responsible for supervising twenty-seven registered representatives, including Mark Depew and Buzz Masee, who also were registered representatives at Rocky Mountain.

About this time, Horning discovered that Depew and Masee had loaned Clarke money and that she had repaid these loans in part with funds generated by fictitious profitable trades in those representatives' inventory trading accounts. One of the fictitious trades in Masee's account was for \$500,000, even though his trading limit was at most \$40,000 to \$50,000. Neither Depew nor Masee told Horning about the loans before February 2003. When Horning discovered the loans and fictitious trades used to repay the loans, he refused to give the representatives involved their purported trading profits that they allegedly had earned in January 2003. However, Horning initially accepted Depew and Masee's explanation that they did not realize that Clarke had repaid the loans with profits from fictitious trades.

Horning testified at the hearing that he came to believe that Clarke was paying a personal obligation with firm money because some of the fictitious trades made by Clarke to repay Depew and Masee were made at "outlandish" prices that were not related to the market price of the securities involved. For example, Depew's account listed a sale of Imclone stock in August 2002 which was purportedly made at \$22.50 per share when, in fact, Imclone stock traded in the range of \$6 to \$8 per share during August 2002. Horning testified that he now considered the conduct of Depew and Masee in loaning money to Clarke, accepting money from fictitious trades in repayment, and not telling Horning as "probably" dishonest. Nonetheless, Horning testified that,

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7/ (...continued)

On August 21, 2006, Clarke was indicted and charged with six counts of wire fraud in connection with the scheme to defraud Rocky Mountain and its customers. Clarke pleaded guilty to one count of wire fraud and, on September 4, 2007, the district court sentenced her to fifty-four months imprisonment and three years supervised release, and ordered her to make restitution in the amount of \$6,922,774.00. United States v. Clarke, No. 06-CR-00333 (D. Colo. 2006).

as of the time of the hearing, he had taken no steps to place Depew or Masee under heightened supervision at Moloney Securities in response to their conduct at Rocky Mountain.

### III.

Exchange Act Sections 15(b)(4)(E) and 15(b)(6) provide that we may sanction a person associated with a broker-dealer if we find that such person failed reasonably to supervise, with a view to preventing violations of the federal securities laws and rules and regulations thereunder, another person who commits such violations if such person is subject to the individual's supervision. <sup>8/</sup> No person shall be deemed to have failed reasonably to supervise any other person if (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with. <sup>9/</sup>

Exchange Act Section 10(b) makes it unlawful for any person "[t]o use or employ in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." <sup>10/</sup> Rule 10b-5, which implements this section, prohibits any scheme, device, or artifice to defraud, misleading statements or omissions, and any act, practice, or course of business that operates as a fraud "in connection with the purchase or sale of any security." <sup>11/</sup>

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<sup>8/</sup> 15 U.S.C. §§ 78o(b)(6), (b)(4)(E).

<sup>9/</sup> Id.

<sup>10/</sup> 15 U.S.C. § 78j(b).

<sup>11/</sup> 17 C.F.R. § 240.10b-5; see SEC v. Zandford, 535 U.S. 813, 825 (2002) (stating that a scheme to defraud is "in connection with" with a securities transaction if it "coincides" with that transaction). Scierter is a necessary element of a violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5. See Aaron v. SEC, 446 U.S. 680, 695, 697 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976); Steadman v. SEC, 603 F.2d 1126, 1134 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). Reckless behavior satisfies the scierter requirement. See, e.g., Hackbart v. Holmes, 675 F.2d 1114, 1117-18 (10th Cir. 1982) (defining recklessness as "an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known or is so obvious that the actor must have been aware of it") (quoting Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977)).

Clarke engaged in unauthorized trading. She concealed this activity by entering fictitious profitable trades and not recording losing trades. She directed others to enter false data into Rocky Mountain's books and records. Based on these facts, the United States District Court for the District of Colorado found that Clarke violated Exchange Act Section 10(b) and Rule 10b-5, among other provisions. <sup>12/</sup> Horning stipulated that Andrade engaged in a scheme to make unauthorized trades on Rocky Mountain's books and to conceal this activity. <sup>13/</sup> Andrade knowingly falsified Rocky Mountain's books and records to hide Clarke's unauthorized trades, diverted approximately \$4.5 million of customer funds from Rocky Mountain's omnibus account at Reich & Tang to cover Clarke's trading losses, and withheld information from the forensic accountant hired by Rocky Mountain to investigate the missing Reich & Tang funds. We find, based on these facts and for purposes of this proceeding only, that Clarke's and Andrade's actions violated Exchange Act Section 10(b) and Rule 10b-5.

Rocky Mountain's procedures to detect these violations generally were deficient. Horning failed to institute any procedure to reconcile the account balance of the omnibus account reflected in the Reich & Tang Daily Reconciliation and Summary Sheet with Rocky Mountain's records. Horning's own expert witness agreed that the lack of a procedure to reconcile these amounts was improper. Horning also failed to implement any procedures in response to the auditor's warning that Rocky Mountain's plan of organization did not include adequate separation of duties with respect to cash receipts and cash disbursements and that Rocky Mountain's supervisory procedures were inadequate. Horning did not put in place an operations manual for the Operations Department and lacked accurate information about the duties performed by Rocky Mountain's three-person Operations Department staff.

Moreover, Horning failed reasonably to supervise Andrade and Clarke in particular. Supervision of an associated person must be "reasonable . . . under the attendant circumstances." <sup>14/</sup> As a result of the examination by the Commission staff and the resulting deficiency letter, Horning knew that in 2000 and 2001 Clarke had incurred more than \$600,000 in trading losses in the firm's proprietary accounts and instead of reporting those losses accurately, she concealed them, with Andrade's assistance, by omitting to record executed losing trades. Horning knew that Clarke's and Andrade's conduct had resulted in inaccuracies in Rocky Mountain's net capital calculations and in its books and records.

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<sup>12/</sup> SEC v. Clarke, No. 03-MK-0228 (D. Colo. 2005).

<sup>13/</sup> Of course, Horning's stipulation cannot bind Andrade. Our findings here with respect to Clarke and Andrade are made solely for the purpose of this proceeding.

<sup>14/</sup> Clarence Z. Wurtz, 54 S.E.C. 1121, 1130 (2001) (quoting Arthur James Huff, 50 S.E.C. 524, 528-29 (1991)); see also Louis R. Trujillo, 49 S.E.C. 1106, 1110 (1989) (stating that supervision must be reasonable "under all the circumstances").

These facts highlighted the need for Horning's heightened supervision over Clarke and Andrade, especially regarding trading in the firm's proprietary account and maintenance of the firm's books and records. 15/ However, Horning made no personnel changes and took no meaningful disciplinary action. Horning continued to allow Clarke to execute trades in the firm's proprietary account at her discretion and he continued to allow Andrade to be responsible for Rocky Mountain's books and records, both subject to his sole supervision. Thus, Horning had a particular responsibility to ensure not only that rules and procedures were in place to supervise Andrade and Clarke properly, but also that those rules and procedures were enforced. 16/

The procedures Horning instituted in response to Andrade and Clarke's earlier misconduct and his implementation of those procedures were inadequate. The Commission staff's 2001 deficiency letter had highlighted the errors that resulted from Rocky Mountain's previous failure to accurately reconcile its clearing account records. 17/ Rather than reduce the likelihood of future misconduct, many of the procedures that Horning instituted appear counterproductive. He reduced the commissions that Clarke received from her trades in Rocky Mountain's proprietary account, thereby creating an incentive for Clarke to trade more frequently, yet he took no steps to monitor her trading. He instituted a system where each of the three traders would be fined for every trade that Horning found had not been reconciled, which provided the other traders with an incentive not to report Clarke's unrecorded trades. He assigned to Andrade the responsibility to prepare handwritten Reconciliation Reports and trade error reports even though she had been responsible for concealing Clarke's previous trades. These procedures were not reasonably designed to prevent or to detect additional fraudulent conduct by Clarke or Andrade.

Horning's review of the Reconciliation Reports and trade error reports also was deficient. He spent only "ten seconds" once a week reviewing the Reconciliation Reports. He did not review the NSCC daily report or the Rocky Mountain trading records attached to the summary

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15/ See John A. Chepak, 54 S.E.C. 502, 514 (2000) (stating that "prior misconduct indicated the need for heightened supervision, particularly in areas that had resulted in previous violations"); see also Consol. Invs. Servs., Inc., 52 S.E.C. 582, 588 (1996) (stating that an employee who has previously evidenced misconduct can only be retained if he subsequently is subjected to a commensurately higher level of supervision).

16/ See Wurtz, 54 S.E.C. at 1130 (stating that supervisors who know of an employee's past disciplinary history must ensure not only that rules and procedures are in place to supervise the employee properly, but also that those rules and procedures are enforced).

17/ See Blinder, Robinson & Co., 47 S.E.C. 812, 814 (1982) (finding respondents' " cursory examination" "clearly inadequate" because a failure of supervision "connotes 'a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them'" (quoting Jerome F. Tegeler, 45 S.E.C. 512, 515 n.8 (1974) and Anthony J. Amato, 45 S.E.C. 282, 286 (1973)).

sheet to determine if the figures on the supporting documents matched those on the summary sheet. He did not add up the columns on the summary sheet to check that the totals were accurate and instead reviewed only the bottom-line numbers to see if they balanced. He failed to notice obvious discrepancies on the face of the summary sheets of the Reconciliation Reports, including a \$1 million error on one of the summary sheets, or to detect obvious discrepancies between the summary sheets and the supporting documents. Although Horning assigned to Andrade the responsibility to prepare daily reports on any trading errors or unreconciled trades, he never reviewed the records on which those reports were based and he never asked anyone to verify that the information in those reports was correct.

Horning's argument that he could not have detected Clarke and Andrade's scheme because it was complicated and well concealed is unfounded. Contrary to Horning's assertion, Clarke and Andrade's scheme was not particularly well concealed. For example, the Reconciliation Reports contained numerous blatant errors that could have been uncovered had Horning engaged in more than a cursory ten-second review. Further evidence of the scheme was available had Horning taken the time to review the supporting documents attached to the Reconciliation Report and the trading error reports or to review the Reich & Tang facsimiles. 18/

As Rocky Mountain's FINOP, Horning was responsible for the firm's compliance with net capital requirements and for ensuring that the net capital calculations were made correctly. Yet, Horning signed at least nine FOCUS Reports prepared by Andrade after a review that took approximately two minutes each. Horning was the only person at Rocky Mountain to review the materials that Andrade prepared and he failed to take any steps to check for irregularities or to verify independently the information he was given. We agree with the law judge's conclusion that "his review was so superficial as to be worthless." Horning's total reliance on Andrade was unreasonable given her concealment of Clarke's misconduct in 2000 and 2001.

Horning claims that he relied on Clarke and Andrade's assurances and that no further investigation was needed. "We have repeatedly stressed that supervisors cannot rely on the unverified representations of their subordinates." 19/ This is especially true where the subordinates have committed misconduct in the past. Horning's claim that he had no reason to believe that "two of his most trusted employees" were engaged in misconduct ignores the numerous red flags that served to warn Horning that he could not rely on these employees. He

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18/ See Christopher J. Benz, 52 S.E.C. 1280, 1282 (1997) (rejecting contention that supervisor "could not have discovered" employee's violations when there were "numerous red flags" that supervisor "should not have ignored" such as employee's history of compliance problems and suspicious activities in employee's accounts).

19/ Quest Capital Strategies, 55 S.E.C. 362, 372 (2001) (citing Michael H. Hume, 52 S.E.C. 243, 248 (1995); John H. Gutfreund, 51 S.E.C. 93, 108 (1992)).

admitted that Clarke and Andrade's actions in 2000 and 2001 were "basically" dishonest, and he should have taken steps to verify the information that these employees provided to him. 20/

Horning also faults Wing and Carter-Hall for failing to inform him that their duties had changed, but this does not excuse his failure to supervise Andrade. The Operations Department consisted of three people: Andrade, Wing, and Carter-Hall. Rather than monitor the three-person Operations Department to make sure that each of the employees were performing their assigned duties, Horning relied on the representations of Andrade and, given her previous misconduct, such reliance was unreasonable.

Horning claims that the scheme implemented in 2002 and 2003 was "dramatically different" from the trading irregularities detected during the examination conduct by Commission

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20/ At oral argument, Horning's counsel admitted that Horning was responsible for supervision at the firm:

Commissioner Nazareth: Isn't it true, though, that the – what is in the record is that the books and records of this firm were completely unreliable? The books and records of the firm did not match the reality, either as to the trading or as to the financial position of the firm.

Mr. Birge: That is true. The evidence suggests that both [Andrade and Clarke] actually pled guilty and were convicted for their involvement in this scheme. And part of their guilty plea was they admitted that they dummied up the records, created false reports, plugged numbers, created fictitious transactions and created a whole series of documents to hide exactly what they were doing.

Commissioner Nazareth: And doesn't the record also show that substantial amounts of customer funds which were held by the firm on behalf of customers were misappropriated by employees of this firm?

Mr. Birge: At least \$5 million of customer funds were stolen by Ms. Andrade and Ms. Clarke.

Commissioner Nazareth: And wasn't your client the supervisor in charge of these employees?

Mr. Birge: He was their supervisor. He was the president of the firm. It was his responsibility to supervise them, yes. He takes full responsibility for his supervision. He hasn't laid that off onto anyone else. He was their supervisor.

staff in 2001. 21/ However, in both instances Clarke suffered trading losses in Rocky Mountain's proprietary account and, along with Andrade, concealed those losses. The only material differences between Clarke and Andrade's previous conduct and that at issue here is that Andrade diverted \$4.5 million in customer funds from the Reich & Tang omnibus account to pay for the trading losses and entered fictitious trades in Rocky Mountain's books and records. Clarke and Andrade's prior misconduct required heightened supervision not just with respect to the precise actions they took in committing that misconduct, but also in areas that had resulted in the previous violation. 22/ In both cases here, the misconduct could have been uncovered had Horning taken basic steps to ensure that the firm's records were consistent with those of its clearing agent rather than simply relying on Andrade's assurances. 23/ In addition, unlike the previous conduct, Horning could have discovered Clarke and Andrade's misconduct had he instituted a procedure to check Reich & Tang Daily Reconciliation and Summary Sheets against Rocky Mountain's records.

Horning contends that Rocky Mountain's failure to include the Reich & Tang omnibus account on its balance sheet or its FOCUS Reports was never challenged by the firm's auditors, NASD, or Commission staff. He further claims that after the Commission staff conducted its 2001 examination, it failed to conclude that a fraud had been committed or to recommend enforcement action against Clarke or Andrade. These claims are beside the point. We have held that persons in the securities industry cannot shift their responsibility for compliance with applicable requirements to NASD or to the Commission. 24/ "A regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation." 25/

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21/ Horning contends that, unlike the scheme at issue here, the earlier scheme did not involve false documentation, fictitious trades, unauthorized modification of internal control provisions, trades at fictitious prices, unauthorized entries in the firm's books and records, or "plugged numbers" into the computer system.

22/ See Chepak, 54 S.E.C. at 514 (stating that "prior misconduct indicated the need for heightened supervision, particularly in areas that had resulted in previous violations").

23/ Cf. Quest Capital Strategies, 55 S.E.C. at 374 (finding that, although respondents had a comprehensive set of rules, respondents' system for applying the rules to the misconduct at issue was "woefully inadequate" because "[r]elying on a subordinate's assurances is hardly an effective method of preventing or detecting violations").

24/ See, e.g., William H. Gerhauser, 53 S.E.C. 933, 940 (1998) (finding applicants liable "even had there been an NASD audit that found no violations"); Richard R. Perkins, 51 S.E.C. 380, 384 n.20 (1993).

25/ Gerhauser, 53 S.E.C. at 940; Rita H. Malm, 52 S.E.C. 64, 75 n.40 (1994) (rejecting applicant's "contention that, because the NASD noted no markup, pricing or other

(continued...)

Horning maintains that he reasonably believed that the supervisory procedures he adopted after Commission staff discovered Clarke's unreconciled trades in 2001 would prevent further violations. Horning asserts that he adopted the supervisory procedures with "the approval of the SEC and the NASD," that the procedures were "fully vetted with the . . . regulators," and that "all parties agreed that they were reasonable under the circumstances." Horning has offered no evidence to support his assertion that NASD or the Commission approved the additional procedures or concluded that they were reasonable under the circumstances and nothing in the record supports such an assertion.

#### IV.

Exchange Act Section 15(c)(3) requires that broker-dealers observe Commission rules prescribed to provide safeguards for the broker-dealer's financial responsibility and related practices when effecting the purchase or sale of securities. <sup>26/</sup> The requirements of the Commission's net capital rule, Exchange Act Rule 15c3-1, are intended "to ensure that broker-dealers have sufficient liquid capital to protect the assets of customers and to meet their responsibilities to other broker-dealers." <sup>27/</sup> These requirements "involve fundamental safeguards imposed for the protection of the investing public on those who wish to engage in the securities business." <sup>28/</sup> Rocky Mountain's FOCUS Reports for the months ending June 30, 2002, through December 31, 2002, represented that it met its net capital requirement of \$250,000 when, because of Clarke and Andrade's actions, in each of the seven months it had a net capital deficiency ranging from a deficit of \$793,503 to a deficit of \$3,629,434.

Exchange Act Rule 15c3-3 requires, among other things, that a broker-dealer establish and maintain a customer reserve account and sets forth a formula for calculating the required balance to be maintained in the reserve account. <sup>29/</sup> Rocky Mountain's Rule 15c3-3 calculations were erroneous for each month from April 2002 through December 2002, because its books and records contained inaccurate information about the value of the Reich & Tang omnibus accounts.

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<sup>25/</sup> (...continued)  
'exceptions' during its audit . . . NASD was subsequently precluded from bringing markup or supervisory charges").

<sup>26/</sup> 15 U.S.C § 78o(c)(3).

<sup>27/</sup> Lowell H. Listrom, 50 S.E.C. 883, 886 (1992), aff'd, 975 F.2d 866 (8th Cir. 1992) (Table).

<sup>28/</sup> Id. at 888.

<sup>29/</sup> 17 C.F.R. § 240.15c3-3 and Exhibit A to Rule 15c3-3; see also Kevin Upton, 52 S.E.C. 145, 146 (1995).

During this time, Rocky Mountain's Rule 15c3-3 calculation showed no reserve deficiency when it had reserve deficiencies that ranged from a deficit of \$1,725,330 to a deficit of \$4,429,635.

Exchange Act Section 17(a) provides that brokers and dealers shall make, keep, furnish, and disseminate records and reports prescribed by Commission rule "as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act." 30/ The requirement that a firm maintain records and file reports encompasses the requirement that these records and reports be true and correct. 31/ Exchange Act Section 17(e) requires that a broker-dealer file with the Commission annually a balance sheet and income statement certified by an independent public accountant and provide its customers with its certified balance sheet. 32/

Rocky Mountain was required to make and keep current books and records that accurately represented its net capital. 33/ The firm also was required, as a self-clearing broker-dealer that carried customer accounts, to file monthly, quarterly, and annual FOCUS Reports containing a net capital computation. 34/ Rocky Mountain was obligated to supply audited financial statements to its customers and to file audited financial statements annually with the Commission. 35/ Rocky Mountain further was required to provide same-day notice of a net capital deficiency to the Commission. 36/

Rocky Mountain maintained insufficient net capital for the months of June 2002 through December 2002, and an insufficient balance in its reserve account. The firm's FOCUS Reports and its books and records reported that Rocky Mountain had met its net capital requirement and had no deficiency in its reserve account. Horning acknowledges and the record establishes that Rocky Mountain's books and records were inaccurate and that it filed materially false reports.

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30/ 15 U.S.C § 78q(a).

31/ FundCLEAR, Inc., 51 S.E.C. 1316, 1318 n.7 (1994).

32/ 15 U.S.C § 78q(e).

33/ Exchange Act Rule 17a-3; 17 C.F.R. § 240.17a-3.

34/ Exchange Act Rule 17a-5a(2); 17 C.F.R. § 240.17a-5(a)(2).

35/ Exchange Act Rule 17a-5(c) & 17a-5(d); 17 C.F.R. § 240.17a-5(c) & 17a-5(d).

36/ Exchange Act Rule 17a-11; 17 C.F.R. § 240.17a-11(b). The rule also provides that a broker or dealer that fails to make or keep current the books and records required by Rule 17a-3 must give notice to the Commission of this fact on the same day. 17 C.F.R. § 240.17a-11(d). The broker or dealer must transmit a report to the Commission within forty-eight hours of the notice stating what it has done or is doing to correct the situation. Id.

We find, therefore, that Rocky Mountain violated Exchange Act Sections 15(c)(3), 17(a) and 17(e), and the net capital, customer reserve, and recordkeeping and reporting requirements.

A respondent can be found to have caused a broker-dealer's violations of Exchange Act Sections 15(c)(3), 17(a), and 17(e) if he was responsible for an act or omission that he knew or should have known would contribute to the violation. <sup>37/</sup> As FINOP, Horning was responsible for Rocky Mountain's compliance with applicable financial reporting, net capital, and customer reserve requirements. <sup>38/</sup> From April 2002 through January 2003, Rocky Mountain's books and records, its FOCUS Reports, and its 2002 Annual Report which Horning signed were materially false because Horning failed to discharge his duties as Rocky Mountain's president and FINOP. Among other things, Horning undertook only a cursory review of Rocky Mountain's FOCUS Reports that had been prepared by Andrade, spending less than two minutes on each report and making no attempt to verify that the information in the reports was accurate. His review of the Reconciliation Reports and the trade error reports also was unreasonable. He did not put in place an operations manual for the Operations Department. Horning failed to determine the correct amount of Rocky Mountain's holdings in the Reich & Tang omnibus account in making the calculations required by the net capital rule and the customer reserve rule. These unreasonable deficiencies contributed to Rocky Mountain's violations. Accordingly, we find that Horning was a cause of Rocky Mountain's violations of Exchange Act Sections 15(c)(3), 17(a), and 17(e) and Exchange Act Rules 15c3-1, 15c3-3, 17a-3, 17a-5(a), 17a-5(c), 17a-5(d), 17a-11, and 17a-13.

## V.

Exchange Act Sections 15(b)(4)(E) and 15(b)(6)(i) authorize the Commission to censure, place limitations on, suspend, or bar a person associated with a broker, dealer, or municipal securities dealer if we find that such person failed reasonably to supervise, with a view to preventing violations of the federal securities laws and rules and regulations thereunder, another

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<sup>37/</sup> Exchange Act Section 21C; 15 U.S.C. § 78u-3; see Rita J. McConville, Exchange Act Rel. No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3145 (citing Robert M. Fuller, Exchange Act Rel. No. 48406 (Aug. 25, 2003), 80 SEC Docket 3539, 3545, petition denied, No. 03-1334 (D.C. Cir. 2004)).

<sup>38/</sup> George L. Freeland, 51 S.E.C. 389, 392 (1993); see also Gerhauser, 53 S.E.C. at 940 n.18 (noting that the "duties of a FINOP include the 'supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the [Exchange] Act' as well as the 'responsibility for the accuracy of financial reports submitted' to the NASD and [the] Commission") (citing NASD Membership and Registration Rule 1022(b), NASD Manual (CCH), at 3173); Gilad J. Gevanyahu, 51 S.E.C. 710, 712 (1993).

person who commits such violations if such person is subject to the individual's supervision. <sup>39/</sup> Section 14(b) of the Securities Investor Protection Act of 1970 ("SIPA") authorizes the Commission to bar or suspend for any period "any officer, director, [or] general partner . . . of any broker or dealer for whom a trustee has been appointed pursuant to [the] Act from being or becoming associated with a broker or dealer," if the Commission finds such sanctions to be in the public interest. <sup>40/</sup> When Congress grants an agency the responsibility to impose sanctions to achieve the purposes of a statute, "the relation of remedy to policy is peculiarly a matter for administrative competence." <sup>41/</sup> We have stated that, in determining an appropriate sanction in the public interest, we consider the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations. <sup>42/</sup>

We agree with the law judge that Horning should be barred from association with any broker-dealer in a supervisory capacity. Horning is an experienced securities professional and supervisor and should have recognized the many red flags indicating that Clarke and Andrade required heightened supervision and were engaging in fraudulent misconduct. Instead, Horning abdicated his responsibility by repeatedly failing to discharge his supervisory duties. Horning's supervisory failures allowed Andrade and Clarke to commit repeated securities law violations from April 2002 through January 2003 and were causes of Rocky Mountain's violation of the net capital, customer reserve, and books and records requirements. Horning's failure to supervise continued over a ten-month period and occurred fourteen months after Horning learned that Clarke and Andrade had engaged in similar misconduct which resulted in an \$800,000 discrepancy in Rocky Mountain's books and records and a \$600,000 loss to Rocky Mountain. Horning's conduct resulted in the illegal taking of \$4.5 million in customer funds, the appointment of a trustee under SIPA, and SIPC's advancing more than \$5 million to the estate of Rocky Mountain in order to settle customer claims.

Although scienter is not required to establish that Horning failed to exercise reasonable supervision, the record establishes that he acted recklessly by failing to implement basic

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<sup>39/</sup> 15 U.S.C. § 78o(b)(4)(E), (b)(6)(i); see also Leslie A. Arouh, Exchange Act Rel. No. 50889 (Dec. 20, 2004), 84 SEC Docket 1880, 1894.

<sup>40/</sup> 15 U.S.C. § 78jjj(b).

<sup>41/</sup> Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 185 (1973) (quoting American Power Co. v. SEC, 329 U.S. 90, 112 (1946)).

<sup>42/</sup> Arouh, 84 SEC Docket at 1894-95; see also Sharon M. Graham, 53 S.E.C. 1072, 1090 n.48 (1998) (quoting Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981)), aff'd, 222 F.3d 994 (D.C. Cir. 2000).

supervisory procedures when confronted with previous misconduct. Moreover, Horning's conduct and his arguments reveal a fundamental misunderstanding of his supervisory duties that presents a significant likelihood that he will commit similar violations in the future. As discussed above, Horning, when confronted with misconduct by Clarke and Andrade, instituted procedures that were inadequate because they relied substantially upon Andrade. Horning undertook only a cursory review of Andrade's work and took no step to verify that what she was reporting was accurate. He ignored warnings from Rocky Mountain's auditor and Commission staff about inadequate supervision and deficient internal controls, failed to check simple math on the Reconciliation Reports prepared by Andrade, failed to examine documents used to compile the Reconciliation Reports and the trading error reports, and failed to compare Reich & Tang omnibus account balances with those of the firm. Horning blames those he supervised for not adequately performing their duties and for not informing him about their actions and the actions of other Rocky Mountain employees.

Horning contends that the record does not support a finding that he be barred from supervising sales activities, as opposed to financial and operations activities, because he has not committed any supervisory violations in the sales area. However, there is no basis for carving out sales activities from the supervisory bar. Horning's continued association in a supervisory capacity with Moloney Securities presents opportunities for future violations. For example, Horning currently supervises Depew and Masee, who each loaned money to Clarke and were repaid with fictitious trading profits. Horning failed to detect these activities. Although Moloney, Horning's current supervisor, testified that he trusted Horning to fulfill his supervisory duties, Horning has taken no steps to investigate Depew and Masee's actions or to place them under heightened supervision in response to their conduct at Rocky Mountain, even though Horning testified that the conduct was "probably" dishonest. Horning's own expert testified that Depew and Masee's actions should have been investigated. Horning's supervisory failures and his fundamental misunderstanding of the duties of a supervisor present too great a risk to investors to allow him to remain in the industry as a supervisor. A supervisory bar will protect investors from dealing with securities professionals who are not adequately supervised and will deter Horning and others entrusted with supervisory positions from ignoring the important duties that accompany such positions. <sup>43/</sup> Accordingly, we find that the public interest warrants barring Horning from associating with any broker or dealer in a supervisory capacity.

Horning claims that the law judge erred by allowing the Division to change its position with respect to the sanctions sought. A respondent is entitled to be informed of the charges

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<sup>43/</sup> In making this determination, we are mindful that although "general deterrence is not, by itself, sufficient justification for expulsion or suspension . . . it may be considered as part of the overall remedial inquiry." PAZ Sec., Inc. v. SEC, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (quoting McCarthy v. SEC, 406 F.3d 179, 189 (2d Cir. 2005)).

against him in enough detail to allow him adequately to prepare his defense. <sup>44/</sup> The Order Instituting Proceedings charged Horning with a failure to supervise pursuant to Exchange Act Sections 15(b)(4)(E) and 15(b)(6)(A)(i) and SIPA Section 14(b) which authorize the Commission to impose a supervisory bar, among other things, against any broker-dealer, any person associated with a broker-dealer, or the general partner of any broker-dealer for whom a trustee has been appointed pursuant to SIPA. Although the Division's Pretrial Brief states that it sought to bar Horning "from association with a broker-dealer in a supervisory, non-supervised capacity," at the hearing, prior to Horning's presentation of his direct case, the Division clarified that it was seeking a supervisory bar. Thus, Horning was aware that the issue in the case was the reasonableness of his supervision of Clarke and Andrade and that one of the sanctions being sought by the Division was a supervisory bar.

Horning argues that Section 14(b) of SIPA is unconstitutionally vague. However, in Dirks v. SEC, <sup>45/</sup> the Court of Appeals for the District of Columbia Circuit rejected this argument. The Court held that the Commission placed a narrowing gloss on Section 14(b) in Carol P. Teig. <sup>46/</sup> The Court stated that the Commission determined that Section 14(b) does not "impose a regime of strict liability on individuals whose firms enter SIPA liquidation," but instead "held that simple neglect or nonfeasance provides an adequate basis for imposition of sanctions under Section 14(b)." <sup>47/</sup>

Horning claims that the conduct in two cases applying Section 14(b) is dissimilar from the conduct that occurred here. Specifically, Horning claims that respondents in these two cases had much greater knowledge of the problems that led to the demise of the firms in question. <sup>48/</sup> Regardless of the state of mind of the respondents in the cases cited by Horning, as discussed above, simple neglect or nonfeasance provides an adequate basis for imposition of sanctions

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<sup>44/</sup> McConville, 85 SEC Docket at 3149 n.55.

<sup>45/</sup> 802 F.2d 1468 (D.C. Cir. 1986).

<sup>46/</sup> 46 S.E.C. 615 (1976).

<sup>47/</sup> 802 F.2d at 1470-71.

<sup>48/</sup> See Raymond L. Dirks, 48 S.E.C. 200 (1985) (finding that respondents aided and abetted the firm's net capital violations), aff'd, Dirks v. SEC, 802 F.2d 1468 (D.C. Cir. 1986); Thomas R. Brimberry, Exchange Act Rel. No. 23682 (Oct. 3, 1986), 36 SEC Docket 1289 (barring respondent in a default administrative proceeding and finding that respondent (1) had been found guilty of corruptly endeavoring to influence, obstruct, and impede the administration of justice in connection with federal grand jury proceedings, (2) had been found guilty of making false, material declarations to the grand jury, and (3) had converted the firm's assets to his personal benefit after the appointment of a trustee).

under Section 14(b). As we have stated previously, Section 14(b) was designed to protect public investors by authorizing us to sanction those persons in a position to guide a brokerage firm's financial affairs who fail to exercise reasonable diligence in preventing their firm's financial collapse. <sup>49/</sup> We have determined that Horning failed to exercise reasonable diligence in his supervision of Clarke and Andrade and in performing his duties with respect to the firm's net capital, customer reserve, and books and records requirements which resulted in the collapse of the firm. As such, his conduct falls within Section 14(b).

We also agree with the law judge's conclusion that Horning should be suspended from association with any broker-dealer for twelve months. Our net capital rule, which was "designed to assure financial responsibility of brokers and dealers," is "one of the most important weapons in the Commission's arsenal to protect investors." <sup>50/</sup> The net capital requirements are designed to "operate as an early warning system" of potential financial difficulties at a firm. <sup>51/</sup> The books and records that broker-dealers are required to maintain are "a keystone of the surveillance of brokers and dealers by [Commission] staff and by the securities industry's self-regulatory bodies." <sup>52/</sup> Although we have determined to bar Horning from association with a broker or dealer in a supervisory capacity, he still may be employed in a financial or operations position at a broker or dealer in a non-supervisory capacity. At a minimum, Horning was negligent in failing to take the steps necessary to ensure that Rocky Mountain complied with applicable net capital, customer reserve, and books and records requirements in order to prevent the firm's financial collapse, and, therefore, a suspension under Exchange Act Section 15(b)(6) and SIPA

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<sup>49/</sup> Dirks, 48 S.E.C. at 206.

<sup>50/</sup> Livada Secs. Co., 45 S.E.C. 598, 600 (1974) (citing Blaise D'Antoni & Assocs., Inc. v. SEC, 289 F.2d 276, 277 (5th Cir. 1961)).

<sup>51/</sup> William J. Blalock, Exchange Act Rel. No. 35002 (Nov. 23, 1994), 58 SEC Docket 155, 166 n.30, aff'd, 96 F.3d 1457 (11th Cir. 1996) (Table).

<sup>52/</sup> Edward J. Mawod & Co., 46 S.E.C. 865, 873 n.39 (1977), aff'd, 591 F.2d 588 (10th Cir. 1979).

Section 14(b) is appropriate. A twelve-month suspension will impress upon Horning the seriousness of his misconduct with respect to the net capital, customer reserve, and books and records requirements and will protect the public interest by reducing the likelihood of any recurrence.

An appropriate order will issue. 53/

By the Commission (Chairman COX and Commissioners ATKINS, NAZARETH and CASEY).

Nancy M. Morris  
Secretary

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53/ We have considered all of the parties' contentions. We have rejected or sustained these contentions to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 56886 / December 3, 2007

SECURITIES INVESTOR PROTECTION ACT OF 1970  
Rel. No. 167 / December 3, 2007

Admin. Proc. File No. 3-12156

In the Matter of  
STEPHEN J. HORNING

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day it is

ORDERED that Stephen J. Horning be, and he hereby is, barred from association with any broker or dealer in a supervisory capacity; and it is further

ORDERED that Stephen J. Horning be, and he hereby is, suspended for twelve months from association with any broker or dealer in any capacity.

By the Commission.

Nancy M. Morris  
Secretary