ADMINISTRATIVE PROCEEDING
FILE NO. 3-7528

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

	)
In the Matter of	)
	)
STEVEN ERIK JOHNSTON	)
PATRICIA ANN GRIFFITH	)
ALBERT VINCENT O'NEAL	)
	)

INITIAL DECISION

June 23, 1992
Washington, D.C.

Brenda P. Murray
Administrative Law Judge

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APPEARANCES: Nancy E. McGinley, Stephen Webster, and Ronda J. Blair of the Fort Worth Regional Office for the Division of Enforcement, Securities and Exchange Commission

R. H. Wallace for Steven Erik Johnston

Coyt Randal Johnston for Patricia Ann Griffith

John F.X. Peloso, Anne C. Flannery, Maureen Beyers, and Paul J. Dubow for Albert Vincent O'Neal

BEFORE: Brenda P. Murray, Administrative Law Judge

The Securities and Exchange Commission (Commission) initiated this proceeding on July 18, 1991, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act). The proceeding is to determine whether the Commission's Division of Enforcement (Division) is correct that: (1) from in or about 1985 to about October 1987, Steven Erik Johnston (Mr. Johnston) willfully violated Section 17 (a) of the Securities Act of 1933 (Securities Act) and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (2) from in or about February 1986 to October 1987, Roger William Ballou (Mr. Ballou) willfully violated Section 17 (a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (3) from in or about February 1987 to October 1987, Patricia Ann Griffith (Ms. Griffith) willfully violated Section 17 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (4) from in or about June 1986 to October 1987, Prakash Rameshchandra Shah (Mr. Shah) willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (5) from in or about 1985 to in or about October 1987, Albert Vincent O'Neal (Mr. O'Neal) violated Section 15(b)(4)(E) of the Exchange Act as incorporated by Section 15(b) (6); and from in or about 1986 through October 1987, Mr. O'Neal willfully aided and abetted violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and what, if any, remedial action is appropriate in the public interest.

Thirty-two witnesses testified at eleven days of hearing in Forth Worth, Texas, in October, 1991. The record consists of 2,700 transcript pages and about 210 exhibits. I correct the transcript to show that I made the statements allowing exhibits into evidence following the word Stipulation on transcript (Tr.) page 356, line 7 through line 17.

The parties filed briefs and proposed findings of fact. I grant Respondents Johnston and O'Neal's request to file a joint brief exceeding 60 pages. The Division filed its Reply Brief, the last brief under the schedule set at the conclusion of the hearing, on January 31, 1992.

I grant Respondents Johnston and O'Neal's request to file the Sur-Reply Brief dated February 11, 1992. In its Reply, the Division emphasized different issues than it did in its Initial Brief to which Respondents replied. The result is that the Sur-Reply is necessary to know Respondents' position on several points.

I deny Ms. Griffith's Motion to Dismiss. The reasons are stated in my findings and conclusions which are based on the preponderance of the evidence and upon my observation of the witnesses.

RESPONDENTS

Steven Erik Johnston

Mr. Johnston graduated from the University of Texas with an undergraduate business degree in 1975 and received a Masters of Business Administration from the University in 1978, the same year he became a certified public accountant. In May 1981, Mr. Johnston became a registered securities representative. He worked for a local securities firm in Ft. Worth from 1980 until 1982 when the firm asked him to leave because it was uncomfortable with his option trading. Mr. Johnston joined Dean Witter Reynolds, Inc., (Dean Witter) a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, as an account representative in June 1982.

In the relevant period, Mr. Johnston specialized in trading options at Dean Witter's Fort Worth, Texas office. Mr. Johnston consistently produced the largest amount of commissions in the office, and he was one of Dean Witter's top producers nationwide. In

October 1986, Dean Witter appointed Mr. Johnston Senior Vice President, Investments based on his sales production (Division Exhibit 139). Mr. Johnston's business card announced that he was a First Vice President, Investment Coordinator, Equity Options at Dean Witter. Mr. Johnston's status with Dean Witter caused customers to trust him because they trusted Dean Witter.

Several registered representatives in Dean Witter's Fort Worth office, including Ms. Griffith and Mr. Ballou, shared customer accounts with Mr. Johnston on which they split the commissions.

Mr. Johnston's interest in options began in 1978. He claimed to be an expert at trading options based on experience and reading books. He is not a Registered Option Principal (ROP). 1/ In mid-1983, Mr. Johnston began advocating a strategy of selling out-of-the-money uncovered puts and calls in combinations on a variety of underlying securities (Tr. 1956). A put is an option to sell at a certain price within a certain period, and a call is a similar option to buy. Options provide a cheap form of speculation. 2/ The term out-of-the-money indicates that the exercise price specified in the option (the strike price) was higher or lower than the market value of the underlying security (Tr. 1947). Many of Mr. Johnston's option customers followed his advice and established margin accounts with highly marginable assets such as Ginnie Mae or Fannie Mae securities.

1/ According to Mr. O'Neal, there is no reason for a registered representative to become an ROP because it is just a little bit of extra training and most salespeople who trade options are not ROPs. People in management positions, like Mr. O'Neal, become ROPs so that they can sign the paper work necessary for option trading (Tr. 2308-09).

2/ Options can serve as a hedge (form of insurance) against future market movements, however, in practice it appears that most people use them for the opportunity they provide to speculate on a small amount of capital. Louis Loss, Fundamentals of Securities Regulation 251, n.4 (1983).

Mr. Johnston's strategy was based on selling options where the strike price made it unattractive for people to exercise the options so that his clients received the option premium, less commissions, and did not have to perform under the option, i.e., buy or sell securities. This strategy ran the risk that the market value of the underlying security would rise above the strike price specified in the call in which case the call holder would exercise the option, or that the market value of the underlying security would fall below the strike price so that the put holder would exercise the option. The latter situation occurred with a vengeance on October 16 and 19, 1987, when this nation's securities markets suffered dramatic value losses. Mr. Johnston's customers who had written uncovered puts suffered severe losses as they had to buy securities at prices set prior to the precipitous market decline. Some of Mr. Johnston's customers went into debt to Dean Witter when the balances in their margin accounts were insufficient to cover their losses.

Dean Witter suspended Mr. Johnston for 30 days in June 1983 for agreeing to share profits and to guarantee losses on customer accounts in violation of New York Stock Exchange Rule 352. In 1983 and 1984, three customers sued Dean Witter and Mr. Johnston alleging that Mr. Johnston traded illegally in their accounts. This litigation resulted in an award of commissions to one plaintiff, a settlement by a $23,000 payment to another, and a referral to arbitration.

Dean Witter fired Mr. Johnston on October 30, 1987, for failing to follow the Branch Manager's instructions to liquidate client accounts.

Patricia Ann Griffith

Ms. Griffith began working at Dean Witter in 1984, about a year after she graduated from Texas A&M University with a Bachelor of Science degree in biomedical science. She qualified as a registered representative in February 1985. Ms. Griffith earned $982 from trading options in 1986. In 1987, Ms. Griffith recommended to four of her clients - Walt and Elaine Burgess, Adrian and Nancy Gonzalez, Joseph Michael Jez, and Ruth McAdam - that they open accounts to trade options with Mr. Johnston. The four customers did so and Ms. Griffith and Mr. Johnston shared the commissions that resulted from the trading activity in these accounts. Ms. Griffith earned $17,017 from trading options in 1987 (Division Exhibit 77).

Dean Witter fired Ms. Griffith because she refused to sign a note assuming liability for her customers' losses that occurred in these accounts. Since October 1991, she has been employed by a bank as a retail sales representative/investment officer, and she uses her security licenses in her employment.

Albert Vincent O'Neal

Mr. O'Neal graduated from Texas Christian University in 1963, and Southern Methodist University's Graduate School of Banking in 1971. In August 1982, Mr. O'Neal began a career in the securities industry as a registered representative in Dean Witter's Fort Worth office. Dean Witter named him Branch Manager of the office in November 1983, and he qualified as a ROP about a year later.

FINDINGS

Mr. Johnston's Violations - Antifraud Provisions

I have treated the allegations against Mr. Johnston in the order they appear in the

Commission's Order Instituting Proceedings. I will refer to the Burgess, Coale Trust, Dwyre, Gonzalez, Horn, Hyden, McAdam, Nemser, Peterson, Southern Asphalt and Petroleum (SA&P), Smith, and Thomas accounts as Mr. Johnston's accounts. Mr. Johnston shared many of these accounts with Mr. Ballou or Ms. Griffith. Both account representatives are responsible for the events in the account.

I find that Mr. Johnston willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 in that, in connection with the offer, purchase and sale of securities and by using the means of interstate commerce and the mails, he employed devices, schemes or artifices to defraud; he obtained money by lying about material facts and omitting to disclose material information; and he engaged in acts, practices, and course of business which operated as a fraud or deceit upon other persons.

1. Option agreement forms

Dean Witter advised Mr. Johnston in early 1986 that in all cases clients must complete their own option agreements, however, throughout the period 1985 through October 1987, Mr. Johnston had customers sign blank option agreement forms which he filled out (Division Exhibit 82, Bates stamp 5216). Acting with other account representatives on the shared accounts, Mr. Johnston placed false and misleading information on the forms so that they would pass in-house review and permit the opening of options accounts to allow his type of option trading. The options forms for all Mr. Johnston's customer accounts have speculation and/or speculative income checked as the primary or secondary investment objective.

Mr. Johnston violated the securities statutes because either alone or with another account representative on the shared accounts he entered this fraudulent information on

the customer's form. Almost none of the customers agreed to these investment objectives, and the few customers that did agree did so in reliance on Mr. Johnston's false and misleading representations and material omissions. (Tr. 150-51, 214-19, 249-50, 461-64, 528-34, 563-64, 575-80, 791-94, 861-63, 866-68, 931-35, 987, 1048-49, 1053-54, 1245, 1259-60). 3/ The selection of investment objectives on the options client information form was very important because the trading strategies had to be compatible with the investment ojectives. The Branch Manager's Manual characterized writing naked calls and puts as investment strategies offering high risk and moderate rewards in line with investment objectives of speculative income (Division Exhibit 131).

Mr. Johnston also violated the antifraud provision of the securities statutes by filling out options applications which falsely represented that: (1) Evelyn N. Smith had experience in stocks and bonds since 1950, and prior options experience 4/, (2) Betty Lou Horn, a 64 year old divorced female with a college degree in home economics who never professed to be a businesswoman, had experience in options since 1983, (3) Mr. and Mrs. Gonzalez had prior options experience, (4) Mr. Hyden had annual income of $45,000, and (5) Dr. Thomas had options experience.

3/ Mr. Johnston's customers testified with the exception of Mrs. Nemser and Mrs. McAdam. Mrs. Nemser died on July 2, 1987. The Nemser estate did not sign an option agreement form. I reject Mr. Johnston's claim that he had approval to trade uncovered options between Mrs. Nemser's death and the appointment of the administrator a month later. The estate attorney instructed Dean Witter to do "only what was necessary to wrap it up and close it down" (Tr. 2703).

4/ Mr. Johnston signed the form on June 15, 1987, representing that Mrs. Smith, a widow in her 60s, had experience in options since 1987. Even though the experience claimed is not long, the false statement is material where Mrs. Smith's ability to establish an account was questionable since her annual income was the minimum Dean Witter allowed for an account trading naked optiuons.

I reject Mr. Johnston's representation that Dr. Thomas and Mrs. Smith had options experience based on his claim that they discussed options with friends who traded options and reviewed their friends' monthly statements (Tr. 2037-38). Counsel argues that close scrutiny of another's options account may qualify as options experience. I disagree. The term experience indicates knowledge gained from direct participation. For example, Dean Witter materials discussing investment experience suggest looking at the types of accounts an applicant has had (Division Exhibit 131). In any event, even if experience was defined in an indirect sense, there is no persuasive evidence that Dr. Thomas and Mrs. Smith studied or closely scrutinized their friends' options statements. Finally, Mr. Hyden did not have annual income of $45,000 as Mr. Johnston fraudulently represented. Mr. Johnston included in that figure $15,000 in anticipated earnings from securities in Mr. Hyden's margin account which would trade naked options.

2. Unsuitable transactions

Dean Witter defines suitability as investment recommendations that are in the customer's best interests. Mr. Johnston conducted fraudulent and unsuitable options trading in the Burgess, Coale Trust, Dwyre, Gonzalez, Horn, McAdam, SA&P, and Smith accounts.

Mrs. Horn and Mrs. Smith were both over 60 years of age, widowed or divorced. Mr. Johnston represented that his trading strategy satisfied their need for safe, conservative investments which would provide them with additional revenue for living expenses. Mrs. Horn's investment of $50,000 was a major portion of her net worth, exclusive of her home. Dean Witter's policy was to require a minimum annual income of $25,000 for customers to trade naked options (Division Exhibit 117). Mrs. Smith's taxable income of $25,000 was at the minimum, and Mrs. Horn's annual income of $22,000 was below the minimum.

Mrs. McAdam was an unemployed widow in her mid-twenties with two dependents. Her annual income was $5,000 below Dean Witter's annual income requirement for trading uncovered options. Mrs. McAdam funded the account with a one time windfall, $65,000 from an insurance benefit. Mr. Johnston determined the account suitable for options because of the irrelevant fact that Mrs. McAdam was related to Ms. Griffith, the account representative with whom he shared the account (Tr. 1998).

Mr. Burgess retired the same year he opened the account. He was uninformed about the securities markets, he was always excited about his latest, greatest deal for making money in securities, and he was unwilling to accept a loss of equity in his account. Mr. Johnston and Ms. Griffith told him that Mr. Johnston had developed a safe way to trade options which involved little risk and limited loss possibility.

Mr. Johnston falsely represented to Mr. and Mrs. Gonzalez that his options trading strategy was safe, and that losses were limited.

The SA&P employee pension account was established to provide retirement benefits to the company's 15 employees. The two trustees did not understand option trading and Mr. Ballou, the account representative on the account with Mr. Johnston, conveyed to them Mr. Johnston's claim that the investments were safe. At age 76, Mrs. Coale, one of the SA&P trustees, a successful businesswoman with a ninth grade education, put her life savings of $268,000 in an options account in trust for her daughter who is a diabetic because Mr. Ballou, the account representative with Mr. Johnston, relayed Mr. Johnston's claim that his options strategy was a safe investment.

Dean Witter's Branch Manager Manual acknowledges the firm's responsibility to ensure that recommended client activity satisfied the suitability requirements of New York Stock Exchange Rule 405 and the National Association of Securities Dealers Rules of Fair

Practice, Article 3, Section 2. Dean Witter's materials specify an account executive's affirmative duty to gather and update essential information and to explore a person's financial obligations and investment objectives before recommending options. The materials note that a customer's previous investment experience is an important consideration in making the suitability determination, and they warn that being in the market does not equate to understanding. The materials point out that whether a customer can comfortably meet margin call requirements is a consideration in determining suitability. Finally, Dean Witter auditors advised Mr. Johnston in 1986 that if a particular client was living on investments, he should determine if the client was suitable to continue the highly speculative activity he conducted by examining the type of investments and the client's age and sophistication (Division Exhibit 82, Bates stamp 5216).

Mr. Johnston activities in the Johnston accounts totally ignored Dean Witter's directives and advice on suitability set forth immediately above. Mr. Johnston knew that none of these customers were experienced in options, that they lacked the financial sophistication to understand a strategy of selling uncovered puts and calls, that their prior investment experience had been almost entirely in conservative investments, and that each customer, with the exception of Dr. Thomas, was unable or unwilling to absorb the losses that were possible from his trading strategy.

Respondents' expert Mr. Ferguson claimed that options experience is of little significance in determining suitability because options are easy to understand. I disagree, but even if Mr. Johnston were correct that some of his customers had options experience, my observation of the witnesses convinced me that these customers did not understand options.

Mr. Johnston violated the antifraud provisions of the securities statutes because he

lied and omitted material information, and he traded highly speculative securities in customer accounts when he knew that customers wanted conservative investments, that these securities did not meet the customers' investment objectives, and that these customers were unsuited for these high risk investments. Clark v. John Lamula Investors, Inc.. 583 F.2d 594, 600 (2d Cir. 1978); Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135, 142-43 (7th Cir. 1969), cert. denied, 396 U.S. 838 (1969). 5/

3. Excessive trading 6/

A finding of excessive trading is appropriate when the account executive controlled the account, he or she traded excessively in light of the customer's investment objectives, and he or she did so with scienter. Miley v. Oppenheimer & Co., 637 F.2d 318, 324 (5th Cir. 1981); Mihara v. Dean Witter & Co., 619 F.2d 814, 820 (9th Cir. 1980); Shad v. Dean Witter Reynolds, Inc., 799 F.2d 525, 529 (9th Cir. 1986). The evidence is overwhelming that Mr. Johnston's conduct satisfied all three elements.

Mr. Johnston did not have formal discretionary authority to conduct trades in any of the accounts so the question is whether he in fact exercised control. Counsel concedes that Mr. Johnston exercised control in all but the Hyden, Nemser, and Thomas accounts (Johnston and O'Neal Reply Brief, 49). For the following reasons, I find that Mr. Johnston controlled these accounts also.

Mr. Johnston's description of the way he conducted business demonstrates that he

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5/ Respondent Johnston does not challenge the Division's position that unsuitable transactions violate the antifraud provisions (Johnston and O'Neal Reply Brief 51-54).

6/ After reconsideration, I affirm my ruling allowing the Division's expert to opine that Mr. Johnston excessively traded assets in the Coale Trust, McAdam, and Nemser accounts (Tr. 1657-65, 1690-1702).

controlled the accounts of all his option customers. He admits he did not talk to clients before executing specific trades. According to Mr. Johnston, if he sold stock in a customer's account it was because the customer relied on him to do so and "upon my first opportunity I would communicate the specific trade" to the customer (Tr. 2019). I accept as fact the unanimous customer testimony which is that Mr. Johnston traded in the accounts without prior consultation, and that they learned about the transactions when they received the confirmations or when Mr. Johnston or another account executive told them. None of the customers who testified directed Mr. Johnston to undertake a single option trade.

Mr. Hyden told Mr. Johnston at the end of 1985 to curtail the number of transactions in his account because he was concerned about the losses and volatility in the account balance. Mr. Johnston ignored his instructions. In September of 1986, Mr. Hyden instructed Mr. Johnston to close the account as quickly as possible. Mr. Johnston said it would take time and some positions would have to be "fortified". Mr. Johnston agreed to tell Mr. Hyden when he was going to take positions but he continued to open new positions without any authority from Mr. Hyden and contrary to Mr. Hyden's instructions. Mr. Hyden directed Mr. Johnston not to write any new option positions in a letter in March 1987 with a copy to Mr. O'Neal. It was not until mid-August 1987, that Mr. Johnston changed his approach and began seeking Mr. Hyden's approval before executing transactions (Tr. 954).

Mr. Johnston continued trading options in what had been Mrs. Nemser's account after her death on July 2, 1987, in the same independent manner he conducted trading in other option accounts. Mr. Johnston did not seek prior approval of transactions from Mrs. Nemser's son who he understood to be the beneficiary of her estate or from the attorney

probating the estate.

Mr. Johnston was Dr. Thomas's accountant prior to becoming his account executive and the two shared business investments. Dr. Thomas opened an individual option account based on Mr. Johnston's representations that his options trading was relatively safe, with risks equivalent to buying a stock or bond, and that returns would be as much as 20 percent (Tr. 1245, 1254). 7/ Dr. Thomas was Mr. Johnston's biggest customer. Mr. Johnston talked with Dr. Thomas every two weeks or every month to review the account. Dr. Thomas did not direct trading in the account, and the only trade which Mr. Johnston mentioned in advance was a bond purchase. In August 1986, Dr. Thomas directed Mr. Johnston to close the account, however, Mr. Johnston is "very persuasive" and he continued to argue that he needed more time to close the account. In March or April 1987, Dr. Thomas demanded that Mr. Johnston close the account that day, and it was closed in a week.

Having determined that Mr. Johnston controlled trading in all the Johnston accounts, the issue is whether the number of trades was necessary to meet the customers' investment objectives. Trading in these accounts was excessive because the customers' investment objectives were not speculation and speculative income. Less risky objectives did not require the high level of trading, and the resulting commissions and transaction costs, that occurred in these accounts. In addition, as noted later, these trades were incompatible with instructions to close an account.

Evidence from the Division's experts, Mr. Stuart C. Goldberg and Mr. Robert E. Connor, provides an independent ground for finding that Mr. Johnston engaged in

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7/ In addition to a personal account, Dr. Thomas also opened a profit sharing account for his business, Otolaryngology Associates, and a trust account for his son.

excessive trading. I accept the cost maintenance equity factor (CMEF), the return on the account's average net equity needed to pay commissions and other expenses, as a valid indicator of excessive trading. The annualized CMEF for several of Mr. Johnston's customers within the relevant time frame shows excessive trading because there was either no probability or a very low probability that Mr. Johnston's trades would earn a return above the CMEF/the return sufficient to cover costs.

CMEF - ANNUALIZED (percent)

Burgess	13.3
Gonzales	19.9
Dwyre	32.1
Horn	35.8
Peterson	22.5
SA&P	23.3

Respondents' criticisms do not invalidate the experts' opinions or their use of the CMEF. The time periods selected were not arbitrary or capricious and it is reasonable to annualize a mathematical calculation. The events on October 19 were atypical so it was reasonable to exclude those market results; also, inclusion of net equity figures after that date would have caused the CEMF to be higher not lower. Respondents have not demonstrated why a customer's mutual funds should have been included, in fact Dean Witter's account statements do not include customer "mutual funds held at custodian banks" in net equity (Division's Reply Brief 24-25). 8/ The account's profitability is a factor to be considered but it does not invalidate the CMEF.

8/ Respondents claim the Division is wrong and that the mutual funds "are valued for purposes of the account's net equity." (Sur-Reply Brief 9). My perusal of the account statements indicates the Division is correct because the figure for mutual fund holdings appears on the line below the net equity figure. In any event, Respondents are not persuasive that omitting the mutual funds, held by some but not all of the Johnston customers, invalidated the calculation.

Mr. Johnston's claim that his customers' losses occurred because the prices of underlying securities dropped precipitously on October 19, 1987, is unpersuasive. Mr. Johnston's material misrepresentations and omissions were independent and unrelated to what occurred in the securities markets on that date. In addition, while the events of October 19 had a devastating impact on many of Mr. Johnston's customers who traded on margin, Dr. Thomas, Mr. Johnston's largest customer, suffered severe losses and finally succeeded in closing his account in March or April 1987.

Mr. Johnston's claim that his representations were made in good faith based on his market experience is false. There was nothing unique about what he did which was to sell options and hope that the strike prices was such that the option holder would have no incentive to exercise the option. Mr. Johnston was no options expert. He had not developed a low risk way to trade options with returns of up to 20 percent. In fact, he admitted to fairly large losses in his personal accounts as the result of options trading prior to 1987 (Tr. 1945). Mr. Johnston's market experience of four years, 1981 - 1985, was no basis to give advice that contradicted the warnings of high risk contained in Dean Witter's literature and other options materials the firm circulated. The overwhelming evidence is that Mr. Johnston deliberately lied, and that his objective in conducting trades in the accounts was to benefit himself not his clients. In 1986 and 1987, Mr. Johnston's commissions totaled $672,845 and $855,137, and 70 percent and 78 percent, respectively, resulted from trading options.

I reject the opinion of Respondent's expert, Mr. Henry R. Ferguson, and his use of the Option Contract Index (OCI) to show that Mr. Johnston's trading was not excessive because Mr. Ferguson falsely assumed that all the data on the options application, including the customers' investment objectives as speculation and speculative income, were

true. Additionally, the Commission has noted serious limitations in the OCI (Division's Reply Brief 25). 9/

4. and 5. Unapproved and unauthorized and trading

Mr. Johnston violated the antifraud provisions of the securities statutes because he conducted unapproved trading, that is he traded options in accounts which were not properly set up to trade options and he employed unapproved trading strategies, and he conducted unauthorized trading, that is he opened new positions after customers directed him to close their accounts (Order Instituting Proceedings, July 18, 1991). Mr. Johnston continued trading options, and, in some cases, opened new positions in the Hyden, the Peterson, the Thomas, and the Nemser Estate accounts after Mr. Hyden, Dr. Peterson, Dr. Thomas and the attorney for the Nemser estate told him to close the accounts. In addition, Mr. Johnston opened new positions in Mrs. Nemser's account contrary to Mrs. Nemser's instructions in May 1987. 10/

The evidence is conclusive that these customers informed Mr. Johnston in unequivocal terms that they wanted to stop trading options. Only because Mr. Johnston advised that they would suffer financial losses if they stopped immediately did they agree that he should wind down the accounts. Mr. Johnston, however, ignored their instructions. He did not close the accounts in a reasonable time; instead he continued trading options and, in some cases, he opened new option positions (Tr. 536-43, 936-64, 1710-36).

Mr. Johnston violated these same antifraud provisions because he traded in the

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9/ The OCI is the number of options contracts opened for every thousand dollars of monthly equity.

10/ Mr. Ballou gave Mr. Johnston copies of his correspondence to Mrs. Nemser confirming her directives (Division Exhibits 39, 40; Tr. 1112-14).

account after Mrs. Nemser's death and the account was not approved for options trading. Dean Witter's option account documentation guide stated that NO OPTION TRADING is allowed in an estate account, and Mrs. Nemser's son, the executor of the Nemser Estate, did not sign an option agreement form, yet Mr. Johnston executed trades in the account from early July 1987, when Mrs. Nemser died, through October 1987 (Division Exhibit 125; Tr. 1000-04, 2706-07).

Mr. Johnston's claims that he did not know that Dean Witter's policy prohibited option trading in estate accounts or that an appropriate signed options form was not on file are unbelievable and unacceptable (Tr. 2205). I make this judgment based on a number of instances in the record where Mr. Johnston lied, and because it is unreasonable to believe that an account executive who specialized in options would be unaware of such basic information. In any event, if Mr. Johnston did not know, he should have known and he was grossly negligent in not knowing.

I reject Mr. Johnston's position that he did not engage in unauthorized trading because Mr. Hyden, Dr. Peterson, and Dr. Thomas ratified the trades at issue and that trading in Mrs. Nemser's account was in keeping with her instructions. Respondents acknowledge that a customer must have full knowledge of the facts to be able to ratify a broker's action (Johnston and O'Neal Reply Brief 54). These clients did not have that knowledge because they were unsophisticated about options. Mr. Johnston was "very persuasive", and he lied and omitted material information about his options strategy and about the time and type of trades necessary to wind down or withdraw from options trading (Tr. 528-30, 687, 930-49, 1250-62). When a customer lacks the skill or experience to interpret confirmation slips, monthly statements or other such documents, courts have generally refused to find that they relieve a broker of liability for its misconduct. Karlen v.

Ray E. Friedman & Co. Commodities, 688 F.2d 1193, 1198-1200 (8th Cir. 1982); See, Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 434-39 (N.D. Cal. 1968), modified on other grounds, 430 F.2d 1202 (9th Cir. 1970); Newkirk v. Hayden, Stone & Co., Fed. Sec. L. Rep. 1964-66 (CCH) ¶91,621 at 95,320-21 (S.D. Cal. 1965).

6. and 7. Material misrepresentations and omissions - account profitability, risks of option trading, margin calls, and hedging

(a) Profitability of customer accounts

The Division alleges that Mr. Johnston misrepresented material facts to customers about the profitability of their accounts in that he prepared and sent to SA&P, Gonzales, and Peterson monthly schedules of closed trades, which, among other things, failed to disclose the cost to close the open positions and unrealized losses in their accounts, and that he made oral misrepresentations to customers Dwyre and Gonzalez regarding the profitability of their accounts (Division Reply Brief 9).

I find that Mr. Johnston deliberately misled customers and omitted to disclose material information as to the profits and losses in their accounts. Mr. Johnston developed a Closed Trade Report which he and other account representatives on shared accounts sent to customers throughout the relevant period. 11/ The report showed profit (loss) on closed trades but did not disclose the unrealized profit or loss from the open option positions. Under Mr. Johnston's trading strategy, the customer's open option positions either expired, were exercised, or he bought them back. In early 1986, Dean Witter had Mr. Johnston add to the Closed Trade Report the following; "The attached statement does not reflect gains

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11/ I find that Mr. Johnston transmitted the reports and attachments even though he did not sign the cover letters that accompanied the reports that are in the record. Mr. Johnston developed the report and provided the option information, and on shared accounts he worked closely with the other account representative.

or losses in open positions and should not be considered a substitute for the regular monthly statement which Dean Witter provides." For reasons which are not clear on the record, Mr. Johnston and the account representatives he shared accounts with sent customers Closed Trade Reports in mid-1986 and in 1987 which did not contain the disclaimer (Division Exhibits 32, 51, 52).

Mr. Johnston falsely represented to customers that their accounts were profitable by preparing and giving customers: (1) Closed Trade Reports without making clear that the profits and losses shown did not consider open positions, (2) a copy of the printout from the computer screen display (Quotron) showing the open option positions with positive market values, when the values were negative or buy back costs since Mr. Johnston usually wrote or sold options, (3) materials which showed the "market value of securities held" without any reference to the impact closing open positions would have on the value shown, 12/ and (4) a list of open positions with the designation NA in the profit (loss) column. (Division Exhibits 32, 43A, 43B, 51-55; Tr. 586-89, 1056-58).

Mr. Johnston conveyed misleading information orally when he informed Ms. Dwyre that the market value of her account was $265,979, when this was the value of stocks and bonds in the account and did not consider the value of the open option positions (Tr. 2196).

I reject Respondents Johnston and O'Neal's requested findings of fact, numbers 188-91, because information about a customer's profit and loss is by its nature meaningful to the customer, the evidence is that customers did not know how to calculate the unrealized profits or losses, and even though the values of open positions changed from day to day a

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12/ The fact that an open option position is technically not a "security held" does not excuse the deception.

calculation around the date of the report would not, as Respondents contend, have been a meaningless number. The events of October 19, 1987, proved Respondents wrong that such a calculation was valueless because there was little likelihood that all open positions would be closed at once.

In making my determination, I did not consider the Division's calculations, made after the close of the hearing, which indicated that many of the accounts would have been in a negative position if the cost of closing the open positions had been considered. The Division should have introduced these calculations at the hearing so that it would be clear how they were derived and Respondents could have had an opportunity to respond orally.

(b) Risks of option trading

Mr. Johnston made false and misleading representations of material facts and omitted to disclose material information to customers - Burgess, Coale Trust, Dwyre, Gonzalez, Horn, Hyden, McAdam, Peterson, SA&P, Smith, and Thomas - that the option trading he conducted was a safe, conservative investment strategy involving minimum risk, that the accounts would have equity returns from 12 to 18 percent, and that losses would not occur in the account or that losses were limited to 20 percent of account equity. Mr. Johnston falsely represented to several customers - Burgess, Gonzalez, and Peterson - that he would limit the amount that they could lose to a particular dollar amount (Tr. 582-83, 661-62, 815-16, 1880-82). Mr. Johnston did not tell investors that they could lose all the equity in their account, and that investors with margin accounts could end up owing Dean Witter money.

(c) Margin

Mr. Johnston told his customers to disregard every margin call received prior to

October 19, 1987, and he represented that the calls were erroneous and the customers should not worry that Dean Witter had made mistakes which he would resolve. I find that Mr. Johnston, directly, and on occasion through the account representative with whom he shared the account, made material misrepresentations to customers Burgess, Dwyre, Gonzalez, Horn, Peterson, SA&P, and Thomas as to the reason for the calls they received from Dean Witter for additional funds or securities to be credited to their margin accounts, and he did not disclose that he disposed of assets in the accounts to satisfy those calls (Tr. 223-24, 464-68, 545-47, 565-66, 796-98, 815, 820-21, 870, 1061-62, 1260).

At the hearing Mr. Johnston continued to claim that all the margin calls prior to October 19, 1987, were erroneous for one of the following reasons: Dean Witter had failed to correctly price securities such as the customer's municipal bond holdings (Dwyre, Smith, and Gonzalez accounts); Dean Witter had failed to note the funds in the customer's Active Asset Account (Horn account); and deposits were unnecessary because of market changes which occurred within the three day period allowed to cover the call (Tr. 2001-22). Mr. Johnston insists that he never told a customer to disregard a valid margin call.

Mr. Johnston's position is unpersuasive because the only evidence that supports it is his testimony and this records demonstrates that he does not tell the truth. On the other hand, Mr. Johnston admits he sold open positions to meet margin calls, and the account records show that the following liquidations occurred to satisfy margin calls (Stipulation 3; Tr. 2029; Division Exhibits 158, 160).

Customer	Period	Number of liquidations
Dwyre	3/13/87-10/14/87	28
Gonzalez	6/9/87-10/1/87	13
Horn	12/5/85-7/23/87	26

Hyden	11/13/85-4/29/87	28
Nemser Estate	9/24/87-10/2/87	04
Peterson	8/28/86-10/16/87	27
SA&P	2/6/87-10/5/87	08

These liquidations demonstrate that Mr. Johnston lied and omitted material information to his customers when he told them all the margin calls received prior to October 19, 1987, were erroneous and did not disclose that he sold securities to satisfy margin requirements. Furthermore, the Division is correct that Mr. Johnston's omission to tell customers that he satisfied margin calls by selling shares of their Active Asset Accounts, i.e., money market funds, was a violation of the antifraud provisions of the federal securities statutes (Division Reply Brief 15 n.19).

(d) Hedging

Customers Hyden and Thomas directed Mr. Johnston to close their options accounts. Based on his representations that it would be costly to abruptly cease activity, they followed his advice and directed him to close the accounts by winding them down. Mr. Johnston did not follow these instructions; instead he continued trading as before and falsely represented that the new positions he opened were appropriate as hedging transactions (Tr. 945-46, 951-55, 966-70, 1249-51, 1258; Division Exhibits 18, 19, 21).

I reject Mr. Johnston's claim that his representations were accurate because buying combinations is a hedge, and adjustments to those combinations are hedging transactions (Johnston and O'Neal Reply Brief 42). This statement is true in the abstract but we are not considering what in the abstract is or is not a hedging transaction. The issue is the nature of certain transactions which Mr. Johnston initiated while he was under instructions

to close down these accounts. Mr. Hyden asked Mr. Johnston in September 1986 to close the account by the end of 1986 or the beginning of 1987. Mr. Johnston, under the guise of winding down, opened new positions in August 1987 (Tr. 969-70).

I accept the expert's opinions that winding down means to close out in orderly fashion, that opening new option positions is inconsistent with instructions to wind down, and that the many transactions in the Hyden account were not hedges (Tr. 1707, 1717-32). In addition, Mr. Johnston initiated transactions which he falsely represented were hedges in the Thomas account after Dr. Thomas directed him in mid-1986 to wind down the account (Tr. 1251). Dr. Thomas finally demanded in April or May 1987 that Mr. Johnston close the account immediately (Tr. 1255-58). For all these reasons, I find Mr. Johnston willfully made untrue statements of material fact to customers with respect to hedging transactions in violation of the antifraud provisions of the securities statutes.

Scienter

I find that Mr. Johnston acted with scienter with respect to all the antifraud violations detailed above because the evidence is overwhelming that he intended that investors rely on material information he knew or should have known was false and that he intentionally omitted to provide material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; that he deliberately engaged in a course of business which operated as a fraud or deceit on other persons; that he purposefully employed devices, schemes or artifices to defraud; and that he acted in a manner to deceive, manipulate, or defraud his customers or he acted with willful and reckless disregard for their interests. Aaron v. SEC, 446 U.S. 680, 690 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, n.12 (1976).

Mr. Johnston's impressive academic record and the opinions of his customers show him to be a smart, persuasive individual with an air of assurance that, together with his impressive Dean Witter title, caused people to believe his lies and misrepresentations about his options trading (Tr. 463, 534, 581, 810, 862, 1253, 2048-49). The record is filled with instances where Mr. Johnston lied to excuse his actions. For example, after Dean Witter suspended Mr. Johnston for 30 days in 1983 for guaranteeing clients against losses in their accounts, Mr. Turbeville, Dean Witter's Fort Worth Branch Manager, warned Mr. Johnston that

> You will, under no circumstances, enter an order without first visiting with the client. This is to say, there is to be no discretion taken in an account ever. . . Upon receipt of this you are acknowledging that should I become aware of any discrepancy in any compliance related area . . . you will be subject to termination without questions. (Division Exhibit 72) 13/

Mr. Johnston ignored this warning and continued to execute trades without first meeting with or even talking with clients.

Mr. Johnston's explanation that he thought Mr. Turbeville's warning applied only to his family accounts, and that he had established trading parameters with clients and knew they approved of his trades is just one of several bizarre rationalizations Mr. Johnston offered to justify his actions (Tr. 1985-86). The record contains no reasonable basis for Mr. Johnston's interpretation of Mr. Turbeville's memo, and Mr. Johnston did not seek clarification from Mr. Turbeville. In addition, his trading violated directions from customers, and Dean Witter's prohibition against discretionary trading in option accounts (Tr. 1976-

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13/ Mr. Tuberville believed Mr. Johnston lied in 1983 when he denied knowing that a New York Stock Exchange rule prohibited a registered representative from guaranteeing customers against losses in their accounts.

80, 1985-86). 14/ The same Dean Witter Compliance Bulletin issued in 1982 which sets out the latter prohibition also stated "[A]n order entered without first contacting a customer is contrary to firm policy", and "Firm policy does not permit an employee to exercise price or time discretion unless the account has been approved in writing for discretionary transactions." (Division Exhibit 161).

Further support for my conclusion that Mr. Johnston deliberately lied and schemed to cover his intentional fraudulent acts is that in early 1987 Mr. Johnston begged Dr. Thomas to keep his account open and offered to guaranty Doctor Thomas against future losses even though he knew it was illegal. For this reason, he refused to give Dr. Thomas a written guaranty but he offered to buy some of Dr. Thomas's interests in their joint business deals to accomplish the same result. Without Dr. Thomas's knowledge, Mr. Johnston deposited $35,000 or $50,000 in Dr. Thomas's account (Tr. 1255-56). Mr. Johnston denied he made these representations but Dr. Thomas had no reason to fabricate and I find his testimony persuasive.

Finally, the testimony of the numerous customers and Ms. Griffith is persuasive that Mr. Johnston, despite his denials, represented that he had developed a unique strategy for trading options that resulted in a conservative, low risk investment with returns of from 12

14/ Customers, whose answers on cross-examination and demeanor support my conclusion that their testimony was truthful, did not approve Mr. Johnston's trades because Mr. Johnston lied and omitted material facts and they lacked sufficient knowledge of options to give informed consent. Mr. Johnston admits that Dr. Thomas, his biggest account, was a novice in options even though he had considerable investments (Tr. 2059). In addition, some customers rarely talked with Mr. Johnston after they opened their accounts. Mrs. Coale, one of two trustees on the SA&P account and the owner of the Coale Trust account, never met or talked with Mr. Johnston (Tr. 495, 560, 861). Mr. Hyden directed Mr. Johnston to seek his prior approval before he conducted business in his account, and as discussed previously, trading was unauthorized where customers had directed Mr. Johnston to close their accounts.

to 18 percent, and that the risk was limited to 20 percent of the equity in the account, and that Mr. Johnston did not mention that investors could lose everything in the account and that those with margin accounts could become indebted to Dean Witter, as happened to several customers.

I reject Mr. Johnston's claims that he believed and had a good faith basis to believe the opinions and predictions he made to his customers (Johnston and O'Neal Reply Brief 37). It is preposterous that a registered representative with Mr. Johnston's academic credentials could make representations that were directly contrary to the accepted view about the riskiness of trading naked options without any scholarly basis for his position and claim he acted in good faith, i.e., he did not know any better.

Dean Witter required its sales people to give option customers materials which stated (Division Exhibit 122, 19-21);

> The writer of an uncovered call is in an extremely risky position, and may incur large losses if the value of the underlying interest increases above the exercise price. . . . The potential loss is unlimited. . . . Uncovered call option writing is thus suitable only for the knowledgeable investor who understands the risks, has the financial capacity and willingness to incur potentially large losses, and has sufficient liquid assets to meet applicable margin requirements.
>
> [A] requisite for writing puts is the financial capacity and liquidity to meet margin requirements and to buy the underlying interest in the event that the option is exercised. . . . Since exercise will ordinarily occur only if the market price of the underlying interest is below the exercise price of the option, the put writer can be expected to pay more for the underlying interest upon exercise than its current value (Division Exhibit 122, 20).
>
> The writing (selling) of puts . . . combinations is not for everyone. It is not an appropriate strategy for the novice or casual investor. Neither is it appropriate for the individual who lacks the time or temperament to pay close and continuing attention to his investments. Nor for the individual who fails to recognize the risks that any given investment involves.

Mr. Johnston's representations were directly contrary to this advice. His trading practices were not unique and did not eliminate the risks described above. 15/

The only evidence that supports Mr. Johnston's claim that he acted in good faith are his self-serving statements. I accord little validity to these assertions because the compelling evidence is that Mr. Johnston does not tell the truth and intended to deceive.

Mr. Ballou's Violations - Antifraud Provisions

Mr. Ballou was a registered representative at Dean Witter's Fort Worth office from 1983 until November 11, 1987. Mr. Ballou earned $16,893 from trading covered options in 1985. Mr. Ballou's commissions from options increased to $60,486 in 1986 and $79,647 in 1987 after several of his clients - the Coale Trust, Nemser, Peterson, and SA&P (Mr. Ballou's accounts for this discussion) - followed his recommendation and opened options accounts on which he and Mr. Johnston shared commissions. 16/ In the first quarter of 1987, Dean Witter named Mr. Ballou an Associate Vice President, Investments.

On July 18, 1991, Mr. Ballou accepted a sanction barring him from association with any broker, dealer, investment company, investment adviser or municipal securities dealer, provided that, after three years, he may reapply to become associated in a non-supervisory, non-proprietary capacity. Mr. Ballou neither admitted nor denied the Commission's findings that were the basis for the sanction - that he willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 by fraudulent activities

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15/ The experts on both sides differed about how to characterize the transactions but none of the experts found anything unique about the strategy employed.

16/ Mr. Ballou's total commissions in those two years were $230,845 and $266,323, respectively (Division Exhibit 77).

in the accounts he shared with Mr. Johnston. Roger William Ballou, Securities Exchange Act Release No. 29448, 49 SEC Docket 0584 (July 18, 1991).

I have treated the allegations against Mr. Ballou, which are the same as those in the administrative proceeding, seriatim as they appear in the Order Instituting Proceedings. Mr. Ballou testified at the hearing.

I find that Mr. Ballou in the period February 1986 to October 1987, willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 in that, in connection with the offer, purchase and sale of securities and by using the means of interstate commerce and the mails, he employed devices, schemes or artifices to defraud; he obtained money by lying about material facts and omitting to disclose material information; and he engaged in acts, practices, and course of business which operated as a fraud or deceit upon other persons.

1. Option agreement forms

The persuasive evidence is that Mr. Ballou willfully violated the antifraud provisions of the securities statutes because he, along with Mr. Johnston, deliberately had customers sign blank option agreements on which he and Mr. Johnston fraudulently checked speculation and speculative income as investment objectives. Mr. Ballou knew that Mr. Willis and Mrs. Coale, trustees of the SA&P employee pension account, wanted the plan's funds in safe investments. Mr. Ballou knew the trustees were unsophisticated investors who trusted him and depended on him for investment advice. Mr. Ballou misrepresented to the trustees that Mr. Johnston's option strategy was a safe, low risk investment in which many retirement funds participated, and he arranged to have the legal documents prepared for the trustees to allow the fund to open an account with Mr. Johnston in 1985-86 to trade

uncovered options. 17/ The trustees never agreed to uncovered option trading because they received false information about Mr. Johnston's trading practices and they were not given information that they needed to make an informed judgment. Mr. Ballou falsely claims that all his customers either filled in and signed their option agreement forms or signed a form that was filled out with their answers (Compare Tr. 530, 564, 1048-49, 1077-90 with Tr. 1124).

Mr. Ballou prepared the option client information form for the Caroline Nemser Estate, Michael Nemser Executor, which contained erroneous information and gave it to Mr. Nemser for his signature in August 1987. Mr. Nemser was unemployed and had been employed in sales, yet the form shows his occupation as personal investments; he had no prior options experience but the form shows option experience since 1984; and the age and marital status are correct for Mr. Nemser but the financial data reflect the estate's substantial assets. 18/ Mr. Nemser did not sign the form, however, Mr. Ballou and Mr. Johnston continued trading in the account after Mrs. Nemser's death.

2. Unsuitable transactions

Mr. Ballou willfully violated the antifraud provisions of the securities statutes because he actively participated with Mr. Johnston in unsuitable option trading in the Coale Trust,

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17/ Prior to answering a Dean Witter advertisement, SA&P funds had been in certificates of deposit. The trustees signed their first option agreement with Dean Witter in 1984. Mr. Ballou was the registered representative and the form listed income as the investment objective and covered call writing as the only anticipated type of option transaction. The later option agreement forms signed in 1985 and 1986 that authorized trading in naked options are the ones at issue.

18/ Mrs. Nemser's will left half her estate to Mr. Nemser and half to a trust for a grandson.

Nemser Estate, and SA&P accounts. 19/ Trading uncovered options in these accounts was unsuitable because Mrs. Coale for the Coale Trust account and Mrs. Coale and Mr. Willis, trustees of the SA&P pension plan, told Mr. Ballou they wanted safe investments 20/; Mr. Ballou and Mr. Johnston had fraudulently indicated that speculation/aggressive income, speculation, and/or speculative income as the accounts' investment objectives; and Dean Witter prohibited option trading in estate accounts and limited trust accounts and pension sharing accounts to cash trades (Division Exhibit 125).

3. Excessive trading

Excessive trading is trading that is not required to satisfy the customer's investment objectives. I find that Mr. Ballou controlled trading in the Coale Trust, Nemser Estate, Peterson, and SA&P accounts with Mr. Johnston, that trading in these accounts was excessive, that Mr. Ballou acted with scienter, and that his actions violated the antifraud provisions of the securities statutes. Miley v. Oppenheimer & Co., 637 F.2d 318, 324 (5th Cir. 1981)

Mr. Ballou considered himself an expert in trading options. "I never met a single client that was able to comprehend it as fully as I understood it, because it was an extremely complex issue." (Tr. 1133) Mr. Ballou and Mr. Johnston shared responsibility for these accounts, and they had de facto control since they exercised their independent judgment as to trades and did not consult with the customers in advance, with the possible

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19/ The Division does not charge Mr. Ballou with unsuitable trading in the Peterson account. (Division's Initial Brief 26)

20/ All trading in the Nemser account after Mrs. Nemser's death on July 2, 1987, was unauthorized because Mr. Nemser the executor of the estate did not sign the option agreement form. Mr. Ballou, the account executives who gave Mr. Nemser the form, knew or should have known this.

exception of Mrs. Nemser. In correspondence to Mrs. Nemser, Mr. Ballou left no doubt that he was involved in trading; "[I] will be eliminating all existing option positions relating to Tandy stock. . . [I] will continue to write covered calls and hedging positions until the stock prices move to a reasonable level at which time I will sell them." (Division Exhibit 40)

These customers never gave informed consent to trade naked options. Mr. Ballou and Mr. Johnston misrepresented that the customers' investment objectives were speculative. Since the transactions were not warranted under the customers' true investment objectives, and since Mr. Ballou acted willfully with full knowledge of the facts, it follows that Mr. Ballou excessively traded in the account and thereby violated the antifraud provisions of the securities statutes.

The prior finding is determinative of this issue but the same result is reached in an alternative manner. The CMEF or the commissions and other costs in the Peterson and SA&P accounts amounted to 22.5 and 23.3 percent on average monthly equity, respectively (Division Exhibits 141 and 162). To benefit the customer, trades would have to earn returns greater than these percentages which was highly unlikely. Furthermore, Dean Witter transferred the assets in Mrs. Nemser's account to an account in the name of Estate of Carolyn P. Nemser, Michael Nemser, Executor on September 14, 1987, over two months after Mrs. Nemser died. That account remained open and Mr. Ballou and Mr. Johnston continued trading through October 19, 1987. Dean Witter's policy did not allow trading naked options in the Nemser account after Mrs. Nemser's death. Trading was unauthorized and unsuited to the preservation of assets pending distribution which is the purpose of an estate account (Division Exhibit 125; Tr. 1702).

4. and 5. Unauthorized and unapproved trading

Mr. Ballou wrote to Mrs. Nemser not long before her death:

> May 20, 1987
>
> I very much appreciate your telephone call earlier today. Both Eric and I have been very concerned about you.
> Now that we have reacquired most of the Tandy stock we will be limiting the scope of the trading activity in your account as you have requested. Our objective will be the elimination of all option positions on a timely and prudent basis while giving due consideration to our profit objectives.
>
> June 25, 1987
>
> It was good to visit with you and Michael yesterday. . .
> I would like to confirm to you that I will be eliminating all existing option positions relating to Tandy stock with an objective of achieving a reasonable profit in each position, where possible, while not letting the currently held stock be called away. The majority of positions expire in July so they will be closed by July 17th. (Division Exhibits 39 and 40)

Mr. Ballou and Mr. Johnston conducted high volume trading in the Nemser account from its opening in June 1985, until the assets were transferred to the Estate account in September, and in the Estate account through October 1987 (Division Exhibits 104-115). Mr. Ballou could not explain how the opening trades that occurred on July 1, 1987, and July 17, 1987, after Mrs. Nemser's death, were consistent with Mrs. Nemser's instructions (Tr. 1169-72).

I agree with the Division's expert, that the high volume of trades and new option positions in Tandy that occurred after June 25, 1987, were inconsistent with Mrs. Nemser's instructions referred to in the quoted portion of Mr. Ballou's letters (Tr. 1732-36). I am persuaded that Mrs. Nemser wanted to eliminate her option positions. Mr. Ballou recalled that Mrs. Nemser's directions did not change, and it is reasonable that someone facing

imminent death would want to eliminate options in their account where neither the estate executor nor the legal representative had options experience (Tr. 997, 1168, 2708). Nothing in the record supports Mr. Johnston's claim that Mrs. Nemser told him in a phone conversation not to wind down the account.

Mr. Ballou had no authority to trade in the account after Mrs. Nemser's death on July 2, 1987, so that all the trades in Mrs. Nemser's account after her death and in the estate account Dean Witter established in September 1987 were unapproved.

On September 28, 1997, Dr. Peterson told Mr. Ballou absolutely not to open any new positions, hedging or otherwise. When he received his monthly statement, Dr. Peterson learned that Mr. Ballou and Mr. Johnston had opened new positions in his account on September 30, October 14 and 16, 1987 (Tr. 684-88).

For all these reasons, I find that Mr. Ballou willfully violated the antifraud provisions of the securities statutes as alleged because he, along with Mr. Johnston, conducted unapproved and unauthorized trading in the Nemser account, the Nemser Estate account, and the Peterson account.

6. and 7. Material misrepresentations and omissions - account profitability, risks of option trading, margin calls, and hedging

Mr. Ballou violated the antifraud provisions of the securities statutes by misrepresenting material facts and failing to disclose material information in the following areas:

(a) Profitability of customer accounts

Mr. Ballou misrepresented the profitability of the accounts he shared with Mr. Johnston because he gave clients Closed Trade Reports without disclosing that the reports did not consider unrealized profits or losses in open option positions. Even after Dean

Witter required that the reports state that they were not a substitute for the customer's monthly statement, Mr. Ballou sent out a report which did not contain the warning (Division Exhibit 32).

In addition, Mr. Ballou sent a letter with the Closed Trade Reports which contained a value for a line item "Market value of securities." The value accorded this item did not consider the financial impact of open option positions. However, customers did not know this and received the false impression that the market value of securities held represented the value of their account when, in fact, the account value depended on the disposition of the open positions (Tr. 1056-57).

I reject Respondents' exculpatory arguments. The omitted information was material and meaningful because people make investment decisions based on profit and loss, and information as to what the impact would be to close the open option positions at market prices would provide a reasonable estimate of the account's profit or loss position. Respondents are wrong that customers were able to calculate the value of open positions for themselves. Customers did not understand the open positions, and they did not understand why the the various statements and reports they received showed different values for their accounts (Tr. 535-36). Finally, during the relevant time period not all the Closed Trade Reports reminded customers to review their account statements.

(b) Risks of trading naked options

Mr. Ballou violated the antifraud provisions of the securities statutes because he willfully made false statements and omitted to disclose material information so that customers would open, and Dean Witter would approve, option accounts on accounts he shared with Mr. Johnston. As an experienced securities professional, Mr. Ballou knew or

should have known that Mr. Johnston's trading strategy was not conservative, low risk, or unique, and losses were not limited to a maximum of 20 percent of account equity, and that it was a material omission not to tell customers that trading naked options was highly speculative, that the use of margin could result in losses greater than the equity in the account, and customers could end up owing money to Dean Witter.

By making false representations and omitting material information, Mr. Ballou convinced Mrs. Coale, a 76 year old widow, whose investment objective was safety, that trading uncovered options with Mr. Johnston was a safe investment for the life savings Mrs. Coale had in trust for her daughter, a diabetic. The option agreement was not filled out when Mrs. Coale signed it. It falsely represented that her investment objectives were aggressive income and speculation, and that she had experience in trading commodities. When Mrs. Coale told Mr. Ballou that she did not understand options, he assured her "Not to worry about it. It was being taken care of." (Tr. 566) Mrs. Coale lost the entire equity in her account, $268,000, and ended up owing Dean Witter money (Tr. 569).

(c) Margin calls

The evidence is persuasive that Mr. Ballou and Mr. Johnston liquidated assets in the Coale Trust, Nemser Estate, Peterson, and SA&P accounts prior to October 19, 1987, to satisfy margin calls (See findings as to Mr. Johnston's material misrepresentations and omissions; Division Exhibits 158, 160). Mr. Ballou violated the antifraud provisions because he knew or should have know how margin calls were being met, and he made material misrepresentations by advising customers that all the margin calls they received prior to October 19, 1987, were mistakes caused by bookkeeping error and they should ignore them, and he omitted material information when he failed to explain to customers the significance

of the calls and how they would be resolved (Tr. 545-47, 565-66, 1061-63).

(d) Hedging

Mr. Ballou became Dr. Peterson's account representative in 1983. At Mr. Ballou's recommendation, Dr. Peterson opened an account with Mr. Johnston and Mr. Ballou in January 1986. Dr. Peterson became uneasy about the account in early 1987, and directed Mr. Ballou to limit trading and to wind the account down. Instead trading increased. In June 1987, Dr. Peterson demanded that Mr. Ballou and Mr. Johnston stop trading in the account. Mr. Ballou promised on a number of occasions to close the account by a date certain. When Dr. Peterson questioned why trading in the account continued, Mr. Ballou said it was necessary to wind the account down in orderly fashion and represented that the positions taken were hedging transactions (Tr. 665-68). Dr. Peterson concluded that Mr. Ballou was flagrantly violating his instructions and confronted him on September 28, 1987. Even when faced with evidence of increased activity in the account, Mr. Ballou insisted that he and Mr. Johnston were winding down the account (Tr. 540-45).

The Division's expert is correct that opening new option positions, which happened in the Peterson account, was inconsistent with instructions to close down the account, and that initiating naked calls and puts is not hedging but speculation (Tr. 1707, 1712-13). I find that Mr. Ballou acted to deceive and to defraud Dr. Peterson by willfully misrepresenting transactions which he and Mr. Johnston executed in the Peterson account as hedging transactions.

Scienter

Mr. Ballou earned a business degree from Northeastern University in 1964. He understood Mr. Johnston's options trading and the risks involved, and prior to sharing

accounts with Mr. Johnston he had a mediocre performance in option trading. Mr. Ballou communicated often with his customers about the status of their accounts. Customers trusted him, and he lied to them to suit his purposes. Two glaring example of Mr. Ballou's perfidy are (1) his claim that his clients understood options and were able to make responsible investment decisions after he educated them for 30 minutes to an hour, and (2) convincing Mrs. Coale, a businesswoman in her mid-seventies with minimal formal education who told him she did not understand options, that trading naked options was a safe investment for her life savings ($268,000) in trust for her daughter.

Based on these facts, and my observation of Mr. Ballou, I conclude that Mr. Ballou acted with scienter when he committed these antifraud violations in that he intended that people rely on what he knew or should have known were fraudulent words and actions (Tr. 1133, 1160). Aaron v. SEC, 446 U.S. 680, 690 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, n.12 (1976).

Ms. Griffith's Violations - Antifraud Provisions

I find that Ms. Griffith willfully violated the antifraud provisions of the securities statutes because in connection with the offer, purchase, and sale of securities, using communications in interstate commerce, she employed devices, schemes or artifices to defraud; she obtained money by means of untrue statements of material fact and she omitted to disclose material information; and she engaged in acts, practices, or course of business which operated as a fraud or deceit upon other persons.

Disposition of the allegations as they appear in the Order Instituting Proceedings follows:

1. Option agreement forms

Mr. and Mrs. Gonzalez and Mr. Burgess gave persuasive testimony that Ms. Griffith with Mr. Johnston misrepresented that the Gonzalezes had prior option experience and their investment objectives, in order of priority, were one investment hedge, and two speculation, and that Mr. Burgess's investment objectives were one speculation, and two aggressive income (Tr. 793-94 867; Division Exhibits 46, 48). 21/

Mrs. McAdam signed an options agreement form that Ms. Griffith filled out and sent her which falsely represented that Mrs. McAdam had prior options experience, no dependents, worked as an investor, and that her number one objective was speculation. Mrs. McAdam, Ms. Griffith's aunt, had graduated high school and had taken some college courses. She had no prior options experience, and was unemployed with two dependents.

Furthermore, customers could not have agreed to the investment objectives shown on their applications because they did not understand options, and Ms. Griffith and Mr. Johnston misrepresented the very risky nature of trading naked options and falsely represented that losses were limited. Ms. Griffith acknowledged that Mr. Johnston filled in the investment objectives on Mr. Burgess's form, and that Mr. Burgess did not understand Mr. Johnston's options strategy (Tr. 1846-47, 1913).

In addition, it would have been out of character for these customers to have agreed to speculate with the principal in their account when the Gonzalez's prior investments were all conservative, and Mr. Burgess moved his account to Dean Witter because he was very upset at losing $2,700 on options with another broker-dealer.

The key misrepresentation on the form was the customer's investment objectives because the types of option trading that occured had to be compatible with the client's

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21/ Customers McAdam and Jez did not testify. Mrs. McAdam opened an account by signing a form that Ms. Griffith sent to her.

objectives. Mr. Johnston's strategy of writing naked options and buying puts and calls required that a customer have speculative investment objectives.

Ms. Griffith willfully violated the antifraud provisions of the securities statutes by falsifying information on the option agreement forms of customers - Burgess, Gonzalez, and McAdam - so that the accounts would be approved for trading naked options. Ms. Griffith shared commissions on trades in these accounts.

2. Unsuitable transactions

Ms. Griffith willfully violated the antifraud provisions of the securities statutes because she traded naked options in the Burgess, Gonzalez, and McAdam accounts when she knew it was not in the best interests of these customers to do so. 22/ Ms. Griffith knew that the Burgesses and Gonzalezes did not want to speculate in high risk investments. In addition, she knew Mr. Burgess was unsuited for option trading because he did not understand Mr. Johnston's strategy, he was always excited about the latest-greatest deal but he was unwilling to lose money, he knew very little about the securities markets, and he believed misrepresentations that the most he could lose was 20 percent of his equity (Tr. 1846-47, 1880-81, 1887). The Gonzalezes were unsuited because they believed misrepresentations that trading options would provide supplemental income to their investment portfolio, and that their liability was limited to $20,000. Mrs. McAdam's income was $5,000 below Dean Witter's minimum income requirement. This fact and her overall financial, personal, and educational situation, as well as her lack of option experience made

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22/ Ms. Griffith cannot avoid responsibility by claiming that Mr. Johnston alone was responsible for the trades. She and Mr. Johnston shared commissions on the trades in these shared accounts, she communicated with these customers about trades and other matters, and she explained the trading activity to them. (Tr. 1847-48, 1933-34).

her unsuited for trading naked options. Ms. Griffith's justification for finding Mrs. McAdam suitable, i.e., if she did not trade options with Ms. Griffith she would have traded them elsewhere is unacceptable (Tr. 1931-32).

3. Excessive trading

Trading that was not reasonably necessary to achieve a customer's investment objectives is excessive (Tr. 1643-44). I find that Ms. Griffith violated the antifraud provisions of the securities statutes because, with Mr. Johnston, she controlled trading in the Burgess and Gonzalez accounts, trading in these accounts was excessive, and Ms. Griffith acted with scienter (Tr. 1702-04). Miley v. Oppenheimer & Co., 637 F.2d 318, 324 (5th Cir. 1981)

I reject Respondent's claim that she is not responsible for excessive trading. Ms. Griffith and Mr. Johnston exercised de facto control over the Burgesses and Gonzalezes accounts. Neither customer directed trading, and neither was consulted before trades were made. As registered representatives on the accounts, Ms. Griffith and Mr. Johnston shared the commissions from trades in the account, and it follows that they share responsibility for what occurred in the accounts.

Mr. Burgess and Mr. Gonzalez did not give informed consent to trade high risk naked options because Ms. Griffith and Mr. Johnston misrepresented their activities as a conservative, low risk investment strategy. Moreover, Mr. Johnston and Ms. Griffith misrepresented that these customers would only put a portion of their equity at risk (Tr. 1880-82). Inasmuch as the customers did not agree to speculative investment strategies, trading in the accounts was excessive and the concomitant risks and costs were unwarranted.

Another indication that trading was excessive was that the annualized CMEF for the Gonzalez and Burgess accounts was 19.9 percent and 13.3 percent, respectively, and it was highly unlikely that trades would make a profit for the customer by earning higher returns (Division Exhibit 162).

4. Material misrepresentations and omissions - account profitability, risks of option trading, and margin calls

(a) Account profitability

Ms. Griffith violated the antifraud statutes and regulations because she sent the Gonzalezes five Closed Trade Reports along with Quotron machine printouts in 1987, which misrepresented the value of the account, and omitted to disclose or describe how disposition of the open positions would impact on the value of the account (Division Exhibits 51-55). 23/

The misrepresentations occurred because all the Closed Trade Reports showed the status of the account without considering possible gains or losses in open positions, and two reports did not contain the required disclaimer that customers should not consider the Closed Trade Reports a substitute for their monthly statements. It was misleading for all five reports to include the premiums received for opening positions in profits and not to estimate the results of closing open positions where Mr. Johnaton's strategy was to sell options, especially naked options. The Quotron printout that accompanied all five Closed

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23/ I do not accept as fact the Division's conclusion that closing the open option positions would result in an unrealized loss in the open positions of $1,512 in the report sent in April, an unrealized loss of $1,806 in the report sent in June, an unrealized loss of $422 in the report sent in September, and an unrealized loss of at least $2,256 in the report sent in October. The calculations are not in evidence and Respondents did not have an opportunity to examine them and to respond (Division's Proposed Findings of Fact, numbers 215, 216, 218, 219).

Trade Reports was misleading in that it assigned positive values for the market value of open positions when many of these were negative numbers (Tr. 1917-19; Compare values on the second sheet of Division Exhibit 51 with those in Exhibit 50, April statement). Mrs. Gonzalez believed the reports showed that the account was profitable even though Ms. Griffith told her that the Closed Trade Reports did not include open positions (Tr. 585, 588-89, 602-04).

(b) Risks of option trading

Ms. Griffith violated the antifraud provisions of the securities statutes because of her material misrepresentations and omissions on this subject. Ms. Griffith's excuse that her actions were not fraudulent because she merely repeated what Mr. Johnston said is invalid on its face. She held herself out as a registered representative and is responsible for her actions.

The Burgesses and Gonzalezes agreed to open accounts based on false statements and material omissions that occurred at meetings Ms. Griffith arranged and attended. As one of the registered representatives on the account, Ms. Griffith was required to do more than act like a potted plant when Mr. Johnston misrepresented to the Gonzalezes that he had a safe way to trade options, that the risk was limited to 20 percent of principal 24/, that returns would be from 12 to 18 percent, and when he failed to inform them that trading naked options was a high risk strategy and that they could lose all their principal and become indebted to Dean Witter by trading on margin. The Gonzalezes lost their entire equity and ended up owing Dean Witter money (Tr. 592).

24/ Ms. Griffith's believed that "theoretically" customers could lose all their investment and more, but that practically Mr. Johnston could limit losses by closing positions (Compare Tr. 1893, 1901-02).

Ms. Griffith shares responsibility for this fraudulent information and material omissions just as she shared in the commissions earned from transactions in the accounts. Even though Mr. Johnston conducted the briefing, Ms. Griffith's presence, her acquiescence, and her recommendation that they open accounts indicated that she agreed with what was said and that she believed that customers had the material information they needed to make an informed decision. Independently, Ms. Griffith misrepresented to Mr. Gonzalez that she would limit his risk exposure to $20,000 (Tr. 797-98).

(c) Margin calls

Ms. Griffith violated the antifraud provisions of the securities statutes by falsely representing to Mr. Burgess and Mr. Gonzalez that the margin calls they received were caused by computer error, by instructing Mr. Burgess to ignore a margin call and the Gonzalezes to ignore some 18 margin calls, and by not informing these customers that assets in their accounts would be liquidated if they did not respond to the calls (Tr. 589-90, 796-97, 906). To satisfy margin calls, Dean Witter liquidated assets in the Burgess account in October 1987, and liquidated assets approximately 13 times in the Gonzalez's account between June 12 and October 26, 1987 (Division Exhibits 158, 160).

Scienter

Ms. Griffith is a college educated licensed security professional. Based on her education and training, the Dean Witter in-house materials describing option accounts, and the information about options contained in booklets which Dean Witter required that option customers receive, Ms. Griffith knew or should have known that the information she provided customers was false and misleading and that she had omitted to disclose to customers material information about options trading; she deliberately engaged in a course

of business which operated as a fraud or deceit on other persons; she purposefully employed devices, schemes or artifices to defraud; and she acted intentionally in a manner to deceive, manipulate, or defraud, or with willful and reckless disregard for her customers' interests. Aaron v. SEC, 446 U.S. 680, 690 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, n.12 (1976).

Ms. Griffith cannot escape liability by claiming she believed Mr. Johnston was telling the truth, and that she relied on him, Mr. O'Neal, and Dean Witter's Compliance Department. As one of the account representatives who benefited from trading in these accounts, she cannot avoid personal responsibility by blaming others for her actions. In addition, not everyone at Dean Witter's Fort Worth office approved of Mr. Johnston's option trading activities. Mr. Wilson, the Assistant Branch Manager, was so concerned about the frequency of Mr. Johnston's trades that he sought a legal opinion on whether he might be liable if things went awry (Tr. 1187). Mr. Wilson left Dean Witter on September 30, 1987, in part, because he did not want to be included in any adverse publicity that Mr. Johnston might cause Dean Witter's Fort Worth office. (Tr. 1198-1200). Mr. Wilson's concerns were based in part on the fact that he initialed Mr. Johnston's order tickets. He did not tell Ms. Griffith of his concerns, however, Ms. Griffith knew firsthand how Mr. Johnston operated.

Mr. Shah's Violations - Antifraud Provisions

Mr. Shah was a registered representative in Dean Witter's Fort Worth office from about June 1986 to about October 1987. In this period, Mr. Shah was the sole account representative on the accounts of Dr. Navin C. Parikh, Dr. Navin T. Parekh, and Dr.

Dinesh Parmar. 25/ These three physicians knew little about securities and nothing about options. Doctors Parikh and Parekh opened accounts with Mr. Shah because he was of the same national origin and they knew him socially. Dr. Parmar transferred his accounts from Merrill Lynch to Dean Witter because Mr. Shah promised higher returns on conservative investments. These customers trusted Mr. Shah to follow their instructions.

On July 18, 1991, the Commission accepted a settlement from Mr. Shah in which he consented to be barred from association with any broker, dealer, investment company, investment adviser or municipal securities dealer based on findings, which he neither admitted nor denied, that he willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5. Prakash Rameshchandra Shah, Securities Exchange Act Release No. 29449, 49 SEC Docket 0587 (July 18, 1991).

The Division alleges that from about June 1986 to October 1987, Mr. Shah violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by the same conduct which was the basis of the Commission's findings in the July 1991, Order Instituting Proceedings, Making Findings, and Imposing Remedial Sanctions.

I find that Mr. Shah willfully violated the antifraud provisions of the securities statutes because in connection with the offer, purchase, and sale of securities, using communications in interstate commerce, he made false statements and omitted to disclose material information; he employed schemes to defraud; he obtained money by means of

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25/ Doctors Parikh and Parekh set up their accounts in 1985 when Mr. Shah was located in upstate New York. Evidently Mr. Shah was not yet a registered representative because he handled the accounts using a power of attorney and another registered representative. In June 1986, Mr. Shah returned to Fort Worth and became the registered representative on the accounts. At all times, the customers followed Mr. Shah's directions.

untrue statements of material fact and he omitted to state material facts; and he engaged in acts, practices, or course of business which operated as a fraud upon other persons.

I have treated the allegations against Mr. Shah seriatim as they appear in the Order Instituting Proceedings against these Respondents. Mr. Shah did not testify at the hearing, and was not represented. The parties agreed that, if called, Mr. Shah would refuse to testify.

1. Unsuitable transactions

Mr. Shah violated the antifraud provisions of the securities statutes by buying and selling options in these three accounts. He willfully engaged in a high risk trading strategy which he knew or should have known was not in his customers' best interests because: (1) they told him to pursue conservative investment objectives, (2) their prior investments had been in conservative instruments, (3) they were unsophisticated about investments and did not understand options at all, 26/ (4) Dr. Parikh's total retirement savings were unsuited for trading naked options and Dean Witter prohibited this kind of trading in an Individual Retirement Account (IRA) account (Division Exhibit 84, Bates stamp 264), 27/ and (5) Dr. Parmar's account with his company's pension plan proceeds was unsuited for trading naked options.

Dr. Parikh's IRA contained his life savings of about $280,000 (Tr. 694-95). He was 52 years of age when he opened the account and the funds represented his accumulated pension savings. Dr. Parikh's option client information form shows income as his

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26/ These two elements are among Dean Witter's essential facts in a statement of suitability guidelines (Division Exhibit 131).

27/ Mr. O'Neal told Dr. Parikh that Mr. Shah acted illegally by trading naked options in an IRA (Tr. 698).

investment objective and authorized covered call writing only. Dr. Parikh told Mr. Shah he wanted conservative investments. Mr. Shah's option trading wiped out the balance in Dr. Parikh's account. By the first week in October 1987, Dr. Parikh owed Dean Witter $22,000, and his October 30, 1987, statement indicated a $189,675 debit balance (Tr. 697; Division Exhibit 64).

In December 1985, Dr. Parekh invested $55,000 and gave Mr. Shah power of attorney over an options account. Dr. Parekh's option client agreement form erroneously lists speculation, speculative income, income, and investment hedge as investment objectives and authorized all types of option trading. Dr. Parekh told Mr. Shah he wanted conservative investments such as safe stocks with good returns.

Dr. Parmar opened a profit sharing account and a money purchase pension plan account for his medical corporation to benefit him and his employees. The accounts contained his life savings of $217,897 - $136,593 in the profit sharing and $81,304 in the pension account (Tr. 739-40; Division Exhibits 66, 68). Dr. Parmar's option client information form lists income and investment hedge as his investment objectives, and authorized covered call writing only. At Mr. Shah's direction, Dr. Parmar signed and returned blank forms to Mr. Shah. Dr. Parmar told Mr. Shah he wanted conservative investments for his retirement funds; Mr. Shah told him he could earn at least 15 percent on such investments, and that he would be personally responsible for any losses. Dr. Parmar received $54,000 when he liquidated his accounts (Tr. 752).

2. Excessive trading

As noted previously, a finding of excessive trading is appropriate when the account executive controlled the account, he or she traded excessively in light of the customer's

investment objectives, and he or she did so with scienter. Miley v. Oppenheimer & Co., 637 F.2d 318, 324 (5th Cir. 1981); Mihara v. Dean Witter & Co., 619 F.2d 814, 820 (9th Cir. 1980); Shad v. Dean Witter Reynolds Inc., 799 F.2d 525, 529 (9th Cir. 1986).

Mr. Shah exercised de facto control in these accounts. Customers did not initiate any trades; Mr. Shah initiated all the trades on his own. These customers trusted him as a friend and relied on him completely since they did not understand what was involved. Mr. Shah violated the antifraud provisions of the securities statutes because he knew his customers wanted, and, some of their accounts required, safe investments, yet he disregarded their best interests and investment objectives and engaged in high risk trades to earn commissions.

In addition, the annualized cost equity factor, the return on average net equity needed to cover broker-dealer costs and other expenses, was 94.6 percent for Dr. Parekh's account, 32.9 percent for Dr. Parikh's account, and 11.29 percent for Dr. Parmar's account (Division Exhibits 141, 162). Mr. Shah did not conduct transactions to benefit customers because there was no likelihood that transactions in the first two accounts would earn returns higher than these percentages, and there was very little likelihood that transactions in the third account would earn more than 11.9 percent.

3. Unauthorized trading

Mr. Shah violated the antifraud provisions of the securities statutes because after Dr. Parekh instructed him to liquidate his options account in early 1987, he continued to trade options in the account at least through August 1987 (Tr. 724; Division Exhibit 61). Mr. Shah admitted to the Chicago Board of Trade that he engaged in unauthorized trading (Division Exhibit 84, Bates stamp 264).

4. Unapproved trading

Mr. Shah violated the antifraud provisions of the securities statutes by selling naked options in Dr. Parikh's and Dr. Parmar's accounts without their approval (Tr. 1637; Division Exhibits 64 and 68). Neither doctor authorized Mr. Shah to buy and sell naked options, and their option agreements specify covered options only. Neither doctor directed Mr. Shah to execute specific trades. Mr. Shah did not have discretionary authority to conduct transactions in the accounts without customer approval, however, Mr. Shah did not seek and receive approval before he executed transactions. In addition, Dr. Parmar had directed Mr. Shah not to invest in any investments without discussing it with him first (Division Exhibit 69).

5. and 6. Material misrepresentations and omissions - account profitability, risks of option trading, and kind of assets purchased

Mr. Shah violated the antifraud provisions of the securities statutes by making false representations to Dr. Parikh, Dr. Parekh, and Dr. Parmar about the risks of option trading and the value and contents of their accounts, and failing to disclose material information to these customers.

In the summer of 1987, Dr. Parikh became concerned when his monthly statement showed a declining account balance. Mr. Shah falsely told Dr. Parikh that his account contained additional assets, including gold stocks, that were not included in his monthly statement (Tr. 696).

In early 1987, Dr. Parekh found out from a third person who reviewed his monthly statements that his account did not consist of conservative investments and was not earning 13 or 20 percent as Mr. Shah represented (Tr. 723-24). Based on this information, Dr.

Parekh directed Mr. Shah to liquidate positions in the account and put the proceeds into Ginnie Mae certificates. It took Dr. Parekh several months to learn that Mr. Shah did not follow his instructions because he stopped receiving a monthly statement. Mr. Shah was unable to explain why this happened. Dr. Parekh had great difficulty getting these statements from Dean Witter and his attorney obtained copies finally (Tr. 724-26).

Mr. Shah falsely told Dr. Parmar that he would earn at least 15 percent on conservative investments, and he assured Dr. Parmar in writing that he would reimburse him for any losses. (Tr. 742; Division Exhibit 69) Mr. Shah lied to Dr. Parmar in the summer of 1987 when he told him that his account was worth more than was represented on Dr. Parmar's account statement.

Mr. Shah admitted that he lied to clients to explain the difference between their monthly statements and the bogus account values he reported (Division Exhibit 84, Bates stamp 264).

Scienter

Mr. Shah lied and sent false reports to hide his actions and he pleaded with Dr. Parikh not to reveal his activities because he knew when he committed these actions that they were illegal. Mr. Shah's experience as a registered representative, an investment advisor, and an assistant college professor gave him an understanding of securities so that he knew or should have known that his actions were illegal (Division Exhibit 83, Bates stamp 243).

I find that Mr. Shah acted with scienter with respect to all the antifraud violations detailed above because he intended to deceive, manipulate, and defraud Drs. Parikh, Parekh, and Parmar in connection with their Dean Witter accounts or he acted with willful

and reckless disregard for their interests; he intended that these customers rely on material information he knew or should have known was false and that he intentionally omitted to provide material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; he deliberately engaged in a course of business which operated as a fraud or deceit on other persons; and he purposefully employed devices, schemes or artifices to defraud. Aaron v. SEC, 446 U.S. 680, 690 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, n.12 (1976).

Mr. O'Neal - Failure to Supervise

Section 15(b)(4)(E) of the Exchange Act provides that the Commission shall sanction a person, who at the time of the misconduct was associated with a broker-dealer, if the Commission finds the person:

> has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. [N]o person shall be deemed to have failed reasonably to supervise any other person, if -
>
> (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

Two key issues are resolved easily. Mr. O'Neal, as Branch Manager, was responsible for supervising the performance of the registered representatives working in the Fort Worth office - Respondents, Mr. Ballou, and Mr. Shah (Tr. 2255-56, 2389-90, 2519, 2541, 2543). And during the relevant period Dean Witter had in place procedures and a system for

applying such procedures intended to prevent violations. 28/

The next question is whether Mr. O'Neal reasonably discharged his duties under Dean Witter's procedures without reasonable cause to believe that Mr. Ballou, Ms. Griffith, Mr. Johnston, and Mr. Shah were violating those procedures. The answer is no. Dean Witter's compliance efforts did not prevent the violations because of the actions and inactions of the key player, Mr. O'Neal, who knew or was grossly negligent in not knowing that the named registered representatives were violating the statutes and regulations and Dean Witter's procedures.

Mr. O'Neal violated Section 15(b)(4)(E) because he failed reasonably to supervise Mr. Ballou, Ms. Griffith, Mr. Johnston, and Mr. Shah who he had reasonable cause to believe were violating the securities statutes and were not complying with Dean Witter's procedures. The violations occurred in several areas:

New Accounts

To prevent violations of the securities statutes and regulations, Dean Witter required that the Branch Manager and a Registered Options Principal approve new option accounts. Mr. O'Neal signed many of the customer applications in both capacities and others as Branch Manager. By approving the applications, Mr. O'Neal falsely indicated that he had fulfilled his responsibilities as Branch Manager.

As Branch Manager, Mr. O'Neal was responsible for making sure that customers were suitable for the types of investments that account representatives recommended

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28/ Dean Witter's Compliance Department, headed by a Vice President, Compliance and Registered Options Principal, was responsible for reviewing Dean Witter's options activity (Tr. 69-70). In addition, a regional administrator was responsible for overseeing all branch office activities, including compliance (Tr. 126-27).

(Division Exhibit 121):

> The Branch Office Manager . . . must review the client's Option Agreement and conduct an independent suitability inquiry based upon the information recorded on the form; discuss the account with the AE and where necessary, contact the client directly to discuss option trading. After review and discussion the Manager must approve or disapprove the account for option trading.

A Dean Witter Compliance Bulletin required a Branch Manager to conduct independent suitability inquiries and, where necessary, to contact the client directly to discuss the type of option trading taking place (Division Exhibit 131). In addition, Dean Witter's Compliance Bulletins warned that trading naked options was high risk and listed among points to consider in approving new option accounts and suitability the following (Division Exhibits 118, 131):

(1) Does the client understand the nature of the strategy and the risks involved?

(2) Can the client accept risks of this financial magnitude?

Another Compliance Bulletin stressed that the Branch Manager was responsible for assuring that the registered representative had clearly explained the risks and exposure to the client, and that only a limited amount of a client's investment capital be put at risk in options trading (Division Exhibit 136, Bates stamp 716). Mr. O'Neal did not assure that either had been done.

Mr. O'Neal disregarded totally Dean Witter's requirements and policies in approving the Burgess, Coale Trust, Dwyre, Gonzalez, Horn, Hyden, McAdam, Nemser, Parmar, Peterson, SA&P in 1986, and Smith option client information forms. Some of these were fiduciary accounts (i.e. trusts, estate, pensions, etc.) which require supporting documentation and otherwise receive a higher degree of care as money held for others (Division Exhibit 136, Bates stamp 713). Mr. O'Neal did not conduct any independent inquiries. He did not

initiate any phone conversations or any face-to-face meetings with any of the applicants even though many of the forms raised questions as to whether the person was suitable for trading naked options, whether the applicant understood Mr. Johnston's trading strategy and the high risks involved, and whether the applicant could accept the financial risks which were increased considerably by the use of margin.

For example, Mrs. McAdam and Mrs. Horn did not meet Dean Witter's annual income guideline of $25,000 for uncovered option trading. Mrs. McAdam's form was blank as to dependents and Mr. O'Neal approved it although he claimed he did not approve incomplete forms. He knew Mrs. McAdam, Ms. Griffith's aunt, was a widow in her twenties with between one and four children, who did not meet the minimum income guidelines, and that the equity she intended to invest was from a death benefit. He approved Mrs. McAdam for trading naked options for the inappropriate and irrelevant reasons that Ms. Griffith's claimed that Mrs. McAdam would go elsewhere and trade options if Dean Witter refused and he thought Dean Witter could "perhaps help her" (Tr. 2423).

Conversations with any of these customers would have revealed immediately that they did not understand options.

Mr. O'Neal did not check that the registered representatives had followed the Branch Manager's Manual which directs that an applicant like Mrs. McAdam whose occupation was (falsely) shown as investor "should be carefully checked to determine income/net worth and the nature of employment." (Division Exhibits 131, 136)

Mr. O'Neal acted unreasonably when he approved Mrs. Smith's option application allowing Mr. Johnston to trade naked options using funds of a widow in her 60s who barely met Dean Witter's annual income guideline. Mr. O'Neal knew Mr. Johnston, not Mrs.

Smith, had filled out the application. He acted fraudulently or was grossly negligent in agreeing with Mr. Johnston that Mrs. Smith had option experience because she had reviewed a friend's option statements and she was aware of what her friend was doing (Tr. 2406-07).

Mr. O'Neal acted unreasonably when he approved Mrs. Coale's application prepared by Mr. Ballou and Mr. Johnston which put Mrs. Coale's life savings of $268,000 in a trust account which would trade naked options. Mrs. Coale, a 74 year old high school graduate, was President of a firm begun by her late husband, and did not understand options at all.

Dean Witter's Branch Manager's Manual directed, "In using due diligence both the broker and the manager must make every effort to learn, record, and maintain those essential facts which are used to recommend specific investments for specific customers." (Division Exhibit 136, Bates stamp 714) 29/ Mr. O'Neal acted unreasonably because he had reasonable grounds to believe that Respondents and Mr. Shah had not complied with Dean Witter's new account procedures for trading naked options, and he failed to discharge his duty to conduct a suitable independent inquiry required by Dean Witter's procedures before approving such accounts (Division Exhibits 131, 136).

Dean Witter wanted customers to fill out their option application forms themselves (Tr. 2395-96). Mr. O'Neal instructed registered representatives that customers must fill out their applications but he specified that the registered representatives could fill in certain items of information provided that the clients initial those items (Tr. 2396-97). Contrary to Dean Witter's policy and his own instructions, Mr. O'Neal approved applications which he knew or should have known were prepared by the registered representatives and where the

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29/ The Manual cites New York Stock Exchange, Rule 405, and the National Association of Securities Dealers, Rules of Fair Practice, Article 3, Section 2.

customers had not initialed significant items.

Mr. O'Neal knew how the registered representatives were conducting business, and it does not appear to have been a secret that Mr. Ballou, Ms. Griffith, and Mr. Johnston filled out the client forms contrary to Dean Witter's preference and Mr. O'Neal's instructions. Moreover, Mr. O'Neal was aware or should have been aware that clients were not filling out their own forms because he approved forms on which the entries were in writing styles unlike the client's signature, and an internal audit report dated January 24, 1986, advised him that Mr. Johnston had completed a client form and auditors had advised Mr. Johnston "that in all cases the client must complete their own option agreements" (Tr. 2405-10; Division Exhibit 82, Bates stamp 216).

Trading in Accounts

I find that Mr. O'Neal did not reasonably discharge the supervisory duties and obligations incumbent upon him when he had reasonable cause to believe that Respondents, Mr. Ballou, and Mr. Shah were not complying with Dean Witter's procedures for trading in option accounts.

Trading options exposes investors to significant risk of loss so that, "the proper supervision of options accounts is crucial to the efficient operation of a branch. . . . By far the most important role of the branch manager in the trading of options is the management of risks involved in recommending and supervising options strategies." (Division Exhibit 136, Bates stamp 709 and 714) Dean Witter advised its Branch Managers that active accounts required close supervision and frequent client contact. It provided guidelines for effective supervision, and warned that failure to supervise could cause problems for the Branch Manager and Dean Witter (Division Exhibit 135).

Dean Witter's Compliance Department sent Branch Managers a report in the form of a computer printout which flagged accounts where the high activity level, the number of uncovered open positions, and the level of commissions, among other things, indicated a need for close scrutiny. This Account Activity Analysis Report was characterized as an exceptions report which meant that it identified accounts where trading exceeded certain parameters (Tr. 106). Branch Managers were responsible for reviewing accounts which appeared regularly on the monthly Account Activity Analysis Report, and for contacting clients who appear regularly on the report by sending "activity" letters and/or making phone calls (Division Exhibit 135). Mr. O'Neal received Activity Reports which alerted him as follows (Division Exhibits 104-14 and Tr. 2464) 30/ :

The November, 1986, report named 22 accounts of Mr. Johnston including Thomas, Horn, and Hyden; six accounts of Mr. Ballou and Mr. Johnston including Nemser, Peterson, and SA&P; three accounts of Ms. Griffith and Mr. Johnston including Gonzalez; and seven accounts of Mr. Shah including Parekh, Parikh, and Parmar.

The December, 1986, report named 20 accounts of Mr. Johnston including Dwyre, Hyden, and Thomas; six accounts of Mr. Ballou and Mr. Johnston including Nemser, Peterson, and SA&P; four accounts of Ms. Griffith and Mr. Johnston including Gonzalez; and four accounts of Mr. Shah including Parekh and Parikh.

The January, 1987, report named 27 accounts of Mr. Johnston including Dwyre, Hyden, and Thomas; five accounts of Mr. Ballou and Mr. Johnston including Nemser, and SA&P; two accounts of Ms. Griffith and Mr. Johnston; and five accounts of Mr. Shah

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30/ The record shows Ms. Griffith with two in-house Dean Witer numbers as an account representative, 29 and 38. I have attributed accounts shown under both of these numbers to her and Mr. Johnston.

including Parekh and Parikh.

The February, 1987, report named 25 accounts of Mr. Johnston including Dwyre, Horn, Hyden, and Thomas; six accounts of Mr. Ballou and Mr. Johnston including Nemser, Peterson, and SA&P; one account of Ms. Griffith and Mr. Johnston; and five accounts of Mr. Shah including Parekh and Parikh.

The March, 1987, report named 29 accounts of Mr. Johnston including Dwyre, Hyden, and Thomas; six accounts of Mr. Ballou and Mr. Johnston including Nemser, Peterson, and SA&P; four accounts of Ms. Griffith and Mr. Johnston; and three accounts of Mr. Shah including Parekh and Parikh.

The April, 1987, report named 17 accounts of Mr. Johnston including Dwyre, Hyden, and Thomas; six accounts of Mr. Ballou and Mr. Johnston including Nemser, Peterson, and SA&P; four accounts of Ms. Griffith and Mr. Johnston; and eight accounts for Mr. Shah including Parekh and Parikh.

The May, 1987, report named 27 accounts of Mr. Johnston including Dwyre, Hyden, Thomas; six accounts of Mr. Ballou and Mr. Johnston including Nemser, Peterson, and SA&P; four accounts of Ms. Griffith and Mr. Johnston; and six accounts of Mr. Shah including Parekh and Parikh.

The June, 1987, report named 24 accounts of Mr. Johnston including Dwyre and Thomas; six accounts of Mr. Johnston and Mr. Ballou including Nemser, Peterson, and SA&P; two accounts of Mr. Johnston and Ms. Griffith including Gonzalez; and ten accounts of Mr. Shah including Parekh, Parikh, and Parmar.

The July, 1987, report named 25 accounts of Mr. Johnston including Dwyre, Horn, Smith, and Thomas; four accounts of Mr. Johnston and Ms. Griffith including Burgess, Gonzalez, and McAdam; six accounts of Mr. Johnston and Mr. Ballou including Nemser,

Peterson, and SA&P; and six accounts of Mr. Shah including Parekh, Parikh, and Parmar.

The August, 1987, report named 21 accounts of Mr. Johnston including Dwyre and Thomas; three accounts of Mr. Johnston and Ms. Griffith including Burgess and Gonzalez; six accounts of Mr. Johnston and Mr. Ballou including Nemser, Peterson, and SA&P ; and four accounts of Mr. Shah including Parekh, Parikh, and Parmar.

The September, 1987, report named 27 accounts of Mr. Johnston including Dwyre, Smith, Thomas; four accounts of Mr. Johnston and Ms. Griffith including Burgess, Gonzalez, and McAdam; eight accounts of Mr. Johnston and Mr. Ballou including Coale Trust, Nemser, Peterson, and SA&P; and six accounts for Mr. Shah including Parikh and Parmar.

I find Mr. O'Neal grossly negligent for not closely supervising Mr. Ballou, Ms. Griffith, Mr. Johnston, and Mr. Shah based on this information which indicated that their activities needed close scrutiny, and for not taking other actions to assure that these customers understood and agreed with what was happening in their accounts. Unbelievable as it might seem, Mr. O'Neal did not initiate a single phone call or visit to any of these customers in 1985, 1986 or the first ten months of 1987 to determine whether the registered representatives were conducting business properly. Mr. Turbeville, who preceded Mr. O'Neal as Branch Manager in Fort Worth, made it a point to call or visit Mr. Johnston's clients because of his concerns about Mr. Johnston's methods (Tr. 1321-22).

In addition to the activity reports, Mr. O'Neal other information which provided had reasonable cause to believe that Mr. Johnston needed close supervision. That in addition to the fact activity reports showed numerous accounts of Mr. Johnson. This information included Mr. Johnston's 30-day suspension in 1983, the three customer suits against him in 1983-84, and the 1985 audit report recommending that he closely monitor Mr. Johnston's

trading. 31/ Respondents' compliance expert agreed that the suits and the audit report noting a need for closer supervision should have alerted the Branch Manager to consider regular and close supervision (Tr. 2556). In addition, Mr. Turbeville told Mr. O'Neal in 1983 that he had recommended that Dean Witter fire Mr. Johnston. Mr. O'Neal denies this conversation occurred. I believe Mr. Turbeville based on my observation of the witnesses, the fact that Mr. Turbeville, who recommended Mr. O'Neal for the Branch Manager position, had no reason to lie, and Mr. O'Neal's inconsistent testimony on other issues. Mr. O'Neal was aware that there were problems with Mr. Johnston's conduct because he told Mr. Wilson, Assistant Branch Manager at Fort Worth from 1984 until September 30, 1986, that he had had an opportunity to fire Mr. Johnston when he took over as Branch Manager in 1983. Mr. Wilson alerted Mr. O'Neal that he was nervous about the frequency of Mr. Johnston's trades, and because Mr. Johnston had executed trades for amounts that exceeded the customer's annual income. Finally, Mr. Wilson told Mr. O'Neal that one of the reason he resigned his position at Dean Witter was his concerned that he might be personally liable for Mr. Johnston's activities.

To assist Branch Managers discharge their supervisory responsibilities, Dean Witter circulated seven form "happiness" or "activity" letters, for Branch Managers to send to clients urging clients to focus on activity in their accounts. The letters ranged from a very basic version to a detailed statement. Mr. O'Neal repeatedly sent only the most basic letter to customers whose names appeared on the Activity Reports. Because they kept receiving the same letter, customers considered it a business thank you rather than a serious invitation to bring problems to Mr. O'Neal's attention. According to Dean Witter's

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31/ The Division is correct that Mr. O'Neal's failure to follow the internal audit's directive was a failure to supervise Mr. Johnston (Division's Initial Brief, 54-55).

Compliance Bulletin, "While a happiness letter is only one means of evidencing supervision, which should be used in conjunction with telephone calls and meetings, it serves to document and reinforce a customer's awareness of and satisfaction with the activity in his account". (Division Exhibit 134) Based on the type of high risk activity in the accounts and the information contained in the Activity Reports, Mr. O'Neal acted unreasonably by sending the same letter over and over and not initiating any other customer contacts which would provide him with input from customers so as to perform his supervisory responsibilities.

Mr. O'Neal claims he believed Mr. Johnston used "time and price discretion", i.e. the account executive has discretion when to execute customer's specific instructions, and he only learned after October 19, 1987, that Dean Witter did not allow time and price discretion in option trading (Tr. 2501-02). I find Mr. O'Neal's excuse unbelievable. As Branch Manager and a ROP, Mr. O'Neal knew or should have known company policy on something so important and basic. In addition, Dean Witter's Law & Compliance Bulletin, April 29, 1986, states, "Option . . . transactions are prohibited by firm policy on a discretionary basis." (Division Exhibit 117, Bates stamp 292).

Mr. O'Neal acted unreasonably in not following several Dean Witter policies. For example the Branch Manager Manual stated that "The Manager must instruct the AE to complete the Account Report Form (ARF), add any comments and return the report to the Compliance Department as quickly as possible." (Division Exhibit 135, Bates stamp 086) Dean Witter also required that customers submit and have approved a personal financial statement before establishing uncovered positions totaling 50 or more option contracts, and that financial information about a customer be kept current (Division Exhibits 116, 131 at 3 and 5). Mr. O'Neal did not require account representatives to comply with Compliance's

requests for these materials in a reasonable time. In March 1987, Compliance made its fifth request for information on one of Mr. Johnston's customers, its fourth request for information on three customers of Mr. Johnston and Mr. Ballou, its third request for information on two customers of Mr. Johnston, and its second request for information on two customers of Mr. Johnston (Division Exhibit 90). Dean Witter's Vice President, Compliance is not sure Compliance ever received the personal financial statement of Dr. Peterson it requested (Tr. 60-61). Finally, many customer had over 50 open contracts, but no one filled out a personal financial statement or updated the financial information on their application.

Respondents' expert's general observation that compliance departments often do not get all the information they request is unpersuasive. These were not just regular Compliance requests. These requests concerned high risk accounts which were trading naked options on margin. The March 1987 Memorandum from Compliance noted above showed customers with "454 open contracts in January", "399 open contracts in January", "61 naked equity options in January". The higher the risk, the greater the need for supervision. Mr. O'Neal's failure to see that the account executives supplied information on a timely basis to Dean Witter's Compliance Department as requested was unreasonable.

The persuasive evidence is that Mr. O'Neal failed reasonably to supervise Mr. Shah's trading practice. Mr. O'Neal ignored many warnings that Mr. Shah needed close supervision. In addition, to the Activity Reports, Mr. O'Neal knew Mrs. Brady, a sales assistant, posted or recorded Mr. Shah's trades because Mr. Shah was very disorganized and did not personally keep his records as required. Mrs. Brady told Mr. O'Neal on two occasions in 1986-87 that Mr. Shah was losing money for customers and appeared to be

churning customer accounts (Tr. 102). 32/ In the months between Mrs. Brady's two warnings, Mr. O'Neal did not look at Mr. Shah's posting book to determine if the kinds of trades she found suspicious continued. In May 1987, Dr. Parmar called Mr. O'Neal to inquire about Mr. Shah's qualifications and performance because his account was losing money. In mid-1987 Mr. Johnston told Mr. O'Neal that Mr. Shah had not posted his trades for months.

In addition to the warnings he received which should have alerted him to Mr. Shah's illegal activities, Mr. O'Neal failed to know very basic information about how Mr. Shah conducted business. For example, in October 1987, Mr. O'Neal told Dr. Parikh that he had not known that Mr. Shah had traded naked options in his IRA account during the relevant period; that Mr. Shah had lost all the equity in the account which began with about $280,000 and that Dr. Parikh owed money to Dean Witter (Tr. 698). Also, Mr. O'Neal should not have allowed Mr. Shah to trade as he did in the Parikh account because Dr. Parikh's option application did not authorize uncovered option transactions (Division Exhibit 63; Tr. 1632-33, 1705).

The expert's view that Mr. O'Neal's supervisory records are among the best she had seen is of limited value because she did not address the substantive nature of the allegations. She focused instead on formalities and quantity not quality, i. e., whether Mr. O'Neal filled out and/or initialled the papers required of Branch Managers and how voluminous this material is. Even in their limited focus, the witness's views are suspect in that she failed to note, or did not think it significant, that Mr. O'Neal repeatedly sent

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32/ The churning of a securities account occurs when an account executive recommends or effects transactions which are excessive in size and frequency in order to generate commissions and without regard to a customer's stated investment objectives, financial resources or needs, and his previous investment history (Division Exhibit 132).

customers trading high risk naked options the same form letter. Mr. O'Neal made notations on the Activity report which indicated that his secretary was to send out the basic version of the Dean Witter form letter. He never personalize it in any way ever. One customer jokingly inquired after receiving the same letter for the fourth time (Tr. 267);

> What the hell, can't you change this thing on your computer. You just print these things out. I know you are glad to have my business, but couldn't you personalize it a little bit.

Furthermore the expert did not consider that even though Dean Witter urged account executives to note customer contacts on their daytimer, Mr. O'Neal's daytimer reflected one call from a customer although several customers testified they called or wrote to him concerning their accounts - Dwyre, Hyden, Dr. Parekh, Dr. Parikh, Dr. Parmar, Smith, and Dr. Thomas (Tr. 2435-37). Mrs. Smith called Mr. O'Neal three times to talk with him or to make an appointment to meet with him but he was unavailable (Tr. 189-91). She also failed to consider that Dean Witter instructed Branch Managers to note contacts with active clients in the Branch Manager's log, yet Mr. O'Neal's log does not note any phone contacts made to clients during the period March 1984 through December 1988 (Tr. 2438-39; Division Exhibits 135, 166).

Counsel does not explain the basis for the claim that examining the activities Mr. O'Neal performed will disclose the reasonableness of his supervision (Respondents Johnston and O'Neal's Reply Brief 63).

Mr. O'Neal - Aiding and Abetting 33/

33/ The Division alleges aiding and abetting or, alternatively, failure to supervise. It agrees with Respondents that the case law holds that an individual cannot be both a substantive wrongdoer and a deficient supervisor based on the same conduct. George Inserra, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶84,334 at 89,522 & n.61;
(continued...)

Mr. O'Neal willfully aided and abetted Mr. Ballou, Mr. Johnston, and Mr. Shah violate the antifraud provisions of the securities statutes and the rule thereunder because he knowingly played a role which substantially assisted their illegal activities in customer accounts. Investors Research Corp. v. S.E.C., 628 F.2d 168, 177 (D.C. Cir.), cert. den., 449 U.S. 919 (1980); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94-97 (5th Cir. 1975). My finding is based on the following:

Mr. Hyden directed Mr. Johnston to stop writing options in his account in a letter dated March 9, 1987. Mr. Hyden wrote this letter and copied Mr. O'Neal because he could not get Mr. Johnston to follow his instructions and close the account. Mr. Johnston continued trading and opened new positions in the account through August 1987. Mr. O'Neal knew these trades were unauthorized. He aided and abetted the violations because he approved the trade tickets opening purchases of 20 or more naked option contracts and other transactions in his capacity as Branch Manager and or ROP and thus knowingly gave substantial assistance to the violations (Tr. 2258-60).

Mr. Ballou wrote to Mrs. Nemser on May 20, 1987, and on June 25, 1987, confirming that he and Mr. Johnston would follow her directions and eliminate option positions in the account. Mr. O'Neal was responsible for reviewing all outgoing correspondence (Tr. 2260). Contrary to what they told Mrs. Nemser, Mr. Ballou and Mr. Johnston continued to trade options and opened new option positions in the Nemser account until September 1987, and in what Dean Witter designated the Nemser Estate account in September and October

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33/(...continued)
Adolph D. Silverman, 45 S.E.C. 328, 331 (1973); Anthony J. Amato, 45 S.E.C. 282, 286-87 (1973).

1987. Mr. O'Neal did not tell Mr. Ballou, who went to him for advice, that he could not trade options in an estate account (Tr. 1118-20). Mr. O'Neal aided and abetted the unauthorized trading in these accounts because he approved the trade tickets, opening purchases of 20 or more naked option contracts, and other transactions in his capacity as Branch Manager and thus knowingly gave substantial assistance to the violations.

Dr. Parmar instructed Mr. Shah in a letter sent to Dean Witter's Fort Worth office in February 1987, not to make any investments without first discussing them with him. He gave the same instruction to Mr. O'Neal on September 26, 1987, and on October 22, 1987, he told Mr. O'Neal to close his accounts. 34/ Even if you accept Mr. O'Neal's claim that the October 24 option trade was an error that was corrected, Mr. O'Neal aided and abetted unauthorized trading in these accounts because by approving other trades he knowingly gave substantial assistance to Mr. Shah's violations.

In the fall of 1986, Dr. Thomas told Mr. O'Neal that he wanted to close his account with Mr. Johnston. They agreed that Mr. Johnston would have 60 days to accomplish the closing. It was Mr. O'Neal's responsibility and practice to review all incoming and outgoing mail at Dean Witter. On November 10, 1986, Dr. Thomas instructed Mr. Johnston in a letter sent by certified mail to close the account. Mr. Johnston disregarded these instructions and continued trading in the account until May or June 1987. Trades which were not part of an effort to close the account were unauthorized and violated the antifraud

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34/ Respondents question whether the September letter was to Mr. Shah rather than Mr. O'Neal. I accept the witness's explanation that he would not have been upset in October that Mr. O'Neal had not followed his instructions if he had not given Mr. O'Neal written instructions in September. In any event, Mr. O'Neal was required to review incoming correspondence so he would have reviewed the letter to Mr. Shah. I assume that if Mr. O'Neal delegated this review to an assistant that person would have brought the letter to his attention.

provisions of the securities statutes. Mr. O'Neal substantially aided and abetted these violations because he knew that all trades after the fall of 1986 which did not further closing the account were unauthorized, yet he approved the trade tickets opening purchases of 20 or more naked option contracts and other transactions in his capacity as Branch Manager and or ROP and thus gave substantial assistance to the violations.

PUBLIC INTEREST

The last issue is what, if any, remedial action is appropriate in the public interest in view of Respondents' willful violations of the securities statutes.

The Division recommends that (1) Mr. Johnston be barred from association with any broker or dealer, (2) that Ms. Griffith be barred from association with a broker or dealer with the right to reapply in a non-supervisory, non-proprietary capacity after one year, and (3) that Mr. O'Neal be barred from association with a broker or dealer in a supervisory or non-proprietary capacity (with no specific right to reapply), and that he be barred from association in any capacity with the right in one year to apply to associate in a non-proprietary, non-supervisory capacity, subject to appropriate supervision.

I reject Respondents' contention that they should not be sanctioned and that the Division's recommendations are too severe. Measuring Respondents' conduct by the established criteria - the egregiousness of the actions, the need to deter others from similar conduct, the degree of scienter involved, the sincerity of assurances against future violations indicates that severe sanctions are required against everyone but Ms. Griffith. Steadman v. S.E.C., 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd Steadman v. S.E.C., 450 U.S. 91 (1981); S.E.C. v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978).

I find that Mr. Johnston should be barred from association with any broker or dealer.

My finding is based on the fact that Mr. Johnston committed innumerable blatantly fraudulent acts in connection with securities involving at least ten customers over a period of two years and ten months. It did not matter to Mr. Johnston whether the customer was rich or poor, young or old, suited or unsuited to trading naked options, or the nature of the equity to be used in the investment. As long as a customer had money to invest, Mr. Johnston used his very persuasive manner and successful demeanor to have the person open an options account on which he earned commissions. In the Nemser situation, he traded options after the customer died and the legal representatives had not established an options account. Mr. Johnston swindled people, and he profited immensely. Mr. Johnston earned commissions of $404,798 in 1985, $672,845 in 1986, and $855,137 in 1987 by lying and misrepresenting the facts. (Division Exhibit 77; Tr. 810, 1253). 35/ Between 75 and 85 percent of Mr. Johnston's gross production came from trading options (Tr. 1989). (Tr. 810, 1253). Mr. Johnston ignored Federal statutes, Commission regulations, and Dean Witter's rules that did not suit his purposes and, if he was caught, he claimed they were inapplicable or he did not know about them at the time.

Mr. Johnston's actions were egregious, extended over a two year period, and involved substantial sums of money of at least ten people, in some cases life savings, and estate, pension, and trust funds. There is a very high probability that Mr. Johnston will violate the securities laws again because he is dishonest, he has no remorse for what he did, he has not acknowledged any wrongdoing, and he has a history of refusing to live by the laws, rules, and standards that apply to participants in the securities industry. It is relevant that Mr. Johnston committed these violations after another securities firm asked him to leave

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35/ In addition, Mr. Johnston received a bonus. The commission figure for 1987 would appear to be higher since the exhibit does not include December.

his employment because it was concerned with the way he traded options; after Dean Witter suspended him for violating a rule of the New York Stock Exchange; after his superior warned him in 1983 not to trade options without first visiting and talking with clients; and after he was a named defendant in several law suits because of the way he handled customer option accounts. It is also relevant to that Dean Witter fired Mr. Johnston in 1987 for not obeying a superior's instructions to liquidate a customer's account. Mr. Johnston needs to be excluded from the securities industry to protect public investors and to deter from similar acts persons impressed by the substantial material rewards Mr. Johnston achieved by his illegal conduct. There are no mitigating factors.

I find that Ms. Griffith should be suspended from association with any broker or dealer for 30 days. This sanction, which is less severe than what the Division recommended, is appropriate in the public interest for the following reasons. On the positive side, Ms. Griffith showed remorse for her actions when she advised Mr. and Mrs. Burgess and Mr. and Mrs. Gonzalez in 1987 to retain counsel because they had relied on false information from her and Mr. Johnston. My observation of the witness and review of the transcript lead me to conclude that Ms. Griffith's testimony was truthful and that she is a smart, honest person who is much wiser today than she was during the relevant period.

Moreover, several mitigating factors influence Ms. Griffith's sanction. Ms. Griffith's illegal conduct occurred just two years after she became a registered representative when her securities experience was limited to Dean Witter's Fort Worth office where management considered Mr. Johnston, a star performer. Her activities occurred over a seven month period in three accounts she shared with Mr. Johnston. Unlike some of the other registered representatives, Ms. Griffith did not participate in unapproved and/or unauthorized trading or misrepresent trades as hedging transactions.

I find that Mr. O'Neal should be barred from association with any broker or dealer. Mr. O'Neal's activities were egregious, occurred over a period of two years, involved substantial sums, and at least 13 customers. Mr. O'Neal's behavior was particularly reprehensible because his job was to assist customers but he did not do so. Instead he benefited through his bonus from the illegal activities he aided and abetted and allowed to occurr because of his failure to supervise (Tr. 1341-42). As Branch Manager Mr. O'Neal was the linchpin to the success of Dean Witter's compliance efforts. He realized the importance of his position because he described the Branch Manager as the front-line compliance officer with day-to-day responsibilities for compliance procedures; even so instead of being part of the answer he was part of the problem.

It is generally accepted that honesty is particularly important in the securities industry because participants have so many opportunities for abuse and overreaching. Customers invested with Dean Witter believing it was a reputable firm run by honest people. However, Mr. O'Neal was not trustworthy. It is relevant to determining a sanction that three years before these illegalities began Mr. O'Neal was asked to resign as the head of a bank's trust department for failing to observe applicable accounting regulations. Even though he had worked in the trust area for 19 years, Mr. O'Neal did not know it was improper to use an error account with respect to trust banking (Tr. 2249). Also Mr. O'Neal did not enjoy a good professional reputation. Dr. Peterson had no confidence in Mr. O'Neal and did not want to deal with him because of things he had heard about him, and Mr. Johnston characterized him to Mr. Hyden as a buffoon (Tr. 547-48, 957). A strong penalty is needed to deter Mr. O'Neal and others from similar behavior. There are no mitigating circumstances. For all these reasons, the Division's recommended sanction whereby Mr. O'Neal could possibly reenter the securities industry in a limited capacity after one year is

insufficient to protect the public.

I have considered all the proposed findings and conclusions and arguments submitted by the parties. I accept those consistent with this initial decision and reject those that are inconsistent.

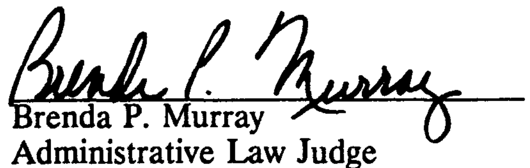
ORDER

Based on the findings set out above, I ORDER that Steven Erik Johnston is barred from being associated with any broker or dealer,

I FURTHER ORDER that Patricia Griffith is suspended from any association with a broker or dealer for 30 days, and

I FURTHER ORDER that Albert Vincent O'Neal is barred from being associated with any broker or dealer.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice. Pursuant to that rule, this initial decision shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 17(b) within 15 days after service of the initial decision upon him or her, unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to a party. If a party timely files a petition for review or the Commission acts to review as to a party, the initial decision shall not become final as to that party.



Brenda P. Murray
Administrative Law Judge

June 23, 1992
Washington, D.C.