

**ADMINISTRATIVE PROCEEDING
FILE NO. 3-8205**

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

**In the Matter of
PATRICIA A. JOHNSON**

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INITIAL DECISION

**Washington, D.C.
April 12, 1994**

**Glenn Robert Lawrence
Administrative Law Judge**

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APPEARANCES: Rebecca Carlins and Ellen N. Hirsch of the Commission's Midwest Regional Office, for the Division of Enforcement.

Arthur W. Hahn and Ronald Bateman of Katten, Muchen & Zavis for Patricia A. Johnson.

BEFORE: Glenn Robert Lawrence, Administrative Law Judge.

These public proceedings were instituted by an order of the Commission dated October 26, 1993 (Order) issued pursuant to Sections 15(b) and 19(h) of the Securities and Exchange Act of 1934 (Exchange Act) to determine whether allegations of misconduct made by the Division of Enforcement (Division) against Patricia A. Johnson are true and what, if any remedial action would be appropriate in the public interest.

In substance, the Division alleged that from approximately November 1984 to May 1991, Johnson was the manager of PaineWebber Inc. (PaineWebber) branch office in Beverly Hills, California. From approximately August 1987 through June 1988, David Zetterstrom, a registered representative in the branch, wilfully violated Section 17(a), of the Securities Act of 1933 (Securities Act), and Section 10(b) and 10(b)-5 of the Exchange Act in that he misappropriated funds from the accounts of customers without their knowledge and consent. From August 1987 through June 1988 Johnson failed to comply with PaineWebber's procedures and to reasonably supervise Zetterstrom to prevent his violation of Section 17(a) of the Securities Act and Sections 10(b) and 10(b)5 of the Exchange Act.

In her answer, Johnson admitted the misappropriation but denied that she reasonably failed to supervise Zetterstrom and to comply with PaineWebber's procedures. She pleaded the statute of limitations and laches.¹ A hearing was held on January 24 and 25, 1994 in Los Angeles on the issues raised by the Order. Timely filings were made by the parties of proposed findings of fact, conclusions of law and briefs.

¹ **On November 13, 1993, respondent moved to dismiss the case on essentially the same grounds. On February 23, 1994 the Commission denied the motion with respect to the statute of limitations and deferred the initial decision on the matter of laches to me.**

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon my observation of the various witnesses that testified at the hearing as well as the argument and proposals of the parties and the relevant statutes and regulations.

Findings of Fact

The respondent, Patricia A. Johnson, is 43 years old and is a resident of Pacific Palisades, California. She was the manager of the Beverly Hills, California office of PaineWebber, Inc. from approximately November 1984 to April 15, 1991. Prior to that time she was the manager of the Santa Monica office and was hired by Gary Evans, an executive vice president in charge of the Western Region. T37 (transcript page 37). PaineWebber's Beverly Hills office employed 31 investment executives during the period ending November 1986. D2 (Division Exhibit 2). In the 12 months ending November 30, 1986, the branch generated \$9,173, 600 in total revenue. D2. Johnson reported to Gary Evans, Executive Vice President of PaineWebber. As branch manager, she was responsible for the supervision of the registered representatives. S1 (Stipulation between the parties dated January 17, 1994).

The PaineWebber standard method of procedure requires:

checks are to be made payable only to the client in whose name the account is carried unless requested otherwise in writing by the client and with the expressed consent of the Branch Manager". CS.2.3, effective June 20, 1986. D1.

The procedures also provide:

Delivery of checks must be made to the client in one of the following ways: By mail directly to the client; Personally picked up by the client - If a client comes to your office to get his or her check the cashier should obtain proper identification from the client before surrendering

the check; In those rare cases where the investment broker is to hand deliver a check to a client outside the office, the investment broker must - obtain permission to do so from the branch manager and sign a log book maintained in the cage, attesting to this course of action. In addition the branch manager is required to send a letter to the client confirming delivery. A copy of this letter is to be retained at branch. CS.2.6., Effective June 30, 1986. D1.

The March 6, 1987, Audit Report of The PaineWebber auditors, provides in part: (DE2 p.11), Operations, the auditors request in a "repeat finding" under Checks requiring LOAs; A review of thirty seven checks disbursed during the period August 25, 1986 to October 29, 1986 with a discrepancy between the payee name and the account name of record disclosed the following: a) There was one instance where a check for \$45,000 was disbursed out of account TP54116 (S.Allen) without a letter of authorization on file. The check (#23347) was made payable to Mr. Robert Edwards. There were seven instances where checks were made payable to financial institutions for the clients without prior written authorization from the customer on file at the branch. The auditors recommend that "in instances where a check is made payable to someone other than the account owner of record, the branch must have a letter on file from the account owner authorizing the disbursement to the payee." p.11 and 12, D2. (Emphasis supplied)

Under the category of Checks Delivered to Customers by I.E.s [Investment Executives] the auditors state " a review of the I.E. hand delivery log for 1986 disclosed that in thirteen of twenty three instances in which I.E. delivered checks a copy of the letter sent to the client to verify delivery was not on file. (Emphasis supplied) In addition there were (8) confirmation letters on file that had no corresponding entry in the delivery log; Recommendation: All checks and

securities delivered by the I.E.s should be listed in the delivery log and signed for by the I.E. Cashiering personnel should have the manager sign a letter to be mailed to the client to conform the delivery of the check or the security. The managers signature may serve as her approval. A copy of this letter should be retained in a separate file in chronological order.

P13 D2. The check list provides in item 10, page 3:

"Permitted deliveries of checks or securities by IEs to clients only under extraordinary circumstances and with my prior written approval with same day notification to the client of such deliveries and notation of the log maintained in the operation area" D3.

The findings of this report were discussed with Johnson. T35

From approximately January 1987 to June 1988, David Zetterstrom was employed as a registered representative at PaineWebber's Beverly Hills Branch Office. From approximately November 1987 through June 1988, Mark Conrad (Conrad) was the assistant branch manager at the Beverly Hills office. Wanda Taktikos was the operations manager from April 1987 through June 1988.

Zetterstrom was placed on probation on February 22, 1988² on account of the following customer complaints:

1. On October 19, 1987 Nina Parkinson purchased 5000 shares of Penzoil. The client was told that the purchase took place at \$51 a share when in fact the correct execution was at \$61.³ Zetterstrom agreed to pay back the \$19,600 difference.

²In the course of the discussion with Evans on whether to place Zetterstrom on probation, Johnson appeared to question the value of probation inasmuch as Zetterstrom lied to a client. Johnson claimed that she did not recall if she recommended whether Zetterstrom be fired. T235-236.

³Edelman indicated that misstating a stock price was unique. T303.

2. Zetterstrom purchased 10,000 shares of Global Fund for Aleta Wallach even though the client timely cancelled the order. He agreed to reimburse the client in the full amount of \$2,018.49.⁴
3. Zetterstrom, using a blank Letter of Authorization (LOA) signed earlier by Gertrude Wallach and Arthur Groman, inappropriately withdrew funds in order to avoid advising the client that the account had declined in value.
4. Zetterstrom misused blank LOAs in transferring sums from one Wallach account to another.⁵
5. Carlene Van Pelt's order was executed without first obtaining detailed instructions. The trade was reimbursed and the loss of \$430 was charged to Zetterstrom's net commission. D6.

The conditions of his probation included the following increased supervisory safeguards, among others: (1) All LOAs presented by Zetterstrom were required to be verified with the client by Johnson, Taktikos or Conrad prior to taking the action requested in the letter of authorization; and (2) Monthly account statements for all of the Zetterstrom clients were to be reviewed each month by Johnson or Conrad until September 1, 1988. Deviation from these rules, regulations and policies in the future will result in more severe disciplinary action being taken

⁴In a letter written by Aleta Wallach on January 10, 1988 it was stated that Zetterstrom "lied concealed and covered up the true facts...I want a copy of this report sent to the regulating agency applicable to broker licensing and oversight along with all the supporting documents I have given Pat Johnson, David's manager" (emphasis supplied). The letter details a multiplicity of improper manipulations by Zetterstrom. D8. On January 14, 1988 Johnson advised the service manager that Aleta Wallach would be reimbursed \$22,000 as a result of an unauthorized trade. R19d.

⁵ Gertrude Wallach in a letter dated January 14, 1988 indicated in detail how Zetterstrom wrongfully used blank LOAs. She stated "Aleta and I are stunned and heartbroken over the discovery of David's elaborate and ongoing course of intentionally deceptive conduct with respect to their management of our accounts at PaineWebber. And I cannot help wondering if his dishonest activities are confined to our accounts. (emphasis supplied). D9.

against you by the N.Y.S.E. and immediate termination by PaineWebber, Inc. S1 (Joint stipulation of the parties dated January 17, 1994); D6. Johnson testified that she met with Wanda Taktikos and Mark Conrad and advised them of the concerns she had about Zetterstrom and suggested they help in watching him and his conduct with respect to the LOAs.⁶ She introduced herself on a regular basis to Zetterstrom's clients and she spot-checked check requests, reviewed order tickets, Zetterstrom's statements, LOAs, and check requests. T233-235.

On January 29, 1988, Aleta Wallach wrote Johnson and complained that Zetterstrom was "(1) forging signatures on LOAs and taking out funds."⁷ (emphasis supplied) (2) using signed by client LOAs for purposes other than those directed by the client, e.g. the mortgage check for \$7259.27 from 57684 on 6/8/87. (3) Using LOAs to remove client funds without client's knowledge or consent in order to present to the client as funds paid to her from outside the accounts, funds that were due and owing client - e.g. Master Global, Federated; management fee.....In this respect the phony LOAs were used to withdraw client funds in order to mislead clients into believing that funds due from her from outside sources were in fact paid to her. I call it the phony 'recycling scheme'." Attached to the letter is a copy of a June 8, 1987 LOA showing an arrow pointing to Gertrude Wallach's signature indicating "this signature is forged" (emphasis supplied). A similar LOA also dated June 8, 1987, indicates that Aleta Wallach's signature was forged

⁶ Taktikos denied he met with Johnson on this issue. T338.

⁷ The respondent could not remember whether or not the forgery charge was fully explored by the use of handwriting experts. T444.

(Emphasis supplied). D10.⁸ Johnson wrote Stevens of the compliance department on February 24, 1988 and included the Wallach complaint letters which stated in part: "This matter has been resolved and I'm currently working with John Oliva on the proper disciplinary action regarding the broker, David Zetterstrom." D11.

Norma Helms, a Zetterstrom customer, called Johnson on June 9, 1988 and advised her that Zetterstrom had informed her that he had sold 1,000 shares of Occidental Petroleum on her "good to cancel order." The statement that Helms received failed to reflect the sale. Johnson fired Zetterstrom the morning of June 10, 1988. S1,T168.

Johnson met with Lillian Kraus, a Zetterstrom customer, on the morning of June 10, 1988. Kraus reviewed the account with Johnson, in anticipation of requesting a loan. It was discovered that an unauthorized \$20,000 check from the Kraus account was made out to Glendale Federal Savings and Loan f/b/o (for the benefit of) Kraus dated October 22, 1987. Kraus did not have an account in Glendale and did not receive the money. On the other hand, Zetterstrom did have a personal account in Glendale. Johnson testified that this was her first notice of a Zetterstrom misappropriation and it was at this point that she called in the PaineWebber auditors and contacted Evans, legal and compliance. T170,171. The audit lasted from 10 days to two weeks. T172. Kraus has no present recollection of signing a letter authorizing the issuance of the check and does not believe she did so. Kraus has no present recollection of receiving a letter confirming that the check had been hand delivered to someone other than herself. Kraus has no

⁸ It was Johnson's contention that Gertrude Wallach was unclear as to whether the signature was forged. Zetterstrom denied the forgery. T229.

present recollection of signing a letter authorizing the issuance of a \$20,000 check out of her PaineWebber account on May 2, 1988 and does not believe she did so. She does not have any present recollection of receiving a phone call from PaineWebber on or about May 2, 1988 verifying that she had executed the letter of authorization for the check issued on May 2, 1988. Kraus has no present recollection of having received a letter confirming that the May 2, 1988 check had been issued to someone other than herself. Kraus did receive monthly statements evidencing the issuance of checks on October 22, 1987 and May 2, 1988. S1 (Supplemental stipulation of the parties dated January 25, 1994).

On June 10, 1988, Johnson confronted Zetterstrom with the complaints made by Kraus and Helms. Zetterstrom gave several differing explanations and Johnson fired him. Zetterstrom conceded at the time that Johnson "had no alternative but to fire him." D7.

Johnson thereafter requested a special audit. PaineWebber's audit commenced on June 14, 1988 and found that Zetterstrom had misappropriated \$114,500⁹ from clients' accounts as follows:

⁹ The audit lasted about two weeks. T172; The aggregate amount that Zetterstrom misappropriated and erroneously displaced from clients' accounts is not entirely clear from the record. For instance the total amount paid to Kraus, Morgan and St. Lawrence by way of reimbursement for Zetterstrom improprieties total \$120,500 plus interest R4 a-c. Johnson testified that she first learned that Zetterstrom misappropriated sums in her conversation with Krause on June 10, 1988. T169.

Harriet Morgan	08/19/87	\$ 9,000 ¹⁰
	11/24/87	18,000 ¹¹
	02/11/88	32,000* ¹²
Lillian Kraus	10/22/87	20,000* ¹³
	05/02/88	20,000* ¹⁴
Beverly St. Thomas	12/23/87	15,000* ¹⁵

Auditors could not find letters of authorization for those transactions marked (*) above. S1. Additionally, letters of confirmation were missing in several instances. Zetterstrom committed suicide on June 13, 1988. S1.

On June 21, 1988, Mark Conrad wrote to Gary Evans indicating the following complaints he received from Zetterstrom clients:

1. December 7, 1987: client Diane Holland came to the office complaining that several RMA checks were bounced notwithstanding a guarantee by Zetterstrom that this would not

¹⁰The figure in the stipulation of \$9,000 is probably an error and should be \$9,500. See R11 a-c.

¹¹ It is a fair assumption that the Morgan signature on the LOA was forged inasmuch as the auditors indicated that the \$18,000 was misappropriated. Further, it is noted that the check was made out to Glendale Federal Savings and Loan. D 13A, 13R-a-c.

¹²Zetterstrom apparently used the device of having a check made out to the order of Glenfed, Inc. and depositing it in his account in Glendale Federal Savings and Loan D14C, R3, 15 a-e.

¹³Zetterstrom also had the check made out to Glendale Federal. D15B, R1(Respondent's exhibit 1) and R12a.

¹⁴Zetterstrom had the check made to the order of Glendale Federal Savings and Loan. Thereafter he probably added " FBO Lillian Kraus" D 16B, 16C, R 16 a-d.

¹⁵ This check was also made to the order of Glenfed. D17 a-c, R2, R14a-e.

happen. Conrad indicates that the client was confused about how a margin account works.¹⁶

2. December 22, 1987: client Connie Crebbin called and indicated that she had only an interest in a particular stock and that without authority Zetterstrom purchased the stock in her behalf. Crebbin closed her account.
3. January 29, 1987:¹⁷ Carlene Van Pelt called and indicated that Zetterstrom made an unauthorized purchase in her behalf.¹⁸ This was corrected.
4. February 22, 1988: client Aleta Wallach's complaints involved an unauthorized trade, an unsuitable trade, and the misuse of LOAs to move funds between accounts to mislead the client.¹⁹
5. June 9, 1988; Client Norma Helms was told by Zetterstrom that 1,000 shares of Penzoil were sold at 28 1/8 when in fact they had not been sold. This incident occurred shortly before Zetterstrom was fired on June 10, 1988. D5, T168.

Gary Evans

Gary Evans was the PaineWebber executive vice president in charge of the Beverly Hills office for 12 years including the period from 1987 to June 1988. T21. Evans was Johnson's immediate supervisor. T22. During the period that Johnson was the manager of the Beverly Hill's office, there was in existence a document entitled, "Standard Methods and Procedures" that was required to be followed, on a non-deviation basis, by the branch manager. CS2.3: It provides:

¹⁶ Johnson was advised of this. T163

¹⁷ D5 lists the date as January 29, 1987 but it appears that this must have been January 29, 1988.

¹⁸ Johnson acknowledges a report from Conrad on this matter.

¹⁹ Johnson advised Stevens of this transaction. T178.

Checks are to be made payable only to the client in whose name the account is carried unless requested otherwise in writing by the client and with the express consent of the branch manager. T26.

PaineWebber defined checks drawn on the client's account but not to the client as "third-party checks." They defined the authorization document as a LOA or letter of authorization. T26. An LOA had to be in the file prior to the release of the check. The branch manager was responsible for seeing that the LOA had been received prior to the release of the check. T28. The branch manager could delegate this function (T28) though the ultimate responsibility was the managers to make sure that the task was carried out T29. "If the person to whom the branch manager delegated the task of approving the issuance of third party checks makes a mistake in issuing the check without a proper letter of authorization," PaineWebber would hold that person and the branch manager responsible. T30. Similarly, the branch manager could delegate the dispatch of confirmation letters required to be sent out in the instance of third party checks and the compliance with procedures when checks were personally delivered to client but the ultimate responsibility devolved upon the manager. T31, 32. However, in the event of a delegation, Johnson was not required to conduct an audit to determine if the delegation was conducted correctly. T45. But if the delegation was ineffective then Johnson was to blame because she was charged with delegating the procedure to someone who was responsible. T52.

Evans testified that his first contact with the Securities and Exchange Commission about the instant case was a few months prior to the hearing. T50. With respect to Johnson, he indicated that she performed her functions generally very well when she worked for two years as manager of the PaineWebber Santa

Monica office. Further, she was promoted by Evans to the Beverly Hills office. She was considered a "very hands on manager and followed the rules and performed her tasks in a very hands on basis." T40. PaineWebber had 250 branch managers and Johnson was given the award as branch manager of the year for 1986 and served on the branch manager's advisory committee. T41,42.

Zetterstrom was a successful broker at Merrill Lynch before coming to PaineWebber. T45. He had a reputation as a big producer. T46. When Zetterstrom was placed on probation, the legal office, as well as Johnson and Evans, entered into the decision. T48.²⁰ In 18 years of being a branch and divisional manager, Evans has had only five or six instances where brokers were placed on probation. T53. "... normally brokers that go on probation are relatively, and in a short period of time after that, are terminated." T54. Referring to Zetterstrom, Evan's testified "Well, I can just tell you that we wouldn't put anybody on probation unless we thought something was extremely wrong..." T54. The company would not put a broker on probation if there was just a difference of opinion as to a trade. T55.

Patricia Ann Johnson

The witness has been employed by Smith Barney Shearson as a broker since June 1992. T57. She was previously employed by PaineWebber from June 1978 until June 28, 1991. T57. She was a broker trainee in the fall of 1978. Johnson worked in New York from the end of 1982 until the spring of 1983. She

²⁰The probation document was signed by Zetterstrom on March 9, 1988. D6; T166.

became the manager of the Santa Monica office in March 1983 and the manager of Beverly Hills in November 1984 and held that position until June 1991. T57.

When Johnson was requested to authorize a third party check she "was given a packet by the cashier, which included the name and address of the client; the balance page, which included a summary of cash in the account , value of the account; a letter of authorization (LOA) designating who the check should be made payable to signed by the client; a check request made out by either the broker or the sales assistant, and someone assisting the broker...." T59. If the LOA was not in the packet, Johnson testified she wouldn't sign the check, unless she was notified that the client was coming in with an LOA. (emphasis supplied) T59-60. From January 1987 through June 1988, Mark Conrad and Wanda Taktikos were authorized to sign checks. They followed the same procedures as she did. T61-62. From January 1987 to June 1988, Johnson testified that a confirmatory letter was sent to clients the same day as the delivery of each check that was delivered outside of the Beverly Hills office. T68. If a check request originally indicated that it was for a client pickup and the broker actually picked it up himself, he would have to sign the top portion of the check, the log book and a confirmation letter would have to be sent out to the client. T71. The witness responded to the question, " At any time prior to August 1987, did you receive notice that the procedures for the issuance of third-party checks out of client accounts were not always being followed by your office?" She responded, "possibly." T71. Later she was asked if she was acquainted with the audit report (D2 page 11) which criticized the branch for failure to secure LOAs. T74. She testified that she did not recall the specific paragraph T74. Johnson did recall signing off on a monthly

check list at D4 during the period from January 1987 to June 1988 that provided, "permit deliveries clients by IEs of securities and checks only under extraordinary circumstances with my prior approval and same day notification to clients." T78-80.

Johnson first met Zetterstrom in the summer of 1986. T81. Thereafter in approximately January 1987, in a joint decision between Evans and Johnson, Zetterstrom was hired for the Beverly Hills Office.

When asked about problems with Zetterstrom, Johnson testified that Zetterstrom's client, Aleta Wallach met with Johnson once or twice a week apparently to try and straighten things out. T82. The meetings with Wallach commenced as early as October 1987 and continued to the end of January 1988. T102. It was Johnson's recollection that the complaint associated with Master Global was one of the complaints that caused Zetterstrom to be put on probationary status. T85.²¹ Johnson acknowledged that she discussed with Wallach the complaint in Wallach's letter of January 10, 1988, D8, and that Zetterstrom failed to cancel the indication of interest. T86. She also discussed with Wallach the statement that Zetterstrom removed money from an account on false pretenses without authorization. T87.

Johnson met with Gertrude and Aleta Wallach and discussed a letter from Wallach dated January 14, 1988. D9. Johnson recalled the Wallach complaints about forgery and improper use of LOAs as set out in the January 29, 1988 letter. D10, T95. The witness raised a question about the credibility of some of the

²¹ According to Johnson, an additional factor was Zetterstrom's misuse of LOAs. T224.

Wallach complaints. T96. Johnson also acknowledged a complaint from Zetterstrom client Nina Parkinson towards the end of 1987. It appears that Zetterstrom reported a certain price and executed the transaction at another price. T101.

On December 8, 1987, Connie Crebbin complained to Mark Conrad about an erroneous trade made by Zetterstrom. Johnson acknowledged that she was told about this. D5, T166. She testified about the Zetterstrom probation letter. D6. Apparently the document was worked on since January 22, 1988. T159.

The witness was asked to detail the steps she took in January 1988 to correct the situation with Zetterstrom. She indicated that she sent all of the complaint letters to the Legal and Compliance Departments. T415. She indicated that she confronted Zetterstrom about the allegations of forgery in the Wallach letters. He denied it and Wallach was uncertain as to the forgery. Johnson appeared to take the position that Wallach could not rationalize the forgery having occurred inasmuch as Zetterstrom did not benefit from the transaction. T417. She advised Taktikos and Conrad to watch Zetterstrom more closely. T418. It was agreed that Johnson and Conrad would monitor Zetterstrom account statements. T422. Johnson recalled making confirmation phone calls in two instances involving LOAs for Zetterstrom clients. In her dealings with Wallach it was brought out that Wallach wrote a letter complimenting Johnson and indicating how happy she was with the resolution that Johnson obtained in her behalf and that at that time Aleta Wallach suffered no loss of funds. T420, 424.

Included in the papers relating to the Morgan misappropriation was the LOA, a check to Gary Humecke, and a copy of the check. T184-186. Johnson did not

recall if she sent a confirmation on this transaction and she does not recall if the auditors found a copy. T190-191. However, she states that it was her policy to send out confirmation letters. There was similar testimony by the witness relating to the Morgan and Kraus misappropriations. T195, 201, 207, 208, 209, 210. Additionally, the witness testified that she did not recall seeing an LOA with respect to the \$32,000 Morgan, the \$15,000 St. Lawrence and the two \$20,000 Kraus misappropriations. T201, 208, 210, 211, 213, 217. Johnson left PaineWebber in June 1991. She indicated that she left because they eliminated her job and offered her another position. T434. She was unable to take a supervisory job because of the pending SEC matter. Johnson is now working as a stock broker for Smith Barney at considerably less compensation than she received while working for PaineWebber. T436. Johnson testified that procedures were changed after the Zetterstrom misappropriation. The new rule requires a negative consent letter before the check is signed. T438.

Beverly St. Lawrence

St. Lawrence, a licensed real estate agent, was a Zetterstrom client during 1977 and 1978. T104. She denied that she had an account at Glendale Federal and that she ever asked Zetterstrom or any one else on or about December 23, 1987, to withdraw \$15,000 from her account and that she never received the sum. T104-105, 107,124. She further denied that the authorization slip contained her signature or her handwriting and that she received a confirmation letter from PaineWebber indicating that the check was issued. T105, 108. Additionally she testified that Zetterstrom was never authorized to withdraw a check from her

account.²² T124. The witness was unable to understand the PaineWebber statements and apparently was unaware when the Zetterstrom misappropriation from her account occurred. T115, 118, 121, 140, 141. There was therefore no communication to Johnson by St. Lawrence indicating the loss of funds. T123. It appears that the first awareness she had of the loss of funds was when the PaineWebber auditors performed their audit.²³ T138. The witness was reimbursed for her loss by a payment including interest. T140. The witness indicated that she probably first saw the documents that Zetterstrom used to accomplish the misappropriation after the audit in 1988.

Nina Parkinson

The witness, an agent of foreign theatrical video and television distributors for the past fourteen years, was a client of David Zetterstrom from 1986 through 1988.²⁴ She talked to him almost daily. The size of her account ranged between three to four hundred thousand dollars. T242. She portrayed Zetterstrom as a very honest, charismatic young broker, extremely bright, seemed well informed, energetic, anxious to provide maximum information so the client could make a decision.

²²There is some confusion in the record on this point. It appears that the witness did authorize a payment in the sum of \$1,600 to Columbia Savings and Loan. T126-128,129. However, the witnesses faulty memory on the point seems of little significance given that the parties stipulated that the \$15,000 St.Lawrence misappropriation occurred and that the LOA documentation was not found by the PaineWebber auditors. S1.

²³ The testimony is not clear, However, by inference it would seem that the discovery of the loss corresponded with the time of the PaineWebber audit and settlement with the witness.

²⁴Part of the time her account was with Merrill Lynch. When Zetterstrom moved to PaineWebber, she moved her account with him. T242.

T243. She described an experience with Zetterstrom dating from October 1987 where the broker misquoted the price on some trades involving Penzoil stock and then prevaricated on how the matter would be cleared up. T248-253. Johnson cleared up the problem and reimbursed Parkinson after Zetterstrom admitted he was wrong. This was in December 1987. T253. In June 1988, Zetterstrom called Parkinson and advised that he left PaineWebber and was going into real estate. Parkinson learned that the next day Zetterstrom committed suicide. T255. Parkinson characterized Johnson's handling of the problem as "exceptionally well". T256.

Philip S. Freeman

Freeman worked for Zetterstrom as a sales assistant at Merrill Lynch and transferred to PaineWebber when Zetterstrom moved to that firm in January 1987. T262. At PaineWebber he worked for Zetterstrom and another broker as a sales assistant. T263. His functions included answering the telephone, answering client questions regarding statements, handling problems involving dividends, posting trades in account holding books and handling check requests for Zetterstrom. T260. He posted most of the information on trades. T291. Freeman estimated that Zetterstrom had about 50 million dollars in accounts. T293. The witness indicated that he never saw Zetterstrom read the compliance manuals. T264. He felt that Zetterstrom was an honest person and he was surprised when he heard that Zetterstrom misappropriated clients' funds. He learned of the misappropriations after they occurred. T266, 280.

The witness was asked about the \$18,000 misappropriation from the Morgan account. D13A. Freeman prepared the documentation 13A. T267. The witness

disclaimed ever seeing the LOA,(D13b), with Morgan's signature authorizing the withdrawal. T268. He testified about dealings with Aleta Wallach. He indicated that these dealings were largely perfunctory inquiries on the meaning of account statements. T271. Freeman stated, in effect, that he never had valid complaints from Wallach about her statements being wrong. T272, 285. Rather, he had complaints that were not warranted and he was not aware of complaints of forgery and misuse of LOAs. T272,285-286, 288. He recalled a complaint by Parkinson against Zetterstrom but he was not familiar with the charge that Zetterstrom misrepresented the price of a stock. T284. Further, Freeman denied he ever had a conversation with Johnson regarding Zetterstrom's transactions ²⁵ and that he did not know if Johnson knew that he performed so much of the LOA work. T291. The witness disclaimed knowledge of the Holland, Crebbin, and Van Pelt complaints against Zetterstrom. T284, 285.

Referring to Johnson's managerial style, he referred to it as strict and that she was strong in complying with and enforcing rules and procedures. She communicated these procedures to the brokers at weekly meetings. T273, 279. When Johnson was going to be out, she advised the office and delegated her functions. T279.

Respecting the LOA procedures he indicated that he handled over fifty percent of the LOAs and that he obtained LOAs from clients but he could not recall any specifically. T274, 290. He indicated that from January 1977 until June 1988 LOAs were procedurally required and insisted upon by management, without

²⁵ The witnesses memory is in question here. See memo to Freeman from Johnson dated November 18, 1987. R 19E, T293.

deviation, as a prerequisite for the delivery of third-party checks. T275. The witness denied that it was a practice of the brokers in the office to receive blank LOAs or to sign customers names to the LOAs. T289.²⁶

Arthur Edelman

The witness, was in the securities business thirty years and for the last ten years as a stock broker at the Beverly Hills PaineWebber office. T296, 303. He characterized Johnson as a superior and excellent manager with a hands on style and that she was meticulous in her instructions how office procedures should be followed. She maintained her control by frequent memos and personal contacts including delivery of reprimands and reviews of branch audits. When she was out of the office she generally informed the staff by a written memo. T300-304.

With respect to the misstatement of the price of stock, the witness indicated that even if a broker had done this repeatedly he would not fire him. T308.²⁷ He further testified that during the 1987 crash a broker might have quoted a price on the screen and when the order was filled it might come back at a different price. T313.²⁸ The witness denied knowing that LOAs were procured signed in blank by other brokers. He also was not aware that Zetterstrom had been placed on probation or that he had been accused of forgery by one of his clients. T309. As

²⁶ Johnson conceded that signing blank LOAs occurred in the industry and that Zetterstrom procured such documents. T231.

²⁷ Parkinson, a Zetterstrom client, received a misstated price as described more fully in the Zetterstrom probation notice. D6.

²⁸ This testimony appears to be intended to exculpate Zetterstrom from the Parkinson loss. However, it is at variance with the probation letter to the effect that Zetterstrom admitted error and a reimbursement arrangement was made. D6.

to the practice required by PaineWebber procedures to send confirmatory letters in the event of third party checks, he disclaimed any knowledge.²⁹ T310.

Wanda Taktikos

The witness worked for PaineWebber from April 1982 until October 1989. She worked as a staff accountant, assistant operations manager and as administrative assistant to Johnson. From April 1987 until July 1988 she worked as the operations manager of the Beverly Hills office of PaineWebber. As operation manager she had the cashier, wire operator, new accounts clerk and sales assistants reporting to her - all in support of Johnson the office manager. She received one week of training prior to her appointment as operations manager. This training included the procedures of issuance and check delivery. According to the witness, these procedures were adhered to in the branch and that she touched upon them daily with Johnson. She indicated that Johnson was the best manager, demonstrating high performance and strongly organized as well as a stickler for details. T316-323, T361-363. The sales assistant and the cashier were responsible for seeing that an LOA was attached to documentation in connection with issuance of a third party check. The witness testified that from January 1987 to June 1988, no checks were issued to third parties without the LOAs. T327-T330. Further, the witness stated that checks to third parties were typically not signed without LOAs. One copy of the LOA would be made and

²⁹The record shows some confusion on this point. After a side bar discussion, the witness reversed his testimony and stated, "I believe letters were sent out in certain situations but I'm not aware how they were done." Later, the witness substantially reverted to his earlier testimony indicating none of his clients had advised him that they received a confirmatory letter. T310-311.

possibly another copy for the broker. The first copy would be kept in a separate file in operations. In the event the broker or client picked up the check, there would be obtained a signed receipt. T329-330, 336.

The witness was asked about the procedures when a broker picked up a check. She indicated that the broker signs a log book and, on occasion, signed the top of the check as well. She was then asked, "when a broker went to pick up a check for delivery, that broker would sign both the check and the log book? She answered, "Possibly yes" T332-333.³⁰ The witness said she did random spot checks to make sure the procedures were adhered to. T335. She claimed that she never had problems with cashiering that had to be reported to the manager. T336. With respect to the period from January 1987 through June 1988, the witness indicated she never had any problems with the procedures of check delivery. T337. The witness indicated that the checks and required documentation was stored in a room in the back office that was locked every night. The confirmation letters were stored in a pendi-flex file with the cashier. T337. The witness knew when Zetterstrom was placed on probation. However she had no specific meetings with Johnson to discuss the issues. T338. The witness was asked, "Are you aware that there were certain restrictions placed on Mr. Zetterstrom's conduct as a result of being placed on probation? She answered "Today I am aware of that, yes."³¹ T339. The witness indicated that the issuance

³⁰ Later her testimony appeared to be unconditional giving the impression that the routine of the broker signing the check and the log book was unvarying. T333.

³¹ Later the position of the witness shifted after a series of leading questions and answers, to reflect that she was aware that restrictions was in fact placed on Zetterstrom at the time of the probation and that she had responsibilities relating

of LOAs was supposed to be verified by telephone. However, she personally made no phone verifications. T340-341. She recalled receiving a complaint about Zetterstrom from Helms which she referred to Johnson. She was not aware of the Parkinson and Crebbin complaints and only vaguely aware of the Van Pelt, Wallach and Holland complaints. T343, 366-367. When the PaineWebber auditors came together with the SEC to review records in the office there was no control over the documents that they removed. T345. When advised that the LOAs were reported missing by the auditors she indicated that it was impossible. T346.

She claimed, in substance, that the LOAs were attached to all the checks at one time. She further claimed that she would not have signed the checks issued to third parties at 14(c) and 16(c) and elsewhere without the LOA. T351, 354, 359. The witness testified that when Johnson was out of the office Taktikos or another designee was in charge.³² T363. When Johnson was away there was a log book kept reciting the details of what transactions occurred. T364.

Conclusions

The parties have stipulated that Zetterstrom misappropriated \$114,500 from client accounts at the PaineWebber office in Beverly Hills during the period from August 1987 through May 1988. This stipulated fact is tantamount to a stipulation that there was a wilful violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and I so find. Prudential-

thereto. This shift in the witnesses position has not been rationalized in the record. T339-340.

³² Johnson disputed that the witness became the manager in her stead. T439. Later the witness said that Mark Conrad ran the office in Johnson's absence. T364.

Bache Securities, Inc., 48 S.E.C. 372, 378 (1986) There appears to be no dispute as to this issue.

"Effective supervision by broker dealers is a critical element in the regulatory scheme." Mabon, Nugent & Co., 47 S.E.C. 862, 867 (1983). In dispute here is whether Zetterstrom's supervisor, the respondent Patricia A. Johnson, in violation of Section 15 (b)(4) (e) of the Exchange Act, failed to effectively and reasonably supervise Zetterstrom with a view towards preventing the above noted violations. In further dispute are what remedial sanctions would be appropriate, assuming there is a failure of supervision. Sections 15(b) and 19(h) of the Exchange Act. For reasons that will be discussed, it is considered that there has been a failure to reasonably supervise and that the proper sanction is in the form of a suspension from association as supervisor with a broker dealer for six months.

Respondent argues that the statute only requires "reasonable supervision under the attendant circumstances." Louis R. Trujillo, 49 S.E.C. 1106 (1989). However in assessing what reasonable supervision would be in this case respondent fails to give proper weight to her failure to take note of a significant number of red flags informing of the lack of LOAs in compliance with the PaineWebber procedures. Had she heeded the red flags and asserted proper supervisory controls, she would have prevented most if not all of the misappropriations. An early red flag occurred in March 1987 when the PaineWebber auditors articulated a repeat finding³³ that: the LOAs were missing

³³ The record does not show when the earlier finding was made. Presumably it was made in 1986 or earlier and would itself represent perhaps the earliest red flag.

in seven cases in 1986 in the instance of third-party checks and that the branch must have a letter of authorization on file before issuing the checks; the procedures for hand delivery of checks were not being followed.³⁴

There were further red flags in the nature of an abundance of serious customer complaints. These began as early as December 1987. At that time Parkinson indicated that Zetterstrom claimed to have purchased a stock for her at one price but actually purchased it at a much higher price and then lied to avoid a confrontation on the issue. Zetterstrom and PaineWebber acknowledged the error and reimbursed the client. Similar complaints were received from Wallach, Crebbin and Van Pelt in December 1978 and January 1988. Substantial settlements were made by PaineWebber and Zetterstrom in a number of these cases. Another customer Wallach, in January 1988, contended that Zetterstrom forged several signatures and lied to her about trading activity as well as using LOAs in blank. After receiving five such complaints, Johnson placed Zetterstrom on probation in February 1988. As indicated, in substance, in the testimony of Evans, the PaineWebber executive vice president, the probation status was one short step removed from firing the broker and it was a very rare action on the part of the company. Probationary status, as explained by the PaineWebber executive, is about the ultimate action that can be taken by the broker dealer to notice the supervisor that the broker involved had a real potential to injure the company and customers and had to be closely watched. It was perhaps the final red flag in a

³⁴When the PaineWebber auditors arrived in June of 1988 they found that in four of the six Zetterstrom misappropriations there was no LOA to be found.

whole series of red flags.³⁵ It is noted that Johnson inexplicably cannot recall whether she favored firing or not. T235-236. If she had fired Zetterstrom at the time, rather than placing the matter in limbo several more months by the device of probation, one more misappropriation would have been prevented.

It also must be asked what did Johnson do by way of enhanced supervision, as specified in the 1997 audit and the probation paper to heed these red flags? On analysis of the record, as will be discussed below, keeping in mind the protestations to the contrary, it is considered that little, if anything, was done to seriously come to grips with the problems. The result of this indifference reflects itself in the June 1988 audit finding of six misappropriations with four of the check packets missing LOAs.

Respondent argues that Section 15(b)(4)(E) of the Act contains a "safe harbor", which provides that no person shall be deemed "to have failed reasonably to supervise any other person" if she "reasonably discharged the duties and obligations incumbent upon him by reason of [his firm's] procedures" and had "no reasonable basis for believing that those procedures were not being complied with." 15 U.S.C. §780(b)(4)(E). Along those lines, Respondent and Taktikos advance the position, in substance, that they had no reason to believe that procedures were not being complied with inasmuch as the LOAs were all there prior to the time that the PaineWebber auditors and the Securities and Exchange Commission investigators visited the branch in June 1988. To follow this argument to its natural conclusion requires the inference that the documents were

³⁵Certainly, the gravity of these complaints might suggest to a competent supervisor that Zetterstrom be fired rather than being placed on probation.

lost by PaineWebber auditors and/or the SEC investigators. No evidence has been produced in support of this proposition and the respondent's testimony in support thereof is found not to be credible. It should be further observed that but for the lack of LOAs there is no explanation how the misappropriations occurred.

A close review of the evidence adduced by the respondent reveals inconsistencies that create further substantial doubt as to her claim that adequate supervisory controls were in place. Asked if at any time prior to August 1987 if she received notice that the procedures for third party checks was not always being followed, she answered "possibly." Asked again, she requested the question be repeated. Then she testified that no client called. She was asked if she received notice. She testified she would have to review documents. T71. Even after being shown the audit section relating to LOAs during cross examination she did not recall discussing the provision with the auditors. T74. This testimony suggests that she did not recognize the March 1987 audit report with respect to LOAs as a red flag or that she took any action in that regard. This lack of recognition on her part was a failure to supervise.

The record contains testimony that Johnson instructed her staff in her absence, especially assistant branch manager Conrad and operations manager Taktikos,³⁶ to follow the required procedures with respect to LOAs and that she also endeavored to follow these procedures. Assuming for discussion purposes

³⁶The respondent argues in her brief, at 9, that "the Commission recognizes that a branch manager may discharge her supervisory duties by reasonably delegating supervisory authority to others. See, e.g., In the Matter of Stuart K. Patrick, Administrative Proceeding File No. 3-7715 (May 17, 1993)." However the record fails to convincingly show that the delegation specifically addressed the problems of the LOAs.

the credibility of this testimony, it is remarkable that the methodology Johnson claimed she employed as did Taktikos was "random spot checking." Conrad's testimony was not offered so that his methodology is not known. Given the magnitude of the sums involved in the brokerage operation, there is no excuse for the failure to review the third party check transactions, item by item rather than randomly, especially considering the numerous red flags received. The result of respondent's failure to check the LOAs item by item was further evident in the probationary letter of February 1988 where two of the five complaints against Zetterstrom were premised on improper manipulation of LOAs. The letter specifically requires that LOAs were to be verified by Johnson, Conrad or Taktikos.³⁷ Notwithstanding this further red flag in the form of a specific admonition, on May 2, 1988, there was consummated by Zetterstrom yet another misappropriation. This was against the account of Kraus in the sum of \$20,000. The PaineWebber auditors reported no LOA was found on this transaction. It is

³⁷The Respondent further argues in her brief at 14 that, "After Mr. Zetterstrom's actions were discovered, PaineWebber modified its procedures concerning broker delivery of checks. Specifically, when a broker picked up a check, the check was not to be signed unless the accompanying confirmation letter was part of the package. Thus, the confirmation letter would be signed simultaneously with the check and given to Ms. Johnson's assistant to be mailed out to the client. The entire packet, the check, check request and proper documentation would then be returned to the cage. T438. It should also be recognized that the SEC found that PaineWebber, during the relevant time frame, failed to design appropriate procedures with respect to the issuance and delivery of checks. See, In the Matter of PaineWebber, Inc., Administrative Proceeding File No. 3-797 (February 18, 1993). Despite these modifications, Ms. Johnson can rely on the then-existing PaineWebber procedures to fall within the Act's safe harbor." This is essentially a digression. The critical procedural step was to obtain the LOA at the latest after the check was drawn. This was not done in a number of instances all in contravention of PaineWebber procedures and the admonition to Johnson by the auditors in March 1997.

submitted that using a random method of checking transactions was a critical failure in reasonable supervision and it enabled the misappropriations that occurred here.

The respondent has argued that Taktikos and Conrad were trained to competently act in her place when she was out of the office. The facts establish otherwise. All but one of the misappropriations occurred when Johnson was out. One might conclude that Zetterstrom particularly picked those occasions to raid the branch accounts knowing that supervision over Taktikos and Conrad and others respecting the third party checks was not disciplined but rather was slack, if it existed at all. The record supports this view: Taktikos was supposed to assert strong supervisory control over Zetterstrom in Johnson's absence but yet testified in substance that there was never any problems with LOAs during her tenure. Such a statement viewed in terms of the probationary status of Zetterstrom and the 1987 audit is astonishing on its face. Not to have known about the Zetterstrom manipulation of LOAs suggests that Taktikos was not trained in the critical area to act in Johnson's absence. Further, Taktikos testified, in effect, that she never met specifically with Johnson to discuss the Zetterstrom probation.

More striking is the testimony of Taktikos in response to the question as to whether she was aware of the restrictions placed on Zetterstrom as a result of the probation, she responded, "Today I am aware of that yes." T399. This strongly suggests that she did not receive even indirect notice of the supervisory controls she was supposed to employ in connection with Zetterstrom until the day of the

hearing seven years later.³⁸ As to the specific Kraus transaction where Taktikos signed the check misappropriated by Zetterstrom, she claimed inability to remember an LOA, a proper log book entry or seeing the confirming letter to the client. This testimony is further support of the view that Johnson failed to train Taktikos.

Also, it should be noted that not withstanding Johnson's contentions, Taktikos had either no knowledge or only vague knowledge of outstanding complaints against Zetterstrom by clients Parkinson, Crebbin, Van Pelt Wallach and Holland. These complaints, charging such things as forgery and manipulation of LOAs, should have been fully communicated to Taktikos if she was to act as Johnson's alternate. Failing to do so reflects a lack of reasonable supervision by Johnson. As was noted in the case of John H. Gutfreund, 52 SEC Docket 4370 (1992), "In situations where supervisors are aware of wrongdoing, it is imperative that they take prompt and unequivocal action to define the responsibilities of those who are to respond to the wrongdoing." This Johnson did not do.

As indicated, the testimony of Johnson and Taktikos to the effect that they observed the proper procedures and monitored Zetterstrom is not credible when

³⁸ Johnson's situation here strongly contrasts with the facts in Arthur James Huff, 48 SEC Docket 878 (1991), relied on by the respondents where Huff was excused by the Commission inasmuch as he had a lack of authority to affect the employees violative behavior. In the instant case, Johnson had the authority require Taktikos to check each LOA. Further, she had the authority to fire Zetterstrom and apparently did so on the spot in June 1978. It can be plausibly argued that Johnson further failed in her supervision when she did not fire Zetterstrom in February 1988, considering the volume and magnitude of complaints against him.

one considers Taktikos ignorance of the charges against Zetterstrom and Johnson's unfamiliarity with the 1977 audit findings on the LOAs.

Public Interest

The determination of a sanction depends on the facts of each case. Critical to such a determination is the value of a sanction in preventing a recurrence of the same or similar violations as well as its deterrent value. Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Leo Glassman, 46 S.E.C. 209, 211 (1975); Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n.67 (1976).

Imposition of administrative sanctions requires consideration of:

...the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that his occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir., 1979), aff'd on other grounds, 450 U.S. 91 (1981).

Respondent argues, citing the same or similar cases as the Division, that "the evidence shows that imposing sanctions on Ms. Johnson would not be in the public interest." I disagree. It is acknowledged that Johnson won the national PaineWebber award for managing a branch and that she presented convincing evidence from a number of witnesses that she was a "hands-on supervisor" with superior qualities. However, her blind spot and egregious behavior was her failure to set up supervisory controls which resulted in the distribution of third party checks without written authority (LOAs) and the attendant loss of large sums of investor money and investor confidence. Further, her failure to supervise was after

repeated red flags. Also, her the failure was recurrent going back to 1986 or earlier. Additionally, the failure to reasonably supervise resulted in misappropriations over many months. Also notable is Johnson's failure to recognize the wrongful nature of her failure to supervise.³⁹

Instructive are analogous sanction cases involving broker-dealers' failure to supervise. In First Albany Corporation, 51 SEC Docket 106 (1992), the branch manager failed to reasonably supervise a registered representative who misappropriated \$129,000 from a customer's account through the issuance of 13 unauthorized checks, and converted the funds to his own use. The registered representative accomplished this scheme by using forged letters purportedly authorizing the withdrawals and transfers. 51 SEC Docket at 109. In First Albany, the company's procedures required that customer letters of authorization be scrutinized. This is similar to the requirement imposed upon Johnson by the 1987 audit and the existing PaineWebber procedures. In First Albany, as in the instant case, the branch manager failed to comply with the procedures. The failure in First Albany resulted in the issuance of seven checks payable to the registered representative's bank where he maintained a personal checking account. Six checks from customer accounts were made payable to third parties, including several of the registered representative's creditors. 51 SEC Docket at 112. The Commission found that the branch manager was not in compliance with the procedures regarding check disbursements and failed reasonably to supervise the

³⁹The single admission of error seemed to be when Johnson fired Zetterstrom and stated to him, "I don't know how to supervise you, I don't know what to do with you."

registered representative. The Commission ordered, among other things, that the branch manager be barred from associating in a supervisory capacity with any regulated entity, with a right to reapply in three years. 51 SEC Docket at 119.

In Prudential-Bache Securities, the Commission found that a branch manager failed to reasonably supervise a registered representative who had misappropriated about \$2,000,000 from customer accounts by inveigling customers to sign LOAs in blank and forging other LOAs. 48 S.E.C. at 383-84. Prudential company procedures required branch manager approval for the issuance of third party checks with this approval being granted rarely. As in the instant case, a log was supposed to be maintained and confirmatory letters were required to be sent. 48 S.E.C. at 385. Before releasing the third-party check, the manager was required to check all procedures and to make a verification call to the customer. At the hearing, the company was unable to establish that the procedures had been followed. 48 S.E.C. at 392. The Commission found that the branch manager failed to comply with the procedures and thus failed to reasonably supervise his subordinates. 48 S.E.C. at 395-96. The Commission ordered, among other things, that the manager be suspended from acting in a supervisory capacity in association with any regulated entity for one year. 48 S.E.C. at 405-06.

Accordingly, it is considered in the public interest that the deficiencies in supervision exhibited in the Beverly Hills Branch by Johnson which resulted in six misappropriations by Zetterstrom from clients accounts be the subject of a sanction. It is considered that a one year sanction as requested by the Division is too harsh under the circumstances and that a six month sanction will suffice.

Upon careful consideration of the record, the arguments and contentions of the parties, it is concluded that it is in the public interest that Johnson should be suspended from association in a supervisory position with any broker or dealer for a period of six months. Although the sanction may seem severe to Johnson, her inability to recognize her supervisory shortcomings, which contributed to still further failures to reasonably supervise as recorded in these proceedings, demands imposition of a stern remedial sanction. The imposition of a six month suspension may serve to impress upon Johnson the seriousness with which the Commission views supervisory responsibilities of those assuming oversight of compliance practices and procedures within a securities firm and serve to deter managerial personnel with other securities firms from taking their supervisory responsibilities lightly.⁴⁰

Last, there is an issue referred to me by the Commission in its order dated February 23, 1994 as to whether the Commission is guilty of laches. True enough the events complained of occurred in 1987 and 1988. However there has been no showing in the record of prejudice to the respondent by reason of the delay in bringing this administrative proceeding.⁴¹

The case law makes clear that the government in general (when acting in a non-proprietary capacity) and the SEC in particular are not subject to a defense

⁴⁰All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

⁴¹Further there appears to be little in the way of facts in respondent's submission of proposed findings of facts and conclusions of law that suggests that she suffered any prejudice by reason of the delay in instituting the administrative proceeding.

of laches. United States v. Summerlin, 310 U.S. 414, 426 (1939); see also Costello v. United States, 365 U.S. 265, 281 (1961) (27 year lapse in commencement of denaturalization proceedings not subject to the defense of laches); Chevron U.S.A., Inc. v. United States, 705 F.2d 1487, 1491 (9th Cir. 1983).

In the context of securities law enforcement by the SEC, the court in SEC v. Gulf & Western Industries, Inc., 502 F. Supp. 343, 348 (D.D.C. 1980), relying on the Supreme Court's decision in Summerlin, held that "[a] claim of laches . . . cannot be applied to a government agency working in the public interest." A similar result was reached in SEC v. Hayes, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96, 236 at 91, 228 (N.D. Tex. July 25, 1991).

The Commission indicated in Milton J. Wallace, 45 S.E.C. 694 (1975), where a similar laches claim was raised that, "the standards applicable to a remedial proceeding such as this where there is no threat to the respondent's liberty and where public interest issues are present can hardly be as stringent as those that govern in a criminal case. Hence Becker's motion lacks merit." Accordingly it is considered by analogy that the laches claim here also lacks merit.

ORDER

IT IS ORDERED that Patricia A. Johnson be suspended from acting in a supervisory capacity with any broker or dealer for a period of six months.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice.

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review

of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Glenn Robert Lawrence
Administrative Law Judge

Washington, D.C.
April 12, 1994