INITIAL DECISION RELEASE NO. 318
ADMINISTRATIVE PROCEEDING
FILE NO. 3-12156

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

In the Matter of	:	
	:	INITIAL DECISION
STEPHEN J. HORNING	:	September 19, 2006
	:	

APPEARANCES: Robert M. Fusfeld, Jennifer A. Ostrom, and Amy J. Norwood for the Division of Enforcement, Securities and Exchange Commission

Thomas D. Birge for Respondent Stephen J. Horning

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

On January 20, 2006, the Securities and Exchange Commission (Commission) issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP), pursuant to Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 (Exchange Act), and Section 14(b) of the Securities Investor Protection Act of 1970 (SIPA). The OIP alleges that from at least April 2002 through January 2003 (relevant period):

A. The head trader and the operations manager for Rocky Mountain Securities & Investments, Inc. (Rocky Mountain), willfully violated Section 10(b) of the Exchange Act and Rule 10b-5;

B. Rocky Mountain violated Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act and Rules 15c3-1, 15c3-3, 17a-3, 17a-5(a), 17a-5(c), 17a-5(d), 17a-11, and 17a-13;

C. Stephen J. Horning (Horning) willfully aided and abetted and caused all Rocky Mountain's violations;

D. The head trader willfully aided and abetted Rocky Mountain's violations of Section 17(a) of the Exchange Act and Rule 17a-3; the operations manager willfully aided and abetted all Rocky Mountain's violations; and

E. Horning failed reasonably to supervise the head trader and the operations manager with a view toward preventing their violations of the federal securities laws. (OIP at 4-6.)

At three days of hearing held in April 2006, in Denver, Colorado, the Division of Enforcement (Division) called two witnesses to support the allegations in the OIP. Horning testified and called six witnesses, including one expert.[1] The last Brief was filed on August 2, 2006.

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

FINDINGS OF FACT

Horning, age sixty-two, holds an undergraduate degree in business administration from Regis College, Denver, Colorado, and a master's degree in business administration from the University of Denver. (Tr. 161, 242.) Horning entered the securities industry in the late 1960s, and holds several securities licenses.[2] (Tr. 163.) In June 1980, Horning founded Rocky Mountain, which began as a penny stock firm and grew into a medium-sized broker-dealer headquartered in Denver, Colorado. (Tr. 139, 164, 175; Horning Ex. 1 at 3.) From 1981 until February 2003, when Rocky Mountain closed, Horning was a director, president, registered financial and operations principal (FINOP), compliance director, and registered representative. (Tr. 169-70.) In 2000, Horning was Rocky Mountain's largest shareholder with thirty-nine percent of the shares, and he ran the firm's operations with the authority to hire and fire employees. (Tr. 170-71, 203.) Horning established Rocky Mountain's supervisory procedures and was responsible for assuring that they were implemented.[3] (Tr. 170-71.) Horning's

[1] I will refer to Horning's Answer as "(Answer __.)." I will cite to the transcript of the hearing as "(Tr. __.)." I will cite to the Division's and Horning's exhibits as "(Div. Ex. __.)," and "(Horning Ex. __.)," respectively. I will cite to the Division's and Horning's Post-Hearing Briefs as "(Div. Post-Hearing Br. __.)," "(Horning Post-Hearing Br. __.)," and "(Div. Reply Br. __.)," respectively.

[2] Horning holds a number of securities licenses: Series 7, General Securities Representative; Series 24, General Securities Principal; Series 27, Financial and Operations Principal; Series 53, Municipal Securities Principal; and Series 63, Uniform Securities Agent State Law Examination. (Tr. 165-66; http://www.nasd.com/RegistrationQualifications.)

[3] Rocky Mountain was a self-clearing or self-executing firm with about fifty registered representatives, all of whom were independent contractors, and it operated from eleven to seventeen offices. (Tr. 138, 168, 174-75; Horning Ex. 1 at 2.) "Self-clearing" indicates that the firm had a back office and a Trading Department. It cleared some trades through Hanifen Imhoff, later known as FiSer, but the majority of its trades were self-clearing. (Tr. 307-08.)

compensation was approximately $202,000 in 1999. (Tr. 181.) In 2000, Rocky Mountain executed about 27,000 trades for more than 5,500 customer accounts. (Tr. 177, 195, 344; Horning Ex. 1.)

Horning met Judy Clarke (Clarke) in 1971 and considered her to be one of his best friends. (Tr. 182.) Clarke, a high school graduate, held a Series 7 license and had worked in E. J. Pittock's Trading Department for four months before she joined Rocky Mountain as a trader in 1980. (Tr. 176-77, 183.) Horning was associated with E. J. Pittock and was its compliance officer from 1976 to 1980. (Tr. 164.) Horning appointed Clarke head trader of Rocky Mountain's three-person Trading Department in the late 1980s. (Tr. 184.) Rocky Mountain had a Trading Manual in place during the relevant period, which set forth the firm's position on the activities of members of the Trading Department. (Tr. 295; Div. Ex. 27.) On a daily basis, Rocky Mountain compared the information received from the two national clearing houses, National Securities Clearing Corporation (NSCC) and Depository Trust & Clearing Corporation (DTC), with Rocky Mountain's books and records.[4] (Tr. 58-60.) Clarke executed trades on behalf of Rocky Mountain's customers and she executed trades using Rocky Mountain's principal. (Tr. 177, 222-23.) In 1999, 2000, 2001, and 2002, when Clarke's salary was $45,000, her compensation was $220,000, $200,000, $100,000, and $80,000, respectively.[5] (Tr. 178-83.) Horning was Clarke's only supervisor throughout the relevant period. (Tr. 173; Admission in Answer at 4.)

Horning was also the immediate supervisor of Leslie Andrade (Andrade), a high school graduate who worked at Rocky Mountain throughout the relevant period. (Tr. 175; Admission in Answer at 4.) Andrade became head of the three-person Operations Department in 1991. (Tr. 171, 186.) Andrade held no securities licenses. (Tr. 176.) During the relevant period, Andrade's salary was $38,000 or $40,000. (Tr. 402.) Her highest total compensation was in 1999, when she received $75,000 or $80,000. (Tr. 402.)

Rocky Mountain's Operations Department did not have a manual that described the policies and procedures to be followed. (Tr. 296.) The Operations Department was responsible for keeping and maintaining Rocky Mountain's books and records. (Tr. 171.) Thus, Andrade was in charge of maintaining the firm's books and records as required by Sections 17(a) and 17(e) of the Exchange Act and rules thereunder; preparing the monthly "Financial and Operational Combined Uniform Single Report," Form X-17A-5 (FOCUS Report) that contained, among other things, the financial statements, the net capital calculation required by Rule 15c3-1,

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[4] The transcript has Depositor Trust Corporation, which appears to be an error. (Tr. 58.) All broker-dealers are members of NSCC and DTC. (Tr. 58-60.) Both clearinghouses send out two types of daily reports: trade reports and cash reconciliation reports. (Tr. 134.) A broker-dealer must record an un-corrected or unreconciled trade difference on its books when its records do not match the clearinghouse's statement on trades. (Tr. 133-35.)

[5] Clarke's total compensation included salary, bonuses, commissions from retail trades for her two dozen customers, and a percentage of trading profits. (Tr. 180.)

and the customer protection rule required by Rule 15c3-3; and working with Rocky Mountain's auditor.[6] (Tr. 28, 185-86, 311, 514.) Rule 17a-5 of the Exchange Act requires broker-dealers to file FOCUS Reports with regulators who use them to monitor that the firms are financially sound. (Tr. 28.).

A number of Rocky Mountain customers agreed to a process whereby Rocky Mountain swept the credit balances in their accounts and deposited the funds into a money market account (omnibus account) at Reich & Tang Services, Inc. (Reich & Tang), a brokerage firm in New York City. (Tr. 23-24, 145, 343-44; Div. Ex. 1.) Customers received an account statement showing cash and securities. (Tr. 323.) Rocky Mountain identified the amount in the Reich & Tang omnibus account to customers as cash. (Tr. 323.) For purposes of Rocky Mountain's reports and financial statements, however, Rocky Mountain should have considered the contents of the Reich & Tang omnibus account as securities. (Tr. 35.)

When customers wanted funds, Rocky Mountain sent a facsimile request to Reich & Tang, which then deposited funds in a Rocky Mountain account at the Bank of Denver, and Rocky Mountain sent the customer a check. (Tr. 347.) Rocky Mountain did not show the amount in the Reich & Tang omnibus account on its balance sheet. (Tr. 324.) Rocky Mountain's annual audit did not reconcile the amount in the Reich & Tang omnibus account with Rocky Mountain's records. (Tr. 254.) Reich & Tang sent Rocky Mountain a "Daily Reconciliation & Summary Sheet" of transactions in the omnibus account. (Tr. 20; Div. Ex. 31.) Horning never established procedures for Rocky Mountain to verify that information in the "Daily Reconciliation & Summary Sheet" matched Rocky Mountain's records. (Tr. 251-52.) During the relevant period, the Reich & Tang report never matched the information in Rocky Mountain's internal records. For about half of November 2002 and all of December 2002 and January 2003, Reich & Tang reported that the omnibus account had less than $100,000, when Rocky Mountain's internal records showed a value of over four million dollars. (Div. Ex. 1.)

Rocky Mountain filed annual reports signed by Horning as president with the Commission on Form X-17A-5 for 2000, 2001, and 2002.[7] (Div. Exs. 20, 21, 22.) The financial statements in these reports were audited by Mortland & Co., P.C., of St. Louis, Missouri, a one-person firm run by Herbert Mortland (Mortland), a college friend of Horning.[8] (Tr. 163, 500.)

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[6] The evidence is that the FOCUS Reports are required by the Commission and the National Association of Securities Dealers (NASD) on a monthly and quarterly basis. (Tr. 28.) In practice, broker-dealers make an electronic filing with the NASD and the Commission has access to that electronic filing. (Tr. 30.)

[7] The reports covered the period beginning July 1, 1999, and ending June 30, 2000; beginning July 1, 2000, and ending June 30, 2001; and beginning July 1, 2001, and ending June 30, 2002.

[8] Mortland audited Rocky Mountain for over twenty years. (Tr. 499.) He has an undergraduate degree from Regis College, Denver, Colorado, a master's degree in business administration from Washington University in St. Louis, Missouri, and is licensed as a certified public accountant in Missouri. (Tr. 543.) To settle an administrative proceeding initiated by the Commission concerning Rocky Mountain's 2002 audit, Mortland accepted a bar from practicing before the

Each report contained an affirmation by Horning that the financial statements were true and correct to the best of his knowledge and belief. In each report, Mortland represented that he found that the financial statements presented Rocky Mountain's financial positions fairly. In a section on internal control, Mortland represented that he had studied the practices and procedures "(1) in making the periodic computations of aggregated indebtedness and net capital under Rule 17a-3(a)(11) and reserve required by Rule 15c3-c(e); (2) in making the quarterly securities examination, counts, verifications, and comparisons and the recordation of differences required by Rule 17a-13." (Div. Exs. 20, 21, 22 penultimate page.) Each audit found:

> more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the financial statements of [Rocky Mountain] may occur and not be detected within a timely period. The Company's plan of organization did not include adequate separation of duties related to daily cash receipt and cash disbursements activities. Appropriate supervisory review procedures were not instituted to provide reasonable assurance that adopted policies and prescribed procedures were adhered to.

(Div. Exs. 20, 21, 22 last page.)

Horning discussed the issue with Mortland when the language first appeared in audit reports in the early 1980s, but Horning did not change Rocky Mountain's organization or internal structure because the firm did not have funds to hire the additional personnel and "the system worked fine as it was." (Tr. 192.) Horning thought Mortland's concern dealt with cash disbursements and the handling of cash, and not the firm's entire supervisory system. (Tr. 193.)

Activities by Clarke and Andrade from Approximately May 2000 to February 2001

The Commission conducted a surveillance exam of Rocky Mountain in January-February 2001. One of the examiners, Juanita Pidcock, informed Horning in early February 2001 that Clarke had "purchased and paid for securities that were not reflected on Rocky Mountain's books" from approximately May 2000 to February 2001. (Tr. 194-98, 335-36, 377.) Clarke had not received Horning's approval of the trade tickets as she was required to do, had not run the tickets through the accounting department, and did not record the trades on Rocky Mountain's books. (Tr. 196-97.)

The examiners discovered an $800,000 discrepancy in Rocky Mountain's books and records by doing a reconciliation of NSCC's records and Rocky Mountain's records. (Tr. 198, 335, 339.) Andrade and Tammy Steffen (Steffen) knew about Clarke's unrecorded trades from reconciling the NSCC and DTC records with Rocky Mountain's books and records, but they

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Commission with the right to apply for reinstatement after three years. Herbert J. Mortland, CPA, 87 SEC Docket 552 (Jan. 20, 2006) (Tr. 501-02.) Mortland also settled a civil suit and paid the Securities Investor Protection Corporation (SIPC) $100,000 in settlement of a claim. (Tr. 501; Div. Ex. 73, Appendix C at 1.)

never notified Horning.[9] (Tr. 197-98, 337.) Horning acknowledges that in 2000-2001, Clarke and Andrade caused: (1) a $600,000 loss to Rocky Mountain; (2) the firm's financial records and FOCUS Reports to be inaccurate; (3) its net capital to be overstated; and (4) its Rule 15c3-3 calculation to be wrong. (Tr. 195, 198-99.)

Clarke's unreported, unauthorized trading reduced Rocky Mountain's capital from over $2 million to $1.4 million. (Tr. 214.) The loss did not affect Rocky Mountain's customer funds. In discussions with Clarke, Andrade, and Steffen, Clarke told Horning, "I'm sorry, the market went against me, I thought I could make up the trading losses and it continued to get worse." (Tr. 338.) Andrade told Horning that Clarke told her the problem would be fixed, and she made the wrong choice by relying on Clarke. (Tr. 340.) Steffen was argumentative. (Tr. 340.)

Horning informed the NASD's Denver office of the Commission's findings in February 2001. (Tr. 95-96, 100.) The Commission's deficiency letter following the examination, dated March 28, 2001, did not mention the $800,000 discrepancy but referred to the fact that Rocky Mountain did not accurately reconcile the clearing reports with its books and records.[10] (Tr. 201, 389; Div. Ex. 23 at 2.) The Commission's letter agreed with the auditor's finding that Rocky Mountain's plan or organization did not adequately separate duties related to daily cash receipts and disbursements. (Div. Ex. 23 at 3.) On this subject, the letter concluded that:

> [Rocky Mountain's] audit failed to comply with Exchange Act Rule 17a-5(g)(1) because the scope of the audit and review of the accounting system and the internal controls, by failing to detect the referenced net capital and reserve requirement deficiencies, were not sufficient to provide reasonable assurance that [Rocky Mountain's] materially inaccurate clearing account reconciliation and inadequate supervisory procedures for reviewing the reconciliations (i.e., material inadequacies) would be detected.
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> . . .
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> [Rocky Mountain's] internal accounting controls appear inadequate in that [Rocky Mountain]: (1) did not have adequate WSPs with respect to supervising the preparation of its financial statements; and (2) did not institute adequate

[9] Horning testified that Andrade's immediate supervisor was Steffen, the assistant director of compliance, from 2000 until Steffen quit Rocky Mountain on her own volition in May or June 2001. (Tr. 169, 188, 312.) Horning did not delegate supervisory authority to Steffen in writing, and he resumed direct supervision of Andrade after Steffen quit. (Tr. 312-14.)

[10] The four-page letter described deficiencies and concerns in the following areas: Rule 15c3-1, Rule 17a-3, and Rule 17a-5 – Net Capital Computation Errors; Rule 15c3-3 – Customer Protection Reserve Computation and Custody of Securities; Rule 17a-3 – Books and Records – Clearing Account Reconciliation; Rule 17a-5 – Annual Audit and Internal Controls; and NASD Conduct Rule 3010 – Internal Accounting Controls and Supervision. (Div. Ex. 23.)

> supervisory review procedures to detect its inaccurate NSCC clearing account reconciliations.

(Div. Ex. 23 at 3-4) The NASD and the Commission took no regulatory action as a result of Clarke's and Andrade's actions in 2000-2001. (Tr. 99-100, 390.)

Horning did not fire, issue a penalty to, or make Clarke, Andrade, or Steffen repay the losses. (Tr. 199.) He warned them that they would be fired if they repeated their actions. Horning admits that Clarke and Andrade's activities in 2000-2001 were "basically dishonest;" however, he continued to consider them to be trusted employees. (Tr. 205, 212-13, 300-01; Horning Ex. 19 at 11.) In Horning's opinion, these trusted employees made a mistake and deserved a second chance. (Tr. 96, 212-13.) Horning did not have the Board consider replacing Mortland even though he was "very angry" that Rocky Mountain's 2000 audit did not catch the books and records discrepancies found by the Commission.[11] (Tr. 201-02.)

On April 27, 2001, Horning informed the Commission that the deficiencies and concerns addressed in its March 28, 2001, deficiency letter had all been remedied. (Div. Ex. 24.)[12] Horning told the NASD that he was putting in specific procedures to ensure that Clarke's activities would not happen again. (Tr. 110.) 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 record. Horning's maintains that Rocky Mountain knew about the problem, but ignored reconciliation discrepancies in hopes that the market would recover. (Div. Ex. 24.) Horning reasons that Rocky Mountain knew of the problem because Andrade and Steffen knew, but "they just had not brought it to my attention." (Tr. 204.)

Horning instituted some new procedures in April 2001. (Tr. 199, 213, 339.) Clarke had been receiving eighty percent of the profits on proprietary trades. (Tr. 222.) Horning continued to allow Clarke to make unlimited trades in Rocky Mountain's proprietary account, but he required that all proprietary trades go under one house account number and that sixty percent of the profits go to Rocky Mountain and forty percent of the profits be divided among the three traders: Clarke, Randy Van Brocklin (Van Brocklin), Clarke's brother, and Jeremy Sanchez (Sanchez). (Tr. 167, 179, 196, 199, 360.) Horning instituted a system so that Clarke, Andrade, Van Brocklin, and Sanchez would be fined a hundred dollars per item for items that he found had not been reconciled. (Tr. 214.)

In addition, Horning required Andrade to prepare daily a handwritten one-page summary reconciling the NSCC/DTC clearing reports and Rocky Mountain's records (reconciliation report). (Tr. 207-08.) Horning received the reconciliation report, which consisted of the one-page summary, the underlying NSCC reports, and Rocky Mountain's trading records. (Tr. 208-

[11] Horning believes that Rocky Mountain's board would have probably agreed if he had recommended retaining a new auditor. (Tr. 203.)

[12] The NASD performed a routine examination of Rocky Mountain in May-June 2001. (Tr. 106.)

09.) 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 2000-2001. (Tr. 356, 539.) Toni Carter-Hall (Carter-Hall), who worked in the Operations Department, was responsible for reconciling the NSCC reports and Rocky Mountain's records three days a week and Andrade prepared the reconciliation report two days a week.[13] (Tr. 350-51, 356-57, 397-99.) Horning received reconciliation reports prior to when the problems were discovered in February 2001, but the new feature after February 2001 was that the columns on the one-page summary should balance indicating that Rocky Mountain's records agreed with the clearing firms' records, which was not possible previously.[14] (Tr. 209-210.)

During the relevant period, Horning reviewed the reconciliation reports one day a week on a random basis.[15] (Tr. 209.) Horning spent ten seconds reviewing the reconciliation reports. (Tr. 238-39.) He only looked to see if the numbers balanced because the "main focus of the new procedure, was to see if the numbers balanced." (Tr. 242-43, 247, 440-41; Div. Ex. 46.) Horning did not "foot" or add up the columns on the summary sheet to check that the totals were accurate or that the figures on the underlying documentation matched the figures on the summary sheet. (Tr. 239, 241-42.)

Horning initialed the reconciliation reports for twelve dates between February 20, 2002, and December 27, 2002. (Tr. 60-61.) The one-page summaries that Horning initialed were inaccurate. (Tr. 70, 238-46; Div. Exs. 4, 40-51.) 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. (Tr. 61-71, 238-45; Div. Exs. 4, 40, 41, 45, 46.) For example, Horning initialed a reconciliation report for March 25, 2002, that shows almost a million-dollar discrepancy between the figure on the summary sheet and the attached information from NSCC. (Tr. 243-45; Div. Ex. 41.) The evidence is that someone inserted numbers in the one-page summary to make the columns appear balanced, but there was no support for the numbers in the materials attached to the summaries. (Tr. 110-13, 123-25.)

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[13] Steffen prepared the reconciliations in April 2001 until she left in May or June 2001. (Tr. 350.)

[14] Horning's testimony is that he had been receiving handwritten summaries and that the reconciliation reports with a handwritten summary were new. (Tr. 207-08; Div. Ex. 40.) In 2000 until February 2001, the columns on the handwritten one-page summary did not balance because Clarke had made purchases that had cleared but the purchases were not recorded on Rocky Mountain's books. (Tr. 209-10.) "[B]ack at that time, the debits never equaled the credits, because we had purchased stock that we had paid for that was not on our books, but it was on the NSCC clearance side." (Tr. 210.) During the relevant period the two columns on the handwritten summary, clearing house debits and Rocky Mountain debits, were expected to balance.

[15] Horning claims that he instituted the new measures, including the random once a week review, after consulting with Mortland on how to prevent what occurred in 2000-2001. (Tr. 247-48.)

In March or April 2001, Horning also required Andrade to prepare a handwritten report daily on any trading errors or out-of-balance items (trade-error report). (Tr. 210-11, 354; Div. Exs. 53, 54.) During the relevant period either Andrade or Carter-Hall prepared the trade error report. (Tr. 397.) Andrade initialed the trade-error reports, regardless of who prepared them, because she was the one responsible for saying that the items had been corrected. (Tr. 398-99.) Horning did not review any underlying material or ask anyone to verify the information in the trade error reports. (Tr. 299-301.) Horning relied totally on the information he received from Andrade because he claims he had no reason to believe she would give him inaccurate information. (Tr. 299-300.) Horning retained the trade error reports for thirty days. (Tr. 211.)

Activities by Clarke and Andrade from at Least April 2002 Through January 2003

On January 21, 2003, the Bank of Denver informed Horning that Rocky Mountain's account was $350,000 overdrawn.[16] (Tr. 215.) When Horning questioned Clarke, he said, "I guess we're back to 2001." (Tr. 366.) Andrade turned to Clarke and said, "[y]ou told me you were going to stop doing this, and started crying." (Tr. 366.) Rocky Mountain hired a forensic accounting expert who determined that the firm was out of net capital and that inaccuracies in its books and records raised significant uncertainty as to Rocky Mountain's financial condition. (Tr. 83, 98, 478; Div. Ex. 26.)

An NASD examination in February 2003, discovered that during the relevant period: (1) Rocky Mountain executed buy transactions cleared through the NSCC that were not shown on its books and records; (2) Rocky Mountain's books and records showed sale transactions that were not cleared through the NSCC; (3) Rocky Mountain had millions of dollars of trading losses that were not shown on its books and records; (4) Rocky Mountain sent inaccurate financial statements to its customers; and (5) funds belonging to customers were taken from the Reich & Tang omnibus account to pay for trading losses. (Tr. 91-93, 125, 444.) Horning later learned that Clarke suffered about $6.5 million in trading losses and Andrade used about $4.5 million of customer funds from the Reich & Tang omnibus account, as well as funds belonging to the firm, to pay for the trades. (Tr. 216, 252-53.) These activities occurred during the relevant period and were not shown on Rocky Mountain's books and records.[17] Rocky Mountain ceased operations on February 3, 2003.

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[16] The record is that notice came from "the bank." (Tr. 215.) I assume that the reference is to the Bank of Denver where Rocky Mountain established an account for customers. (Tr. 347.) There is evidence, however, that Rocky Mountain might also have had an account at the Bank of Cherry Creek. (Tr. 59.)

[17] On February 5, 2003, the Commission filed an injunctive action against Clarke and Rocky Mountain in the United States District Court for the District of Colorado concerning these matters and received a default judgment against Clarke. SEC v. Clarke, No. 03-MK-0228(MJW), (D. Colo. 2003). (Div. Exs. 66, 68.) The district court found that Clarke violated Sections 10(b), 15(c)(3) and 17(a) of the Exchange Act and Rules 10b-5, 15c3-1, 15c3-3, and 17a-3. The district court: enjoined Clarke from violating Section 10(b) of the Exchange Act and Rule 10b-5 and from aiding or abetting violations of Sections 15(c)(3) and 17(a) of the Exchange

Events in January-February 2003

The Commission and 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. (Div. Ex. 73.) The district court appointed a trustee for Rocky Mountain on February 5, 2003. (Div. Ex. 73.) On February 6, 2003, John D. Shively (Trustee), initiated an action in the United States Bankruptcy Court for the District of Colorado to liquidate Rocky Mountain. The Trustee worked under the supervision of the bankruptcy court to marshal and liquidate assets, assert legal claims and actions to recover monies, and to reimburse Rocky Mountain's customers for losses. Horning paid the Trustee $150,000 to settle a civil suit.[18] (Tr. 304; Div. Ex. 73 at 2.) The Trustee filed with the Commission a Uniform Request for Withdrawal from Broker-Dealer Registration, Form BDW, that was signed on April 4, 2003. (Div. Ex. 9.) As of February 28, 2006, SIPC had advanced a net amount of $5,193,782.75 to the estate of Rocky Mountain. (Div. Ex. 73 at 2.) The estate paid some 651 Rocky Mountain customers $5,388,273.15 as compensation for their losses. (Div. Ex. 73 at 2, Exhibit C.) The Trustee expects that SIPC might have to contribute an additional $100,000 to $130,000 before the liquidation is complete. (Div. Ex. 73 at 3.)

Before Rocky Mountain ceased doing business, Horning arranged for himself and twenty-one Rocky Mountain registered representatives to become associated with Moloney Securities.[19] (Tr. 232, 277-78, 369, 480.) Horning learned shortly before Rocky Mountain closed that two of those registered representatives, Mark Depew (Depew) and Buzz Massee (Massee), had loaned funds to Clarke, which she repaid in part with funds generated by fictitious trades. (Tr. 216-18, 224.) Horning accepted Depew's and Massee's explanation that they did not realize that Clarke had repaid the loans with profits from fictitious trades. (Tr. 218.) However, Horning knows now that their explanation is suspect because Clarke repaid them with

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Act and Rules 15c3-1, 15c3-3, and 17a-3; and ordered her to disgorge $5,743.38 and to pay a civil penalty of $120,000. (Div. Ex. 69.)

[18] Horning paid the Bank of Denver "some $65,000" to settle claims arising out of Rocky Mountain's failure. (Horning Post-Hearing Br. at 28 n.15.)

[19] Horning and Edward John Moloney (Moloney), the CEO, president and owner of fifty-eight percent of Moloney Securities in St. Louis, met at Regis College and have been friends for over twenty years. (Tr. 163, 270-01, 283.) Moloney Securities began in 1995. Horning has been a director since 2000, and is a secured debt holder in the amount of $25,000. (Tr. 276, 284.) Moloney Securities is an introducing broker; thus it only has sales side. (Tr. 281, 280-81, 289.) A clearing broker handles the administrative tasks. Moloney Securities only performs agency trades; therefore, the 105 registered representatives do not trade in the firm's proprietary account. (Tr. 232, 284.) Moloney Securities does not do initial public offerings or act as a market maker. Moloney Securities engages only in "best effort" underwritings. (Tr. 289.) Given the lower risk its activities present to customer funds, Moloney Securities' net capital requirement is $50,000. (Tr. 289.)

funds from trades done at outlandish prices that were not related to the market price of the securities involved, the trades were done with Rocky Mountain funds, and some of the trades were fictitious. (Tr. 218, 224-31.) In addition, it appears that in December 2002 Massee executed a trade in Rocky Mountain's proprietary account for almost $500,000, when his trading limit was less that $50,000. (Tr. 233-34.)

In April 2006, Horning was a director and regional vice president at Moloney Securities, responsible for supervising twenty-seven of Moloney Securities' 105 registered representatives, including Depew and Massee.[20] (Tr. 162, 232-33, 270, 276, 278.) Horning considers the conduct of Depew and Massee - in loaning money to Clarke, accepting repayment by Clark from fictitious trades, and not telling him - as "probably dishonest." (Tr. 218.) He has not done any detailed review of Clarke's trades that put funds into the Depew and Massee accounts because he "had no reason to" do so. (Tr. 230-31.) Moloney Securities has no special supervisory procedures in place for either Depew or Massee. (Tr. 232-33.)

EXPERT TESTIMONY

Horning retained Larry D. Hayden (Hayden) a person with thirty-five years of industry experience to provide a professional opinion concerning whether Horning's conduct violated federal securities rules and regulations.[21] (Horning. Ex. 19 at 2.) In Hayden's opinion, Horning had no reason to believe that Clarke and Andrade were engaged in illegal activities, and it was reasonable for Horning to rely on the audits for his belief that Rocky Mountain's internal controls were adequate. (Horning Ex. 19 at 11, 14.)

Hayden opined initially that Horning: (1) acted reasonably; (2) did not cause Rocky Mountain to fail to maintain sufficient net capital or to keep accurate books and records; and (3) did not aid or abet a scheme to defraud. (Horning Ex. 19 at 12-15.) On cross-examination, Hayden altered his opinion because Horning: (1) did not review the documents underlying the one-page summary that was part of the reconciliation report when it is critical for a broker-dealer to reconcile its records with NSCC and DTC, especially where employees have access to the firm's proprietary account; (2) should have noticed that at least one-page summary on its face had an obvious million dollar discrepancy, and (3) failed in his responsibility for putting in place at Rocky Mountain procedures for reconciling the daily reports from Reich & Tang as to the omnibus account. (Tr. 442-50; Div. Ex. 46.)

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[20] Moloney hired Depew and Massee without doing any investigation of their conduct concerning the loans to Clarke because he relied on the NASD and the Commission to make inquiries and take appropriate action. (Tr. 288.)

[21] Hayden has a bachelor's degree from Western State College and a master's degree from the University of Phoenix. Hayden was an assistant district director of NASD from 1968 to 1973, he has held positions with various broker-dealers, and from 1991 to 2003, when he retired, he operated L.D. Hayden & Associates, a consulting firm and registered investment adviser. (Horning Ex. 19, Exhibit A.)

CONCLUSIONS OF LAW

Horning's Argument

Horning claims that he acted reasonably during the relevant period. (Horning's Proposed Findings of Fact and Conclusions of Law at 11-12.) He argues that he put in place reasonable procedures following the conduct of Clarke and its concealment by Andrade and Steffen in 2000-2001. (Horning's Proposed Findings of Fact and Conclusions of Law at 11.) Horning argues that the activity that occurred in 2002-2003 was dramatically different than what occurred in 2000-2001. (Horning's Proposed Findings of Fact and Conclusions of Law at 11.) According to Horning:

> In 2001, Ms. Clarke had engaged in unauthorized trading and failed to report losing trades under the firm's accounting system. Ms. Andrade, in her position as Head of Operations, allowed this activity to continue and did not report it to Mr. Horning. She did not commit any criminal acts, falsify any documents, steal any customer money, or affirmatively mislead Mr. Horning.

(Horning's Proposed Findings of Fact and Conclusions of Law 11-12.)

Horning contends that neither the Commission nor the NASD warned him that some of Rocky Mountain's practices criticized in the OIP were violations. For example, the NASD and Commission knew that Rocky Mountain's: (1) balance sheet did not "carry" the Reich & Tang omnibus account; and (2) audits consistently mentioned problems with Rocky Mountain's internal control structure but concluded Rocky Mountain's practices and procedures were adequate to meet the Commission's objectives. (Tr. 324-26; Div. Exs. 20, 21, 22.) Horning notes that in 2001, Commission examiners knew this information and considered Rocky Mountain to be low risk for financial/operational deficiencies, sales practice abuses, and inadequate supervision. (Tr. 379-80; Horning Ex. 1 at 3; Horning's Proposed Findings of Fact and Conclusions of Law at 12.)

1. Clarke and Andrade Willfully Violated Section 10(b) of the Exchange Act and Rule 10b-5 During the Relevant Period.

Section 10(b) of the Exchange Act and Rule 10b-5 prohibit using the means of interstate commerce to: (1) employ any device, scheme, or artifice to defraud; (2) make any untrue statement of a material fact or to omit a material fact that is necessary not to mislead; or (3) engage in any act, practice, or course of business that would operate as a fraud or deceit on any person in connection with the purchase or sale of a security. The term "willful" as used in the Exchange Act simply requires the intentional doing of the wrongful acts – no knowledge of the rule or regulation is required. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); U.S. v. O'Hagan, 139 F.3d 641, 647 (8th Cir. 1998); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). It is well established that Section 10(b) and Rule 10b-5 require a showing of scienter. Aaron v. S.E.C., 446 U.S. 680, 691 (1980). Scienter may be established by a showing of recklessness, defined as an "extreme departure from the standards of ordinary care . . . present[ing] a danger of

misleading buyers and sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it." Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977) (quoting Franke v. Midwestern Oklahoma Dev. Auth., 428 F.Supp. 719, 725 (W.D. Okla 1976), cert. denied, 434 U.S. 875 (1977)).

Clarke's and Andrade's actions violated Section 10(b) of the Exchange Act and Rule 10b-5 because during the relevant period, Clarke: (1) engaged in unauthorized trading and concealed her activities by entering fictitious profitable trades and not recording losing trades; and (2) directed others to enter false data into Rocky Mountain's books and records. (Admissions in Answer.) As previously noted, in 2003, the district court based on these facts found that Clarke violated Section 10(b) and Rule 10b-5, among other things. (Div. Ex. 69.)

During the relevant period, Andrade: (1) knowingly falsified Rocky Mountain's books and records to hide Clarke's unauthorized trades; (2) diverted approximately $4.5 million of customer funds from Rocky Mountain's omnibus account at Reich & Tang to cover Clarke's trading losses; and (3) withheld information from the forensic accountant hired by Rocky Mountain to unravel the whereabouts of missing funds. (Tr. 476-83; Admissions in Answer.) The parties stipulated that Andrade engaged in a scheme to make unauthorized trades on the books of Rocky Mountain and to conceal this activity during the relevant period.[22] (Stipulation Regarding Witness Leslie Andrade)

2. Horning Failed Reasonably to Supervise Clarke and Andrade with a View Toward Preventing Their Violations of Section 10(b) of the Exchange Act and Rule 10b-5.

Section 15(b)(6) of the Exchange Act, as it incorporates Section 15(b)(4)(E), empowers the Commission to sanction any person associated with a broker-dealer if the person has failed reasonably to supervise, with a view to preventing violations of the provisions of such rules, and regulations, another person who commits such a violation, if such person is subject to his supervision. Section 15(b)(4)(E) specifies that:

> [N]o person shall be deemed to have failed reasonably to supervise any other person, if:

[22] Andrade failed to appear pursuant to a subpoena requested by Horning. I GRANT the parties' request and allow the Stipulation Regarding Witness Leslie Andrade, signed May 9, 2006, into evidence. I also GRANT the Division's unopposed request and take official notice of the Information filed by the U.S. Attorney in the United States District Court for the District of Colorado on May 18, 2006, charging Andrade with one count of mail fraud for the purpose of executing a scheme to defraud Rocky Mountain and its clients. U.S. v. Andrade, No. 06-CR-00196 (D. Colo. 2006). (17 C.F.R. § 201.323.) According to Horning, Andrade pled guilty to one count of computer fraud. (Horning's Proposed Findings of Fact and Conclusions of Law at 7.)

> (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 him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

This Initial Decision has concluded that Clarke and Andrade committed violations of Section 10(b) of the Exchange Act and Rule 10b-5 during the relevant period. The standard for failure of supervision where there has been a violation is whether the supervision was reasonable under the circumstances. Kevin Upton, 52 S.E.C. 145, 153 (1995). The Commission has found failure to supervise where a supervisor failed "to learn of improprieties when a diligent application of supervisory procedures would have uncovered them." Blinder, Robinson & Co., Inc., 26 SEC Docket 238, 240 (Sept. 17, 1982).

The evidence is overwhelming that during the relevant period, Horning, a supervisor with the power to hire and fire employees, failed to supervise Clarke and Andrade with a view toward preventing their antifraud violations. Based on what occurred in 2000-2001, a reasonable supervisor, at a minimum, would have drastically reduced Clarke's and Andrade's responsibilities and increased the level of supervision over their activities. I take official notice of Horning's testimony on April 7, 2005, in SEC v. Clarke, No. 03-MK-0228(MJW), (D. Colo. 2003) that "Ms. Clarke had an incident that came to our attention in 2001, which was not entirely legal in her trading capacity." (Reporter's Transcript 15.) (17 C.F.R. § 201.323.) See Steven E. Muth, 86 SEC Docket 1217, 1242 (Oct. 3, 2005) (knowledge of employee's potential for wrongdoing results in an obligation to insure that procedures are in place to supervise him properly.) Another appropriate action would have been to fire Clarke and Andrade. Horning's expert witness did not know of any other situation where employees were not fired when their dishonest actions caused a securities firm to lose $600,000. (Tr. 429-30.)

Since Horning chose to retain Clarke and Andrade despite their serous misconduct, it was incumbent on him to exercise heightened supervision over them. He failed to do so. Horning continued to allow Clarke to execute trades at her unfettered discretion in the firm's proprietary account. (Tr. 177.) Horning allowed Andrade, who had concealed Clarke's trades, to continue to be in control of Rocky Mountain's books and records. Horning not only allowed Clarke and Andrade to retain their positions, he did not cut back their authority or effectively police their actions. It was highly unreasonable for Horning to allow Clarke and Andrade to remain as Rocky Mountain's head trader and head of operations, respectively, after they caused an $800,000 discrepancy in Rocky Mountain's books and records without taking some kind of measures to strictly oversee their activities.

In its 2001 deficiency letter, the Commission cited Rocky Mountain's violations of Rules 17a-3(11), 17a-5, 17a-3, and 17a-5(d)(4). (Div. Ex. 23.) Horning knew that in 2001 the Commission had discovered these violations by trying to reconcile NSCC records and Rocky Mountain records. (Tr. 198.) Even so, Horning continued to make Andrade, who had previously

made false entries and failed to disclose information, responsible for Rocky Mountain's: books and records, reconciliation reports, trade error reports, and FOCUS Reports. Horning was the only person at Rocky Mountain to review the materials that Andrade prepared and/or initialed, and his review was so superficial as to be worthless.

As Rocky Mountain's president, operations and financial principal, compliance director, and a well-educated securities professional, it was highly unreasonable for Horning to operate Rocky Mountain as if the events in 2000 and 2001 had not happened and did not require strong remedial measures. During the relevant period, Horning signed at least nine FOCUS Reports prepared by Andrade after a review that took about two minutes each.[23] (Tr. 256-58; Div. Exs. 11-19.) Horning knew that the Focus Reports were filed with regulatory authorities, and that the financial information in the FOCUS Reports was distributed to customers, yet he only reviewed "basically the income and expense part." (Tr. 256-57.) Horning did not engage Andrade in a dialogue about the contents of the FOCUS Reports. (Tr. 257.)

The Commission's 2001 deficiency letter emphasized errors that resulted from Rocky Mountain's failure to accurately reconcile its clearing account records. (Div. Ex. 23.) During the relevant period, it was highly unreasonable for Horning to give only a cursory, ten-second review once a week to the daily reconciliation reports that Andrade prepared. (Tr. 239.) Horning did not compare the numbers on the summary sheet with the source documents. In fact, he did not even look at the underlying documents that he received. (Tr. 242.) Horning assumed that Andrade knew he did not "foot" or add up the figures and that he only looked to ensure that the numbers on the summary sheet balanced. (Tr. 242-43.) The numbers on the one-page summary always balanced so Horning did not have any questions. (Tr. 243.) However, the reconciliation reports contained material discrepancies that Horning failed to note when he reviewed them. (Tr. 61-71, 238-45; Div. Exs. 4, 40, 41, 45, 46.) In fact, Horning's own expert faulted Horning for: (1) failing to notice a one million dollar discrepancy on the summary sheet of a reconciliation report that he reviewed; and (2) not reviewing the documentation underlying the one-page summary. (Tr. 444.)

Based on these facts, Horning, who should have been checking for irregularities, did not take any measures to independently verify the information he was given by Clarke or Andrade, and he never closely reviewed the various original informational reports that Andrade prepared and/or reviewed. The fact that Andrade knew that Horning was only performing a cursory review likely allowed Clarke and Andrade to perpetuate their ongoing fraud. (Tr. 242-43.) The record does not support Horning's claim that he spent eighty percent of his time on supervision. (Tr. 170.)

Horning did not subject Clarke and Andrade to heightened supervision in 2002-2003 based on their conduct in 2000-2001. The case law, however, is clear that a broker-dealer should subject an employee who has committed misconduct to heightened supervision. Donald T.

[23] The two minutes that Horning spent reviewing FOCUS Reports does not include the ten minutes to an hour he spent reviewing each of several reports generated by Securities Industry Software, a company that received data from Rocky Mountain electronically and generated daily and monthly reports on the firm's operations and finances. (Tr. 316-22.)

Sheldon, 51 S.E.C. 59 (1992), aff'd 45 F. 3d 1515 (11th Cir. 1995); Gotham Securities Corp., 46 S.E.C. 723 (1976). Horning's own expert agreed. (Tr. 426; Div. Ex. 24.) The expert also disagreed with Horning's position that it was sufficient to initiate procedures aimed at preventing a repetition of the earlier misconduct. (Tr. 440.) Even if one accepted Horning's claim that he instituted new procedures to address the problems identified in 2001, he did not effectively review either the one-page summary of reconciliations where the totals should balance or the trade error reports.

Rocky Mountain's back office staff consisted of six people in the Trading and Operations Departments. Horning's office was located in the same office close to these departments and he claims that he spent eighty percent of his time on supervision. (Tr. 170, 175, 359.) Given these facts and Horning's responsibilities, Horning should have been aware during the relevant period that:

1. Andrade took responsibility away from Rocky Mountain's cashier, Joanne Wing (Wing), in the Operations Department, for handling the Reich & Tang omnibus account. (Tr. 341-42, 348-49.)

2. Andrade took responsibility away from Carter-Hall for resolving reconciliation problems when Carter-Hall prepared the reconciliation reports three days each week. (Tr. 186-87, 350-53.)

3. Andrade would send Carter-Hall home when Carter-Hall could not balance the reconciliation numbers, and when Carter-Hall returned, the numbers balanced. (Tr. 352-53.)

This record shows that Rocky Mountain did not have in place adequate procedures, and a system for applying them, which would reasonably be expected to prevent and detect the violations that occurred. In addition, nothing in the record supports Horning's position that he acted reasonably in supervising Clarke and Andrade because they were trusted employees who deserved another chance. I find, therefore, that Horning did not reasonably discharge his duties and responsibilities. For all the reasons stated, I find that Horning failed reasonably to supervise Clarke and Andrade so as to prevent violations of Section 10(b) of the Exchange Act and Rule 10b-5.

3. Rocky Mountain Violated Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act and Rules 15c3-1, 15c3-3, 17a-3, 17a-5(a), 17a-5(c), 17a-5(d), 17a-11, and 17(a)-13.

(a) Section 15(c)(3) of the Exchange Act and Rules 15c3-1, 15c3-3

Section 15(c)(3) of the Exchange Act 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. A broker-dealer must make the calculations required by Exchange Act Rules 15c3-1 and 15c3-3 as part of the FOCUS Report. (Tr. 31, 35.) According to Vincent Deuschel, 73 SEC Docket 3845, 3850 (Dec. 21, 2000), a settled case, "The FOCUS Report 'constitutes the basic financial and operational report required of those brokers or dealers subject to any minimum net capital requirement . . . .' Form X-17A-

5, Part II (General Instructions). Again, information in those reports must be accurate." (citing D.S. Meyers & Co., Inc., 33 SEC Docket 1739 (Sept. 17, 1985); see also Cost Containment Services, Inc., 52 S.E.C. 266 (1995).

Each of Rocky Mountain's FOCUS Reports filed during the relevant period contains a Computation for Determination of Reserve Requirements for Broker-Dealers Under Rule 15c3-3 and Computation of Net Capital Under Rule 15c3-1. (Tr. 31-33; Div. Exs. 11-19.) The discrepancy between Rocky Mountain's records and Reich & Tang's records for the omnibus account, which is applicable to both Rule 15c3-1 and Rule 15c3-3, is known as a "short securities difference." Rocky Mountain failed to report a short securities difference in its FOCUS Reports during the relevant period. (Tr. 34-36; Div. Ex. 1.)

Rule 15c3-1, the net capital rule, details how the broker-dealer shall calculate its minimum net capital requirements. (Tr. 31-32.) A violation of Rule 15c3-1 does not require a showing of scienter. William H. Gerhauser, 53 S.E.C 933, 942 (1998). Rocky Mountain's FOCUS Reports for the months of June 30, 2002, through December 31, 2002, represented that it met its net capital requirement of $250,000 when, in fact, 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.[24] (Tr. 38-39; Div. Ex. 3.) The unchallenged calculation was done by Lonnie Morgan (Morgan), a Commission staff examiner with a master's degree in accounting and finance.[25] (Tr. 36.)

Rule 15c3-3, Customer Protection-Reserves and Custody of Securities (customer protection rule), details conditions under which a broker-dealer can give up physical possession or control of all fully paid securities carried by a broker or dealer for its customers. (Tr. 33.) Rule 15c3-3 is based on the premise that the broker-dealer must be cognizant of what it owes to customers and where the customers' property is at all times. (Tr. 34.) Rule 15c3-3 required Rocky Mountain to show in its FOCUS Reports the difference between what its books and records showed as the value of its customers' property in the Reich & Tang omnibus account and what Reich & Tang showed as the value of the omnibus account. (Tr. 35.) Morgan adjusted Rocky Mountain's Rule 15c3-3 filings by deducting the difference between what Reich & Tang reported to Rocky Mountain as the value of the omnibus account and what Rocky Mountain showed on its internal records. (Div. Exs. 1, 2.)

Because Rocky Mountain's books and records contained inaccurate information, Rocky Mountain's Rule 15c3-3 calculations were erroneous for each month from April 2002 through December 2002. 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

[24] These amounts were derived from the Commission's calculation of Rocky Mountain's actual net capital and its $250,000 net capital requirement. In only two months from April through December 2002, did Rocky Mountain have more than $250,000 in net capital. (Div. Ex. 3.)

[25] Morgan was employed as an examiner by the NASD for about twenty years, sixteen years as a supervisor. Morgan worked on Rocky Mountain matters for the NASD prior to September 2003, when she became a Commission examiner in broker-dealer audits. (Tr. 16-17.)

based on "market value short securities differences." (Tr. 39-43, 45-46, 56-57; Div. Ex. 2.) It follows that Rocky Mountain did not deposit funds covering the unreported reserve deficiencies of $1.7 million to $4.4 million into a special reserve account for the benefit of customers, as Rule 15c-3-3 required.

(b) Sections 17(a) and 17(e) of the Exchange Act and Rules 17a-3, 17a-5(a), 17a-5(c), 17a-5(d), 17a-11, and 17a-13

Section 17(a) of the Exchange Act requires that every registered broker or dealer make and keep reports for prescribed periods, furnish copies, and disseminate such reports as the Commission shall prescribe. The Commission's rules pursuant to Exchange Act Section 17(a) are called the books and records rules.[26] Information contained in the required records must be accurate. See Sinclair v. SEC, 444 F.2d 399, 401 (2d Cir. 1971); James F. Novak, 83 SEC Docket 1078, 1083 (April 8, 1983) (citing Lowell Niebuhr & Co, Inc., 18 S.E.C. 471, 475 (Mar. 15, 1945); Richard O. Bertoli, 18 SEC Docket 486, 488 n.11 (Sept. 25, 1979)).

Scienter is not required to violate Section 17(a) and the rules thereunder. SEC v. Drexel Burnham Lambert Inc., 837 F. Supp. 587, 610 (S.D.N.Y. 1993), aff'd, 16 F.3d 520 (2d Cir. 1994).

During the relevant period, Section 17(e)(1)(A) of the Exchange Act required that every registered broker or dealer file with the Commission annually a balance sheet and income statement certified by an "independent public accountant" on a calendar or fiscal year basis and such other financial reports as the Commission may require. Section 17(e)(1)(B) of the Exchange Act requires a registered broker or dealer send its customers its certified balance sheet and such other information regarding its financial condition that the Commission may require.

Rule 17a-3 details the records that a registered broker or dealer must maintain such as: ledgers reflecting all assets and liabilities; a securities record or ledger reflecting positions in each security for the broker-dealer's account or a customer account; a memorandum reflecting each purchase and sale showing price and time of execution; and numerous other information.

Rule 17a-5(a)(2) requires that Rocky Mountain, as a self-clearing broker or dealer who carries customer accounts, file Part I of the FOCUS Report monthly and file Part II of the FOCUS Report quarterly and annually. (Tr. 28-30.)

Rule 17a-5(c) details the required information that a broker or dealer must supply to its customers, which includes audited financial statements; Rule 17a-5(d) requires that a registered broker or dealer file audited financial statements annually with the Commission.

Rule 17a-11 requires that a registered broker or dealer give same day notice when its net capital falls below the required minimum pursuant to Rule 15c3-1.

[26] Rule 17a is titled "Preservation of Records and Reports of Certain Stabilizing Activities."

Rule 17a-13 provides that, with certain exceptions not applicable here, every registered broker or dealer shall, at least once every quarter: physically examine and count all securities held; account for all securities subject to his control but not in his possession; compare the count and verification with its records; and record in its books and records all unresolved differences. This mandated quarterly count is called a "box count." (Tr. 36-37.) According to Morgan, if the broker-dealer has placed the securities it holds for customers with someone else, it must also verify that documentation quarterly. (Tr. 37.)

Horning acknowledges and I find that Rocky Mountain violated Sections 15(c)(3), 17(a) and 17(e) of the Exchange Act and rules thereunder. (Tr. 92-93; Horning's Proposed Findings of Fact and Conclusions of Law at 10.) The unanimous evidence is that during the relevant period Rocky Mountain's books and records were inaccurate, and that it filed materially false reports with regulatory authorities.

4. Horning Did Not Willfully Aid and Abet Rocky Mountain's Violations of Sections 15(c)(3), 17(a) and 17(e) of the Exchange Act and Rules Thereunder.

The OIP charges Horning with: (1) aiding and abetting and causing Rocky Mountain's violations of Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act and rules thereunder; and (2) failing to supervise Clarke and Andrade. The Division, however, pled allegations in the alternative contending that, "[t]here cannot be a finding of both failure to supervise and aiding and abetting an underlying violation if they are based on the same facts." (Div. Post-Hearing Br. 23 n.12) (citing Charles E. Marland & Co., Inc., 45 SEC 632, 636 (1974); Anthony J. Amato, 45 S.E.C. 282, 286 (1973)); (Tr. 14-15.)

I agree with the Division's statement of the law. However, as detailed below, I disagree that Horning's failure to supervise resulted from the same facts that brought about Rocky Mountain's violations of Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act and Rules thereunder. Rocky Mountain violated the statutes and rules dealing with books and records, net capital, and other customer protection measures in part because Horning did not reasonably discharge his responsibilities as Rocky Mountain's president and FINOP. Horning failed to have Rocky Mountain implement proper measures for accurately accounting for securities represented by Rocky Mountain's omnibus account at Reich & Tang. Horning failed to adequately review Rocky Mountain's reports that he signed. Horning failed to act on the auditor's warnings concerning Rocky Mountain's internal controls, and he failed to act when the Commission agreed with the auditor's warning. These failures are facts separate and distinct from Horning's failure to supervise Clarke and Andrade.

Aiding and Abetting

Section 15(b)(6) of the Exchange Act, which incorporates Section 15(b)(4)(E), provides that:

> With respect to any person who is associated, . . . at the time of alleged misconduct . . . with a broker or dealer, . . . the Commission, by order, shall censure, place limitations on the activities or functions of such person, or suspend

> for a period not exceeding 12 months, or bar such person from being associated with a broker or dealer, . . . if the Commission finds, . . . that such a sanction. . . is in the public interest and that such person: has willfully aided, abetted, . . . the violation by any person of any provision of . . . this title, . . . the rules or regulations under any such statute . . .

Aiding and abetting violations of the securities laws involve three elements: (i) a primary violation by another party; (ii) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; and (iii) that the aider and abettor knowingly and substantially assisted in the conduct that constituted the primary violation. Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d. 1004, 1009 (11th Cir. 1985); Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir. 1980); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94-97 (5th Cir. 1975). The evidence is that Clarke willfully aided and abetted Rocky Mountain's violations of Section 17(a) of the Exchange Act and Rule 17a-3, and Andrade willfully aided and abetted Rocky Mountain's violations of Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act and Rules 15c3-1, 15c3-3, 17a-3, 17a-5(a), 17a-5(c), 17a-5(d), 17a-11, and 17a-13. (Tr. 92-93, 215-16; Admissions in Answer; Horning's Proposed Findings of Fact and Conclusions of Law at 11.)

Howard v S.E.C., 376 F.3d 1136 (D.C. 2004), is a lead case concerning the "awareness" or "knowledge" required to support allegations of aiding and abetting. In Howard, the United States Court of Appeals for the District of Columbia made clear that for aiding and abetting liability there must be proof that the person was aware or had knowledge of wrongdoing. Howard at 1142. In the absence of knowledge, the court held that an aider and abettor must have a state of mind close to conscious intent. The court affirmed earlier holdings that extreme or severe recklessness may support aiding and abetting liability "if the alleged aider and abettor encountered 'red flags,' or 'suspicious events creating reasons for doubt' that should have alerted him to the improper conduct of the primary violator." Howard at 1143 (citing Graham v. SEC, 222 F.3d 994 1006 (D.C. Cir. 2000); see also Wonsover v. SEC, 205 F.3d 408, 411 (D.C. Cir. 2000)). "[O]r if there was 'a danger . . . so obvious that the actor must have been aware of' the danger." Howard at 1143 (citing SEC v. Steadman, 967 F.2d 636, 641-42 (D.C. Cir. 1992)).

I find that Horning did not willfully aid and abet Rocky Mountain's violations because there is no evidence that Horning had any conscious knowledge of Rocky Mountain's violations, or that any red flags or suspicious events existed, independent of what occurred in 2000-2001 that should have alerted Horning that Rocky Mountain was violating Sections 15(c)(3), 17(a) and 17(e) of the Exchange Act and Rules thereunder.

5. Horning Willfully Caused Rocky Mountain's Violations of Sections 15(c)(3), 17(a) and 17(e) of the Exchange Act and Rules Thereunder.[27]

[27] The Division treated aiding and abetting and causing as one allegation. (Div. Post-Hearing Br. at 23-25.)

Applicability of a negligence standard to establish liability for causation is clear both by the language of Section 21C and the fact that the underlying violations do not require scienter. KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 (2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002). Section 21C of the Exchange Act authorizes the Commission, where it has found a violation of the Exchange Act or rule or regulation thereunder, to require such person, and "any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule or regulation." A causing violation must be supported by findings that: (1) a primary violation occurred; (2) there was an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. Erik W. Chan, 55 S.E.C. 715, 724-25 (2002); Rita J. McConville, 85 SEC Docket 3127, 3145 (June 30, 2005); Robert M. Fuller, 80 SEC Docket 3539, 3545, (Aug. 25, 2003), pet. for review denied, No. 03-1334 (D.C. Cir. 2004). The Division need not show that respondent's conduct was a proximate cause of the primary violations. McConville, 85 SEC Docket at 3146 n.45.

The violation requirement of Section 21C is satisfied because this Initial Decision finds and Horning's admission establish that Rocky Mountain violated Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act and rules thereunder. (Horning's Proposed Findings of Fact and Conclusions of Law at 10.)

Horning was a cause of the violations by conduct, which he knew, or should have known, would contribute to the violations. As Rocky Mountain's FINOP, Horning was responsible for Rocky Mountain's compliance with the Commission's rules issued pursuant to Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act. "[T]he 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." Gerhauser, 53 S.E.C at 940 n.18 (citing NASD Membership and Registration Rule 1022(b), NASD Manual (CCH), p. 3173); see also George L. Freeland, 51 S.E.C. 389, 392 (1993) (FINOP responsible for firm's compliance with applicable financial reporting and net capital requirements.); Gilad J. Gevaryahu, 51 S.E.C 710, 712 (1993).

The Commission has described the records that broker-dealers are required to maintain as "a keystone of the surveillance of brokers and dealers by our staff and by the securities industry's self-regulatory bodies." Edward J. Mawod & Co., 46 S.E.C. 865, 873 n.39 (1977), aff'd, 591 F.2d 588 (10th Cir. 1979). "The net capital rule is one of the most important weapons in the Commission's arsenal to protect investors." Don D. Anderson & Co., Inc., 423 F.2d 813, 816 (10th Cir. 1970). For ten months, Rocky Mountain's books and records and at least nine FOCUS Reports and its 2002 Annual Report which Horning signed were materially false because Horning, among other things, did not: (1) establish procedures whereby Rocky Mountain regularly verified that Reich & Tang's daily reports showed the same value as Rocky Mountain's records for the omnibus account; (2) have Rocky Mountain show investments in the Reich & Tang omnibus account as part of its financials; and (3) consider the correct amount of Rocky Mountain's holdings in the Reich & Tang omnibus account in making the calculations for Rule

15c3-1, the net capital rule, and for Rule 15c3-3, the customer protection rule. The Reich & Tang omnibus account was valued by Rocky Mountain and Reich & Tang at over six million dollars on April 1, 2002. (Tr. 344; Div. Ex. 1.)

In addition, Horning was a cause of Rocky Mountain's violations because he failed to heed the auditor's warnings that: (1) Rocky Mountain's plan of organization did not include adequate separation of duties related to cash receipts and cash disbursements; and (2) Rocky Mountain did not have appropriate supervisory procedures. Horning's conduct in ignoring the fact that the Commission agreed with the auditor's warning was also a cause of Rocky Mountain's violations. Horning's reasons for ignoring these warnings – too costly and the present system worked fine – are unpersuasive.

Finally, Horning was a cause of Rocky Mountain's violations by his abject failure to discharge his duties as Rocky Mountain's president and FINOP. Horning signed reports that he knew were being filed with regulatory agencies and distributed to customers without reasonable review. Horning lacked accurate information on the duties performed by Rocky Mountain's three-person Operations Department staff. Horning did not put in place an operations manual for the Operating Department. Horning did not make clear to Wing, who was responsible for the Reich & Tang omnibus account that she was to prevent unauthorized withdrawals.[28] Horning did not engage the Board in a serious discussion of whether Rocky Mountain should retain Mortland when Horning believed the 2000 audit should have discovered the problems that the Commission found in 2001. (Tr. 201-02.).

For all the reasons stated, I find that Horning's conduct was a cause of Rocky Mountain's violations of Sections 15(c)(3), 17(a), and 17(e) of the Exchange Act and Rules thereunder.

SANCTIONS

The Division recommends the Commission: (1) bar Horning from association with a broker-dealer in a supervisory capacity; (2) suspend Horning from all association with a broker-dealer for twelve months; and (3) order Horning to pay a civil money penalty of $250,000. If Horning is found to have aided and abetted and caused Rocky Mountain's violations of Sections 15(c)(3), 17(a), and 17(e) and rules thereunder, the Division recommends the Commission order Horning to cease and desist from future violations of these statutes and rules. (Div. Post-Hearing Br. 28-29.)

Horning's position is that he should not be sanctioned at all. He particularly emphasizes that he should not be barred from exercising responsibilities under his Series 24, General Securities Principal, license, or be suspended from association with a broker-dealer with respect to sales, an activity at which he claims to excel, and that he needs to work to support his family. (Tr. 372; Horning Proposed Findings of Fact and Conclusions of Law at 19-20.) Horning has no intention of using his Series 27 FINOP license, but he wants to continue to use his Series 24 General Securities Principal license. (Tr. 385.)

[28] Remarkably, Horning never thought unauthorized withdrawals from the Reich & Tang omnibus account would happen. (Tr. 362.)

1. Horning Should be Barred from Association with a Broker-Dealer in a Supervisory Capacity.[29]

As relevant here, Section 15(b)(6) of the Exchange Act authorizes a bar from association if it is in the public interest, where a person was associated with a broker or dealer at the time of the misconduct and where the person has willfully aided and abetted, or has failed reasonably to supervise with a view to preventing violations by a person subject to his supervision. Section 14(b) of SIPA provides an independent basis for barring Horning from association with a broker-dealer in a supervisory capacity.[30]

A bar from supervision pursuant to Section 15(b)(6) of the Exchange Act and Section 14(b) of SIPA, would not force Horning out of the securities industry entirely, but it would cause him to relinquish his supervision over the twenty-seven registered representatives at Moloney Securities, and it would be permanent, unless removed by the Commission. The criteria for making public interest determinations are:

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[29] The Division's Pretrial Brief states that it sought to bar Horning "from association with a broker-dealer in a supervisory, non-supervised capacity." (Division's Pretrial Brief at 6.) At the hearing, the Division stated that it wanted Horning barred from being a supervisor. (Tr. 383-85.) Horning objects to the Division's change of position, claiming that he received insufficient notice citing Carol P. Teig, 46 S.E.C. 615 (1976). (Horning Post-Hearing Br. at 24-25.) I allow the clarification or change of position because Horning had notice that a supervisory bar was at issue, the matter was clarified before Horning presented his direct case, and arguments about sanctions are based on the record.

[30] Section 14(b) of SIPA:

> It shall be unlawful for any broker or dealer for whom a trustee has been appointed pursuant to this Act to engage thereafter in business as a broker or dealer, unless the Commission otherwise determines in the public interest. The Commission may by order bar or suspend for any period, any officer, director, general partner, owner of 10 per centum or more of the voting securities, or controlling person of any broker or dealer for whom a trustee has been appointed pursuant to this Act from being or becoming associated with a broker or dealer, if after appropriate notice and opportunity for hearing the Commission shall determine such bar or suspension to be in the public interest.

Simple neglect or nonfeasance can be the basis for a sanction under Section 14(b) of SIPA even where the conduct does not result in a finding of aiding or abetting or failure to supervise, provided a person is given adequate notice and an opportunity to defend against the charge. See Carol P. Teig, 46 S.E.C. 615, 622-23 (1976)

> [T]he 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.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). See also Joseph J. Barbato, 53 S.E.C. 1259, 1282 n.31 (1999); Donald T. Sheldon, 51 S.E.C. 59, 86 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995). Deterrence is also a factor to be considered. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963.)

Application of the Steadman factors to these facts calls for the imposition of a strict sanction to protect the public. The overwhelming evidence is that Horning's conduct was egregious in failing to supervise Clark and Andrade so as to prevent their antifraud violations. Horning's failure to supervise continued over a ten-month period, and it occurred fourteen months after Horning learned that Clarke and Andrade engaged in dishonest conduct, which resulted in an $800,000 discrepancy in Rocky Mountain's books and records and a $600,000 loss to Rocky Mountain. Horning's own expert agreed that Horning's supervision was not adequate. (Tr. 442-50.) Horning's conduct resulted in the illegal taking of $4.5 million in customer funds, the appointment of a Trustee under SIPA to liquidate Rocky Mountain, and an expected advancement of more than $5 million dollars (net) by SIPC to the "Estate of [Rocky Mountain]." (Tr. 216; Div. Ex. 73 at 3.)

At no time in the proceeding, did Horning give any indication that he accepted responsibility for the misconduct that happened at Rocky Mountain in 2000-2001 and again during the relevant period. Rather, Horning put the total blame for everything that occurred on Clarke, Andrade, Mortland, Wing, and Carter-Hall for not doing their jobs and/or for not keeping him informed about the actions of other Rocky Mountain employees without any recognition that he was responsible for supervising each of these employees.

There is no evidence that Horning would act differently in the future. Horning claims he acted reasonably in not firing or subjecting Clarke and Andrade to heightened scrutiny because the Commission and the NASD took no disciplinary action against them in 2001. As noted previously, the case law is consistent that persons in the securities industry cannot blame the Commission for the failure to carry out their responsibilities.

Horning should be barred from supervision because he does not understand that he failed to discharge basic supervisory responsibilities and, since he does not accept that his supervision was deficient, there is a high probability that he would repeat these actions. Horning argues that he should not be barred from supervising the sales activities of securities professionals because he has not committed any violations in this area. However, Horning does not cite any situations where the sales area has been carved out of a supervisory bar and such a narrow prohibition would be difficult to enforce. Horning's argument that a supervisory bar is not needed because his supervisory responsibilities with Moloney Securities do not include trading and back-office activities are unpersuasive. There is no guarantee that Horning will stay with Moloney Securities. In addition, Horning supervises Depew and Massee at Moloney Securities and there

is no showing that he investigated what occurred or took any action based on his late-gained knowledge of their questionable activities at Rocky Mountain. (Tr. 230-31.) Horning's own expert testified that the trades Clarke executed to pay back her loans to Depew and Massee, and Massee's $500,000 trade using Rocky Mountain's proprietary funds were matters that should have been examined. (Tr. 452-53.)

I have given no weight to Horning's prior regulatory record in reaching a conclusion because the most recent event occurred more than twenty years before these events and the findings involved dissimilar conduct.[31]

The evidence shows that it is necessary to bar Horning from association with a broker or dealer in a supervisory capacity to protect the public pursuant to Section 15(b) of the Exchange Act and Section 14(b) of SIPA.

2. Horning Should be Suspended from Association with a Broker or Dealer for Twelve Months.

The authority for a suspension is found in Section 15(b)(6) of the Exchange Act and in Section 14(b) of SIPA. A twelve-month suspension from association with a broker or dealer would cause Horning to relinquish his position with Moloney Securities. Suspension is a severe sanction, and the Commission is obliged to justify why its imposition is in the public interest. See Steadman v. SEC, 603 F2d 1126 (5th Cir. 1979). The question is whether the record shows that it is in the interest of the public to suspended Horning from association with a broker-dealer for a specific period.

Application of the Steadman criteria makes it necessary to suspend Horning from association to protect the public for the following reasons. Horning's conduct was egregious and recurrent. He does not recognize that he acted negligently. He gave no assurance that he will not act similarly in the future.

Horning's conduct was egregious and recurrent because he caused Rocky Mountain's violations of the statute and regulations governing a wide array of books and records, net capital, and other customer protection measures for ten months. Horning had a graduate degree in business and over thirty years experience in the securities industry, yet he disregarded his responsibilities and caused violations of the law, rules, and practices in place to protect the investing public. For example, Horning signed as "principal executive officer or managing partner," and "principal financial officer or partner," and "principal operations officer or

[31] In 1980, Horning paid $500 and E. J. Pittock & Co. paid $1,000 toward a fine assessed by the NASD for selling shares in an IPO to the lead supervisor on E. J. Pittock & Co.'s audit. (Tr. 301; Div. Ex. 62.) In 1982, Horning resolved Commission allegations by consenting to findings that he violated the broker-dealer registration requirements. (Tr. 303; Div. Ex. 63.) In 1982 and 1983, the states of Illinois, Massachusetts, Minnesota, and Montana, issued cease-and-desist orders against Horning based on allegations that Rocky Mountain was not licensed in the state. (Tr. 303-04; Div. Exs. 64, 65.)

partner," Rocky Mountain's 2002 Annual Report and at least nine FOCUS Reports that contained material errors as to Rocky Mountain's financial status. (Div. Exs. 2, 3, 11-19, 22.) Horning made little, if any, attempt to ensure that the contents of the reports he signed were accurate. (Tr. 321-22.)

The books, records, and reports that broker-dealers have to keep, file, or distribute because of a statutory or regulatory requirement, must be accurate in all material respects. See Sinclair v. SEC, 444 F.2d. 399, 401 (2d Cir. 1971); Cost Containment Servs., Inc., 52 S.E.C. 266, 269 n.7 (1995). Horning did not require that Rocky Mountain reconcile its records daily with what Reich & Tang reported was in Rocky Mountain's omnibus account. For this reason, Rocky Mountain did not know that the amounts were vastly different every day of the relevant period (Tr. 251; Div. Ex. 1.) Horning's justification for not reconciling the Reich & Tang omnibus account that "[w]e were never told by anybody that we should be doing that" reveals a basic ineptitude, an unwillingness to accept responsibility, and a strong likelihood that he will commit future violations if given the opportunity. (Tr. 252.)

Similarly, Horning assumed that Andrade made the calculations in the FOCUS Report correctly not because of any independent review that he made, but because "[s]he had been doing it since 1991 without ever anyone complaining about how she did it." (Tr. 322.) Horning's defense that regulatory authorities did not tell him that Rocky Mountain's action were improper is non-persuasive. The case law is consistent, and Horning's expert agrees, that persons in the securities industry cannot blame the Commission for their failure to carry out their responsibilities. (Tr. 423); Gerhauser, 53 S.E.C. at 940 ("a broker-dealer cannot shift its responsibility for compliance with applicable requirements to the NASD or to us. A regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation.") (citing Variable Inv. Corp., 46 S.E.C. 1352, 1354 n.6 (1978)); see also Richard R. Perkins, 51 S.E.C. 380, 384 n.20 (1993); W.N. Whelan & Co., Inc., 50 S.E.C. 282, 287 (1990).

Horning ignored a Commission warning in 2001 that Rocky Mountain's 2000 audit failed to comply with Exchange Act Rule 17a-5(g)(1) and violated other rules and regulations, and that the actions of three employees caused and covered up an $800,000 discrepancy in Rocky Mountain's books.[32] As the firm's only authorized principal and as the firm's compliance officer, Horning knew he was responsible for reviewing trade tickets and reviewing trades, but there is no evidence that he did so. (Tr. 173-74, 450-52.) For example, Horning did not know that Rocky Mountain's records showed his personal account sold $89,550 worth of ImClone Systems, Inc. (ImClone), in February 2002 at $19.90 a share and bought $44,100 worth of ImClone in March 2003 at $49.00 a share. (Tr. 235-37; Div. Ex. 35A.) In addition, Horning did not know that in December 2002, a Rocky Mountain registered representative with a trading

[32] As noted, Horning's rationalization that it was reasonable for him to keep Clarke and Andrade in their positions and to consider them trusted employees after 2001 because the Commission and the NASD did not take regulatory action against Clarke, Andrade, and Steffen for their actions in 2000-2001 is invalid.

limit of $50,000 executed a trade of $500,000 using the firm's proprietary account. (Tr. 233-34; Div. Ex. 38A.)

Horning ignored annual warnings from the auditor that (1) "errors or irregularities in amounts that would be material in relation to the financial statements of [Rocky Mountain] may occur and not be detected within a timely period"; (2) Rocky Mountain's plan of organization did not separate duties related to cash receipts and cash disbursements; and (3) Rocky Mountain did not have supervisory review procedures to assure that policies and procedures were adhered to. Horning did not make structural and personnel changes in response to the auditor's criticisms because the existing "system worked fine as it was," and he did not think Rocky Mountain had money to hire additional people in the back office. (Tr. 192-93.) As FINOP, Horning should have had Rocky Mountain's Board consider whether Rocky Mountain should retain Mortland after Rocky Mountain's 2000 audit did not discover the problems the Commission found in February 2001. (Tr. 201-02.).

As president and FINOP, Horning was responsible for Rocky Mountain's books and records and for managing the firm. The evidence is that Horning operated Rocky Mountain without knowing what responsibilities Rocky Mountain's three Operations Department employees actually performed during the relevant period. In addition, he staffed Rocky Mountain's Operations Department, which had problems in 2000-2001, totally with employees who had no securities licenses, no college degrees, and little industry experience.[33] Horning was responsible for a broker-dealer whose financial records and organization were in such disarray that shortly before bankruptcy a forensic accountant could not: (1) match the firm's records with those of NSCC, and (2) establish who at Rocky Mountain was responsible for dealing with the Reich & Tang omnibus account. (Tr. 470-82.)

Horning admits that the actions of Clarke, Andrade, and Steffen in 2000-2001 were basically dishonest. (Tr. 205.) Even so, Horning maintains that Rocky Mountain knew about the deficiencies that the Commission informed him about in 2001 because Andrade and Steffen were aware of Clarke's unreported trades. (Div. Ex. 24.) Horning argues that Rocky Mountain knew, but ignored the problem when these employees involved did not inform him of their misconduct. (Tr. 204-05.) The record has no evidence to indicate that Horning recognizes his conduct at any time was wrong. Horning has provided no assurances that he would not repeat his actions, if given the opportunity.

The Honorable Dennis A. Graham of the Colorado Court of Appeals gave strong testimony of Horning's good character. Despite this testimony, the evidence is persuasive that at this time Horning's continued participation in the securities industry is not in the public interest and suspension from association is necessary to deter him, and others, from similar behavior.

[33] Andrade failed the examination for a Series 7, General Securities Representative, license. (Tr. 176-77.) The transcript states Series 27, Financial and Operations Principal, but that appears to be erroneous.) Wing began working for Rocky Mountain right out of high school. (Tr. 341.) In 2002, Wing had worked for Rocky Mountain for approximately sixteen years and had no securities licenses. (Tr. 365.) Carter-Hall, a high school graduate who held no securities licenses, had been Clarke's nanny for five years. (Tr. 354, 357, 365.)

For the reasons stated, I conclude that Horning should be suspended from association with a broker-dealer for twelve months to protect the public from his failure to observe the securities laws and regulations.

3. Horning Should Not be Ordered to Pay a Civil Money Penalty of $250,000.

Section 21B of the Exchange Act authorizes the Commission to assess civil penalties in a proceeding instituted pursuant to Section 15(b)(6) where a person has willfully aided and abetted or caused a violation of the Exchange Act or a person has failed reasonably to supervise within the meaning of Section 15(b)(4)(E). Section 21B sets out three tiers of penalties. The first-tier penalty has a maximum for a natural person at $6,500 for each act or omission. The second-tier penalty requires fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement and sets a $60,000 maximum for a natural person for each act or omission. The third-tier penalty with a maximum per occurrence for a natural person of $120,000 requires the same elements as the second tier with conduct that resulted in substantial losses or risk of substantial losses to other persons, or resulted in substantial pecuniary gain to the perpetrator. 17 C.F.R. §201.1002. A third-tier civil penalty is possible because Horning's failed to supervise employees so as to prevent antifraud violations, and Rocky Mountain customers were at risk of losing almost $5.4 million. (Div. Ex. 73 at Exhibit C at 2.) See Steven E. Muth, 86 SEC Docket 1217, 1248 (Oct. 3, 2005).

I granted confidential treatment to a Financial Disclosure Statement submitted pursuant to Rule 630 of the Commission's Rules of Practice, 17 C.F.R. §201.630, for Horning and his wife.[34] (Tr. 404-05; 17 C.F.R. §201.630(c).) The purpose of the Financial Disclosure Statement is to show Horning's inability to pay the penalty requested by the Division. 17 C.F.R. §201.630(b). Horning asserts that he has settled the civil action SIPC brought against him; therefore, the Division should not be allowed to argue that he should pay a civil penalty because of SIPC's total costs. The Division maintains that SPIC's total cost is a public interest factor to be considered. (Tr. 12-13.)

The Division has reviewed the Financial Disclosure Statement and maintains that Horning has the ability to pay a $250,000 civil penalty and that a penalty in this amount is warranted given the harm to customers that resulted from Horning's egregious failure to supervise and the necessity to deter others from such conduct. (Tr. 406; Div. Reply Br. 12.) The Division does not explain how it arrived at the $250,000 amount.

The evidence is that Horning has already suffered substantial economic loss as a result of what occurred at Rocky Mountain in the relevant period. Horning's thirty-nine percent ownership in Rocky Mountain valued at $862,437, based on the book value of the firm at the end of June 2000, is worthless. Horning paid $150,000 and $65,000, respectively, to settle claims of the Trustee and a bank on a Rocky Mountain note guaranty. (Horning's Post Hearing Br. at 28 n.15.) The bar from supervision and the twelve-month suspension from affiliation with a broker-

[34] When this administrative proceeding is finally concluded, I request that the Commission's Secretary return Horning Ex. 18, the Financial Disclosure Statement, and shred the confidential volume of the transcript, pages 404-412, to Horning.

dealer will likely limit Horning's future income. Horning's Financial Disclosure Statement indicates that a substantial portion of the assets Horning holds with his wife are in IRAs. The fact that the Trustee settled a lawsuit against Horning alleging losses in excess of $7 million to the Estate of Rocky Mountain and to SIPC for $150,000, could be viewed as support for a conclusion that a $250,000 would cause financial hardship to Horning and his wife. (Div. Ex. 73 at 3.) For all these reasons, I will not order Horning to pay any civil money penalty.

4. Horning Should Not be Ordered to Cease and Desist From Causing Violations of Sections 15(c)(3), 17(a) and 17(e) of the Exchange Act and Rules 15c3-1, 15c3-3, 17a-3, 17a-5(a), 17a-5(c), 17a-5(d), 17a-11, and 17a-13.

Section 21C of the Exchange Act states that the Commission may order a person who has been found to have violated a provision of the statue or rule thereunder, and any other person who was a cause of the violation, due to an act or omission the person knew or should have known would contribute to the violation, to cease and desist from committing or causing such violation or any future violation. The following factors are considered relevant in determining whether a cease-and-desist order is appropriate: "the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the respondent's opportunity to commit future violations, . . . whether the violation is recent, the degree of harm to investors or to the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings." KPMG Peat Marwick LLP, 54 S.E.C. at 1192.

Most of these factors were considered in connection with the public interest analysis pursuant to Steadman. What has not been considered is the need for a cease-and-desist order given the other sanctions ordered. Horning's violations occurred in connection with his supervision and his activities as president and FINOP of Rocky Mountain. Imposition of a bar from supervision and suspension from association for twelve months will eliminate Horning's opportunity to fail to supervise and to cause these types of violations in the future. At the end of twelve months, Horning will still be unauthorized to supervise and his ability to cause these types of violations will be eliminated or, at a minimum, greatly diminished. Accordingly, I find that a cease-and-desist order is not required.

RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items described in the record index issued by the Secretary of the Commission on August 3, 2006.

ORDERS

I ORDER that Stephen J. Horning is barred from association with a broker or dealer in a supervisory capacity pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Section 14(b) of the Securities Investor Protection Act of 1970; and

I ORDER that Stephen J. Horning is suspended from association with a broker or dealer for twelve months pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Section 14(b) of the Securities Investor Protection Act of 1970.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Brenda P. Murray
Chief Administrative Law Judge