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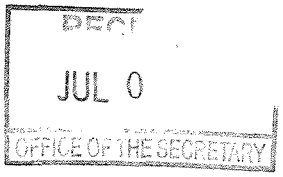
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15873



In the Matter of

Thomas R. Delaney II and
Charles W. Yancey

Respondents.

DIVISION OF ENFORCEMENT'S RESPONSE TO DELANEY'S APPLICATION FOR FEES AND COSTS

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Pursuant to 17 C.F.R. § 201.52, the Division of Enforcement hereby answers and objects to respondent Thomas R. Delaney's application for attorneys' fees and costs under the Equal Access to Justice Act ("EAJA"). As detailed below, the Court should deny Delaney's application because the Division's case, when viewed as a whole (as EAJA says it must be), was appropriately charged and prosecuted: the Division prevailed on its causing claim, which arose from the same facts and evidence as its aiding and abetting claim; there was significant evidence supporting the Division's aiding and abetting allegations, making that claim substantially justified; and the Division's expert's profit calculation error, while regrettable, cannot be the basis of an EAJA award since motive is not an element of an aiding and abetting claim and in any event there was other evidence of Penson's financial motive to violate Rule 204.

I. Introduction

In May 2014, the Commission issued an Order Instituting Proceedings ("OIP") in this matter. In that Order, the Division alleged that Delaney aided and abetted and caused Penson Financial Services, Inc.'s violations of Rule 204T and subsequent Rule 204. *See* OIP ¶ 85.[1] The OIP alleged that Delaney was informed that Penson was not in compliance with Rule 204's requirements but that he did not investigate the violations or elevate the issue to Penson senior management, and that he concealed the violations from regulators. *See* OIP ¶¶ 25-68.

[1] Briefly, Rule 204T and Rule 204 require (among other things) that broker-dealers such as Penson "close out" securities that had been traded but not appropriately delivered within certain specified time frames. As relevant to this proceeding, the rule requires broker-dealers to close out failures to deliver related to long sales of securities by or before the market open on the sixth day after the trade date ("T+6").

Following a two-week hearing, the Court issued an Initial Decision ("I.D.") finding that Delaney was a cause of Penson's Rule 204 violations. Among other things, the Initial Decision found that "[s]ince the time that Rule 204T was adopted in the fall of 2008, Delaney should have known that Penson's Stock Loan department may well face challenges complying with the rule." I.D. at 46. The Initial Decision further found that Delaney was informed about compliance challenges that Stock Loan was having, that "[i]t was not reasonable for Delaney to presume full compliance without follow-up once explicitly informed" of these challenges, and that "[d]ismissively telling [the head of Stock Loan] that if he was having trouble with the rule, he should 'write [his] congressman,' falls short of reasonable prudence." *Id.* at 46-47. The Initial Decision also found, however, that the evidence did not prove that Delaney aided and abetted Penson's violations – a charge that was based on the same underlying evidence as the causing claim, but that required showing Delaney knew of the violations or acted with extreme recklessness.

The Initial Decision sanctioned Delaney by imposing a cease-and-desist order and a civil penalty for each of the four acts that caused Penson's violations. In ordering Delaney to cease-and-desist, the Initial Decision found that "the large number of violations – at least 1,500 – associated in some way with Delaney's negligence, makes this an exponentially more serious matter than a matter in which a compliance officer's failure to exercise reasonable care resulted in only one violation." I.D. at 59. The Initial Decision further noted that Delaney had not "acknowledged his failure to follow the standard of care in relevant respects, apologized, [or] expressed remorse." *Id.* In imposing a civil penalty, the Initial Decision noted that, given Delaney's negligence was

a cause of at least 1,500 violations, "there is a need to deter him, and others like him, from such failures in the future." *Id.* at 62. The Initial Decision did not impose a bar or disgorgement.

Neither Delaney nor the Division appealed either the merits findings or the sanctions imposed in the Initial Decision, which became final on April 29, 2015. On May 29, 2015, Delaney submitted an application for fees and costs under EAJA.[2]

EAJA does not automatically authorize an award of fees and expenses, but rather provides that a respondent may be entitled to fees and costs when he prevails against the government on a "significant and discrete substantive portion" of a proceeding if, and only if, the government's position was not "substantially justified." Moreover, Commission precedent directs that any EAJA analysis must consider the case "as an inclusive whole, rather than as atomized line items.'" *In re Flanagan*, No. 8437, 2004 WL 1538526, *4 (July 7, 2004) (quoting *Comm'r, INS v. Jean*, 496 U.S. 154, 161-62 (1990)).

When the case is considered as a whole, the Division is the prevailing party – there has been a change in the parties' positions in that Delaney was found to have violated the securities laws and sanctions were imposed for those violations. Because the Division is the prevailing party "as a whole," an EAJA award is not appropriate.

But even if the case were considered at a more atomized level – by claim – Delaney is not entitled to fees and costs under EAJA. One could argue, as Delaney has,

[2] Delaney submitted his application under 28 U.S.C. § 2412, which is the EAJA statute that applies to *district court actions. See Melkonyan v. Sullivan*, 501 U.S. 89, 94-95 (1991) (28 U.S.C. § 2412 applies to district court actions and 5 U.S.C. § 504 applies to administrative proceedings). As detailed below, arguing under the wrong statute, much of Delaney's motion is inapplicable or just plain wrong.

that the Division prevailed as to the causing claim against Delaney and Delaney prevailed as to the aiding and abetting claim. As the Court noted in the Initial Decision, however, the facts and evidence underlying each of these claims was the same; the only issue was whether that evidence showed Delaney acted knowingly or recklessly (for aiding and abetting liability) or negligently (for causing liability). *See* I.D. at 49. Because the facts and evidence are inextricably intertwined, Delaney has not prevailed on a "discrete portion" of the proceeding.

In addition, as discussed in detail below, the Division's position on aiding and abetting was substantially justified. The Division had significant evidence that Delaney knew or was reckless in not knowing of Penson's Rule 204 violations, including the investigative testimony of various percipient witnesses who claimed Delaney was informed of the violations. For example, one member of Stock Loan management (Rudy DeLaSierra) testified – both during the investigation and at the hearing – that Delaney knew Stock Loan was not closing out failures to deliver in compliance with Rule 204. While several of these witnesses were less direct regarding Delaney's knowledge at the hearing than they were in their investigative testimony – a reality familiar to any trial lawyer – the fact remains that the Division was substantially justified in asserting that Delaney aided and abetted.

Delaney argues that the Court should consider the case on a still more atomized basis. More specifically, Delaney has focused particular attention on the Division's allegation that there was a financial motive to violate Rule 204. Notably, Delaney cites no authority that would allow such an atomized analysis under EAJA, and such an analysis would violate Commission precedent requiring the Court to consider the

Division's case as a whole. Indeed, this Court has previously recognized that motive is not a mandatory element of the Division's aiding and abetting claim, and the Division focused its case on Delaney's knowledge, recklessness, and negligence, not his motive. Nonetheless, even if Delaney's EAJA claim were isolated to this motive issue alone, there is still no basis for an EAJA award.

First, because motive is not an element of any claim in this case, Delaney cannot be said to have prevailed on a "substantive portion" of the proceeding. In addition, as discussed below, the Division's allegations of financial motive were substantially justified.

The issue of motive – and specifically financial profit to Penson for violating Rule 204 – was never a centerpiece of the Division's case. As an initial matter, the Division never alleged or contended that Delaney personally profited from Penson's violations, or that he intended to do so. Moreover, the Division never alleged or contended that Delaney was motivated solely by financial profits to Penson. As discussed below, the Division alleged that Delaney was primarily motivated by the avoidance of financial losses or costs, which were unquantifiable because they were never incurred.[3] There was significant evidence – both gathered during the Division's investigation and adduced during the hearing – of the costs that Penson would have incurred had it complied with the Rule. For example, a Penson executive (Brian Gover) stated in a

[3] As detailed in Appendix 1, which contains examples of the evidentiary support for the Division's scienter allegations in the OIP, the OIP's allegations and supporting evidence regarding Delaney's motive focused on cost avoidance. Moreover, in the Division's Response to Delaney's pre-trial Motion for a More Definite Statement, the Division specifically noted that its allegations of motive were tied to the avoidance of financial losses or costs. *See* Div. Opp. to Delaney's Motion for a More Definite Statement at 8-9 (filed June 19, 2014).

declaration that Delaney and the senior vice president for Stock Loan discussed possible steps to bring Penson into compliance with Rule 204 but rejected those steps because, among other things, of the costs Penson would have incurred. Similarly, a Stock Loan employee (Lindsey Wetzig) testified that, had Penson complied with Rule 204, it would be "out of business."

This evidence of financial motive was corroborated by admissions in Delaney's own Wells submission, and specifically his admission that Penson had "*huge financial incentives*" to violate the Rule. While the Court ultimately determined to afford this Wells submission little weight, the Wells submission was admitted into evidence, and the Court only made its determination to discount the submission following the hearing. It provides yet additional evidence that substantially justified the Division's allegations of a financial motive for violating Rule 204.

In the Initial Decision, the Court placed great weight on the fact that the Division's expert witness, Dr. Larry Harris, erroneously calculated a measure of financial benefit to Penson for violating Rule 204. While regrettable, that erroneous calculation did not significantly influence the Division's case. The Division did not rely on Dr. Harris's calculation in charging the case: Dr. Harris did not complete his calculation until September 2014, well after this case was charged. And after the error was pointed out by Delaney's expert in mid-October 2014, the Division ceased relying on the calculation at all, and Dr. Harris immediately acknowledged the error at trial.

For all of these reasons, and as explained in further detail below, Delaney was not the prevailing party on any discrete, substantive portion of the proceeding, and so is not entitled to any award under EAJA. Furthermore, the Division's position in this

litigation was substantially justified and thus no fees should be awarded. Finally, Delaney's application suffers from various deficiencies that preclude any award. Delaney's EAJA claim should be denied.

II. Argument

A. The Equal Access to Justice Act

Pursuant to 5 U.S.C. §504, the Commission has adopted regulations for EAJA applications arising in Commission administrative proceedings. *See* Commission Rules of Practice 31-60, 17 C.F.R. §§ 201.31-60. Commission Rule of Practice 35(a) provides that "a prevailing applicant may receive an award for fees and expenses incurred in connection with a proceeding or in a significant and discrete substantive portion of the proceeding, unless the position of the Office or Division over which the applicant has prevailed was substantially justified." 17 C.F.R. § 201.35(a). Other provisions set forth the specific requirements an applicant must meet to qualify for an award of fees and expenses.

EAJA "is not intended to be an automatic fee-shifting device in cases where an applicant prevailed." *In re Flanagan*, Rel. No. ID-241, 2003 WL 22767598, *4 (Nov. 24, 2003). EAJA's aim is to redress abusive governmental conduct. *See, e.g.*, *SEC v. Price Waterhouse*, 41 F.3d 805, 809 (2d Cir. 1994) (Leval, J., dissenting in part from denial of EAJA fee award: "The provisions of the EAJA ... are designed to compensate victims of *unjustified* litigation by the Government .... The Act essentially recognizes that abusive litigation tactics by the United States government, whether the Government appears in the role of plaintiff or defendant, can inflict great unjustifiable cost and expense. It is designed to furnish relief from such governmental litigation abuse.") (emphasis in

original); *Jones v. Hodel*, 685 F. Supp. 4, 7 (D.D.C. 1988) ("Congress enacted EAJA to 'reduce the enormous financial burden' that litigants would face in challenging abusive governmental tactics."). Because EAJA serves as a partial waiver of sovereign immunity, it must be strictly construed in favor of the government. *See, e.g.*, *In re Kirk*, Rel. No. 34-45161, 2001 WL 1618266, *10 (Dec. 18, 2001).

As explained in detail below, this proceeding falls well outside of the type of conduct EAJA was intended to address. The Division prevailed on one of its two claims (causing) arising from the same facts and evidence as the claim it failed to persuade the Court on (aiding and abetting), and obtained some (though not all) of the relief it sought. That the Court was not ultimately persuaded by the Division's evidence of scienter in support of the aiding and abetting claim is a far cry from the type of abusive governmental conduct that EAJA was meant to address.

B. Delaney did not prevail in a "discrete substantive portion of the proceeding."

As noted above, Delaney may only receive an EAJA award if he prevailed in a "discrete" and "substantive" portion of the proceeding. *See* 17 C.F.R. § 201.35(a). As explained below, he did not do so.

1. The Division prevailed in establishing that Delaney's conduct violated the securities laws.

The Division's claim in this case was that Delaney aided and abetted and caused Penson's violations of Rule 204. *See* OIP ¶ 85. While this position encompassed two charges – aiding and abetting, on the one hand, and causing, on the other – as Delaney previously acknowledged and the Court previously recognized, the basic facts and evidence underlying this position were the same. See I.D. at 49. The Court concluded

that those facts and evidence established that Delaney negligently caused Penson's violations. Delaney did not appeal this finding.[4]

Further, the Court sanctioned Delaney for his conduct, imposing a cease and desist order and civil penalties. *See* I.D. at 59-62. Delaney argues the fact that the Division did not obtain all of the remedies it sought, such as a bar or disgorgement, makes him a prevailing party. EAJA Br. at 4-5. But the fact that the Division did not obtain all of the remedies sought does not automatically mean Delaney prevailed. *See SEC v. Litler*, 874 F. Supp. 345, 347 (D. Utah 1994) (defendant was not a prevailing party and thus not entitled to costs/fees because SEC prevailed in proving that he negligently violated Section 17(a)(2), even though defendant won some relief because no injunction was issued against future conduct).

In sum, when the case is considered as a whole, the Division prevailed: it proved Delaney violated the securities laws and obtained sanctions. As a result, an EAJA award is not appropriate.

2. Aiding and abetting was not a "discrete" portion of the proceeding.

Relatedly, the Division's aiding and abetting claim was not a "discrete portion" of this proceeding. Indeed, in assessing Delaney's defenses to the Division's causing claim, the Court specifically analyzed whether it depended on discrete evidence separate from the aiding and abetting claim. I.D. at 49. The Court held that "[t]he

[4] Delaney spends a significant portion of his EAJA application arguing that the Division never asserted a negligence case, including quoting public statements by Division officials at the time the case was charged. *See* EAJA Br. at 3, 4, 5, 7, 8-9. However, ALJ rejected this very argument in the Initial Decision, noting that Delaney himself conceded in his prehearing brief that "the same evidence [relating to the Division's intentional misconduct case] would preclude a finding that Delaney acted negligently or otherwise caused or contributed to any violations ...." I.D. at 49. Delaney did not appeal this ruling and cannot relitigate it now.

Division did not offer a new set of facts or body of evidence in support of its negligence claim – as Delaney acknowledged, the facts and evidence are the same, whether the conclusion is that Delaney acted intentionally, acted recklessly, or acted negligently." *Id.* This conclusion makes good sense: aiding and abetting and causing are both theories of secondary liability, and depend on the finder of fact's assessment of a respondent's state of mind (knowingly, recklessly, or negligently) in assisting the primary violation. Because of this, and as Delaney himself has conceded in prior filings, there was no added burden in defending the aiding and abetting claim. *See* Delaney Prehearing Br. at 36 ("[T]he same evidence detailed above in the background section and with respect to recklessness also would preclude a finding that Delaney acted negligently or otherwise caused or contributed to any violations of Rule 204T(a)/204(a)."). Because this case involved a single set of facts and body of evidence, and Delaney did not prevail on all claims related to that set of facts and body of evidence, there is no "discrete portion" of the proceeding upon which Delaney can be awarded fees.

3. Motive was not a "substantive" portion of the proceeding.

Both Delaney and the Court have focused specifically on the Division's allegation that there was a financial motive to violate Rule 204. Delaney, in his supplemental brief argues that the motive was a necessary element of the Division's case. Supp. EAJA Br. at 9. He is wrong however – as the Court has already noted, motive is not a mandatory element of an aiding and abetting claim. I.D. at 34. Put another way, the Division was not compelled to establish what motivated Delaney to prove its case. As such, the motive issue cannot properly be considered a "substantive" portion of this proceeding. *See, e.g.*, *Black's Law Dictionary* 745 (5th Ed. 1983) (Substantive: An essential part of constituent or relating to what is essential.).

C. The position of the Division was substantially justified.

Even if Delaney were a prevailing party on a "discrete substantive portion" of the proceeding, no fees or expenses may be awarded to Delaney if the Division can show that its position was substantially justified. 17 C.F.R. § 201.35(a). The Commission has instructed that, if the Division's case is "justified to a degree that could satisfy a reasonable person," then an award is not allowed. *Flanagan*, 2004 WL 1538526, at *4 (finding an award of fees unwarranted). As the Supreme Court has explained, "substantially justified," does not mean "justified to a high degree," but rather is satisfied if there is a "genuine dispute." *Pierce v. Underwood*, 487 U.S. 552, 566 n.2 (1988) ("[A] position can be justified even though it is not correct, and ... it can be substantially (*i.e.*, for the most part) justified if a reasonable person could think it correct..."). The substantially justified standard, while greater than "mere non-frivolousness," requires "less than a showing that the government's 'decision to litigate was based on a substantial probability of prevailing.'" *Hill v. Gould*, 555 F.3d 1003, 1006 (D.C. Cir. 2009) (quoting *Taucher v. Brown-Hruska*, 396 F.3d 1168, 1173 (D.C. Cir. 2005).[5]

Because an EAJA claim is evaluated under the "substantial justification" standard, rather than the more stringent preponderance of the evidence standard applied in the underlying hearing, "the conclusions ... reached in the proceeding on the merits do not determine the substantial justification question for EAJA purposes."

[5] *See also SEC v. Fox*, 855 F.2d 247, 254 (5th Cir. 1988) (affirming denial of an EAJA award against Commission, notwithstanding the fact that "SEC was soundly defeated at trial, and the case was not artfully pleaded"); *Broussard v. Bowen*, 828 F.2d 310, 314 (5th Cir. 1987) (affirming denial of an EAJA award and finding that government's position had reasonable basis in fact, so fees denied even though plaintiff "prevailed and should have prevailed," and government's "position was hardly objective").

Flanagan, 2004 WL 1538526, at *4 (denying EAJA application even though Commission had previously dismissed all charges on the merits).[6] Rather, there must be an "independent evaluation" of whether the Division's case was substantially justified. *See, e.g.*, *Flanagan*, 2004 WL 1538526, at *4. The purpose of this evaluation is "not to weigh the strength of [the respondent's] case, but rather to assess the case presented by the Division." *McCook*, 2003 WL 1542104, at *3 *cf. Hill*, 555 F.3d at 1007 ("Of course the Secretary's position did not prevail. But the question is not whether the Secretary had the better arguments. It is enough that the Secretary's interpretation and legal arguments had a reasonable basis ...."). The Division's position may be substantially justified "even if the trier of fact finds the evidence insufficient to prove the violations alleged." *McCook*, 2003 WL 1542104, at *3; *see also Pierce*, 487 U.S. at 565 (substantial evidence does not require "a large or considerable amount of evidence, but rather 'such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.'") (quoting *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938)). For this reason, Delaney's claim that the Division's Director of Enforcement admitted the Division "lost an administrative proceeding against an individual" in this case is simply irrelevant for EAJA purposes. EAJA Br. at 7.

Moreover, no fees or expenses may be awarded under the EAJA if the Division had witnesses or other evidence, but the evidence was not credited or the witness was

[6] *See also In re Blizzard*, Rel. No. IA-2409, 2005 WL 1802401, *3 (July 29, 2005) ("Because 'substantial justification' is a different and less stringent standard than the 'preponderance of the evidence' standard used to determine liability for a substantive securities violation, the conclusions we reached in the proceeding on the merits are not dispositive of the outcome of the [EAJA matter]."); *In re McCook*, Rel. No. 34-47572, 2003 WL 1542104, *3 (March 26, 2003) ("Because the EAJA analysis involves a standard different from that applied in the underlying action, the conclusions reached in the initial proceeding are not dispositive.").

not believed. In fact, it is an abuse of discretion to find that a position is not substantially justified when a case hinges on credibility determinations or other evidentiary issues weighed by the finder of fact. *Wilfong v. United States,* 991 F.2d 359, 368 (7th Cir.1993); *Vendor Surveillance Corp. v. U.S.*, 116 F.3d 488 (Table), 1997 WL 334988, *1 (9th Cir. June 12, 1997); see also *U.S. v. Hurt*, 676 F.3d 649, 653 (8th Cir. 2012) (no EAJA award because outcome of case was based on credibility determinations); *Mester Mfg. Co. v. INS,* 900 F.2d 201, 204 (9th Cir.1990) (same).

Because the Division's positions, as a whole and separately, were substantially justified, Delaney is not entitled to any award.

1. The Division's case viewed as a whole was substantially justified.

The Commission has made clear that the relevant consideration is "whether the Division's case *as a whole* was substantially justified." *Flanagan*, 2004 WL 1538526, at *4 (emphasis added). This is because EAJA "'favors treating a case as an inclusive whole, rather than as atomized line items.'" *Id.* (quoting *Jean*, 496 U.S. at 161-62). Thus, even if certain charges or allegations in the Division's case are not substantially justified, the overall case may still be substantially justified. *Id.* at *8 (finding that "even if the charges dismissed in the Initial Decision were not substantially justified, the overall position of the Division's case ... has a substantial justification.").

As noted above, the Division's case against Delaney was that he aided and abetted and caused Penson's violations of Rule 204. The very fact that the Court found Delaney had caused Penson's violations – a finding based on the same facts and evidence as the Division's aiding and abetting claim – weighs strongly in favor of finding that the Division's overall position was substantially justified. *See Litler*, 874 F. Supp. at

347 (SEC's claims were substantially justified when it prevailed on its claim that defendant acted negligently in violating Section 17(a)(2) of the Securities Act, despite court's determination that defendant lacked scienter and that injunctive relief was unwarranted). Assessing whether evidence shows a respondent acted knowingly or recklessly, or negligently, is often a close call over which reasonable people can disagree without being substantially unjustified if a finder of fact ultimately disagrees with their judgment. Indeed, the Commission has repeatedly found substantial justification for the Division's position even when the Division loses entirely at the merits stage. *See, e.g.*, *Blizzard*, 2005 WL 1802401 (denying EAJA claim even though Commission dismissed aiding and abetting and causing claims at the merits stage); *Flanagan*, 2004 WL 1538526 (denying EAJA claim even though Division failed to prove liability under numerous statutes and rules at the merits stage); *In re Rita Villa*, Rel. No. 34-42502, 2000 WL 300264 (March 8, 2000) (denying EAJA claim even though ALJ dismissed charges at close of Division's case and Commission affirmed dismissal of charges). In short, the Division's case, as a whole, was substantially justified.

2. The Division's aiding and abetting claim was substantially justified.

Even if the Court slices the Division's position more finely, and assesses only whether the aiding and abetting charge was substantially justified, it was.

The elements of aiding and abetting are 1) a primary violation; 2) substantial assistance of that violation; and 3) knowledge of, or reckless disregard of, the wrongdoing and a role in furthering it. *See, e.g.*, *In re Brown.*, Rel. No. 34-66469, 2012 WL 625874, *11 (Feb. 27, 2012). While Delaney contested prior to and throughout the hearing that a primary violation had occurred, he ultimately stipulated that Penson,

through Stock Loan, had committed primary violations of Rule 204T and Rule 204. I.D. at 34. The Division was also substantially justified in alleging that Delaney acted with the relevant scienter, and that he substantially assisted the primary violations.

a. Scienter

The Division was substantially justified in asserting that Delaney knew of or recklessly disregarded Penson's violations of Rule 204T and Rule 204. While the Court ultimately found that the Division had not proved by a preponderance of the evidence that Delaney acted knowingly or recklessly, Delaney is simply wrong when he claims the Division "had no evidentiary support for its scienter allegations in the OIP." Supp. EAJA Br. at 10.

Delaney's scienter was evidenced by numerous admissions in his Wells submission that conceded his awareness that Stock Loan was violating Rule 204, and other percipient witnesses' investigative testimony that Delaney was informed of these violations. Evidence based on these pre-trial statements – which, obviously, was the only testamentary evidence available to the Division at the time of charging and the outset of trial – is particularly relevant. *See Flanagan*, 2004 WL 1538526, at *7 (denying EAJA claim and finding that even though witness gave hearing testimony that was inconsistent with witness's pre-hearing statements to the Division, the Division "had substantial justification for believing it could establish a factual basis for [the allegation] when it brought the case"). Although the Court, after the conclusion of the hearing, determined not to rely on Delaney's Wells submission, and although certain witnesses' trial testimony was less direct than their investigative testimony or statements on the

issue of Delaney's knowledge, the Division, at charging and at trial, had substantial justification for its claims.[7]

i. Delaney's Wells Submission

The Division's position concerning Delaney's knowledge rested, in large part, on Delaney's own admissions in his Wells submission that he knew of Stock Loan's violations of Rule 204. These admissions were not legal arguments of counsel, but rather were factual statements about Delaney's knowledge and Delaney's actions. Moreover, Delaney testified repeatedly that he had reviewed the Wells submission and approved its submission.[8] The Wells was admitted into evidence. While the Court, after the hearing, determined to accord these admissions "sparing weight," they are, nonetheless, admissions against interest by Delaney that provided substantial justification for the Division's aiding and abetting allegations. These admissions include the following:

> Mr. Delaney set up procedures to generate reports and testing specifically designed to address issues raised by regulators concerning timely closing out short and long sale transactions. For example, **when asked about the close out requirements in Rules 204T and 204, Mr. Delaney knew that the close out issue might begin with Stock Lending**, which was the only group at PFSI that could have direct financial incentives not to close out some sales on time, but that several other business units, including the Operations Unit and the Trading and Execution Desk, clearly had a direct role in compliance with the close-out rules.[9]

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[7] In addition to the evidence outlined below, the Division has compiled examples of the evidentiary record to support the scienter allegations in the OIP. Those examples are included as Appendix 1 to this brief.

[8] Hearing transcript (Delaney) at 573, 1410.

[9] Beginning in November 2008, the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted a review of Penson's Rule 204T procedures. Stipulated Finding of Fact 28. Thus, a reasonable reading of Delaney's statement is that Delaney knew OCIE was raising issues concerning timely closing out of short and long sale transactions in

Delaney Wells submission, Ex. 157, at 16.

At all times, Mr. Delaney worked directly with PFSI's business units, management, and outside counsel to bring PFSI into compliance with regulatory issues, including those pertaining to short and long sales. ... **Mr. Delaney escalated issues related to Regulation SHO frequently, sometimes daily, for the entire period from 2008 to 2011**.[10]
Delaney Wells submission, Ex. 157, at 21.

[Delaney] escalated failures to comply with policy to multiple levels of upper management in their regularly-held meetings and in unscheduled visits Mr. Delaney made specifically for the purpose of addressing these compliance failures.[11]
Delaney Wells submission, Ex. 157, at 21.

All of these issues were raised many times – both routinely and extraordinarily – with Mr. Yancey, who was responsible at PFSI to deal with the issues and concerns Compliance escalated. Even though Mr. Yancey was well aware of all the **challenges of complying with Rules 204T, 203, and 204 at PFSI**, he did not take steps to encourage, much less require, changes to PFSI's, and particularly **Stock Lending's, practices**.[12]

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connection with its examination which began in November 2008, otherwise his claim that he set up procedures to address those issues has no meaning. In addition, a reasonable reading of Delaney's statement is that Delaney knew that there were issues with the close out requirements of Rule 204T (which was superseded in July 2009) and Rule 204 (which superseded Rule 204T) which might begin with Stock Loan.

[10] A reasonable reading of Delaney's statement is that he knew Penson was not in compliance with regulatory issues pertaining to short and long sales, otherwise he would have no need to "bring PFSI into compliance." In addition, a reasonable reading of Delaney's statement is that he knew of issues related to Regulation SHO from 2008 to 2011, otherwise there would be no issues for Delaney to "escalate" "frequently, sometimes daily" for that "entire period."

[11] Again, a reasonable reading of Delaney's statement is that he knew of Stock Loan's violations, otherwise he could not escalate their "failure to comply with policy" or "compliance failures."

[12] This admission is in the first sentence of Section III.B.2.a.(4) of Delaney's Wells submission. "These issues" must refer to, at least, the issues identified in the preceding three sections, which include that (1) Delaney worked with "offending business units" but was unable to control Stock Loan or Rule 204 buy-ins, (2)"huge financial incentives" incentivized Stock Loan to delay close-outs in violation of Rule 204, and (3) the Buy-Ins department failed to buy-in by market open "as it knew it was required to do." Delaney Wells submission, Ex. 157, at 31-32. Thus, a reasonable reading of Delaney's statement is that he knew of the issues causing Penson's violations because he either raised the issues with Yancey himself or knew that they had been raised with Yancey. In addition, a reasonable reading of Delaney's statement is that, because

Delaney Wells submission, Ex. 157, at 32.

> [H]is [Delaney's] actions were exclusively aimed at righting the PFSI ship and **bringing it into compliance** with Regulation SHO and other rules and regulations.[13]
> Delaney Wells submission, Ex. 157, at 33.

Each of these admissions provided evidence that Delaney knew Penson's Stock Loan department was not in compliance with Rule 204.

ii. Other Witnesses' Testimony

Along with Delaney's Wells submission, other witnesses' investigative and hearing testimony provided evidence that Delaney knew or was reckless in not knowing of Penson's Rule 204 violations.[14]

For example, Rudy DeLaSierra, a member of Stock Loan management, expressly testified – both in investigative testimony and at the hearing – that Delaney knew Stock Loan was not closing out failures to deliver in compliance with Rule 204. In his investigative testimony, DeLaSierra confirmed that, in conversations with Delaney in October 2008 – around the time the temporary Rule 204 was issued – he "explained that stock loan was not closing out failure to delivers [sic] by open market T+6," and that Delaney "was aware" of the issue.[a] DeLaSierra repeated this testimony in sum and substance at the hearing, confirming that "Tom Delaney kn[e]w what Stock Lending's

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Delaney was the Chief Compliance Officer, he knew of the "issues and concerns Compliance escalated."

[13] A reasonable reading of Delaney's statement is that he knew of Penson's violations, otherwise there would be no "actions" to take to "right[] the PFSI ship" or "bring[] it into compliance with Regulation SHO."

[14] The Division has excerpted the relevant portions of this testimony. For the Court's ease, the Division has appended these excerpts as endnotes to this brief, rather than footnotes throughout the text. Endnotes are designated with alphabetical superscript (*e.g.*,[a]) while footnotes are designated with numeric superscript. The endnotes are contained in Appendix 2 to this brief. The relevant portions of investigative testimony are also attached as exhibits.

practice was,"[b] that he "ma[d]e it clear to Mr. Delaney that Stock Loan was not closing out at market open,"[c] and that there was not "any ambiguity that Mr. Delaney knew that Stock Loan was not closing out at market open T+6."[d]

Similarly, Michael Johnson, the head of Stock Loan, repeatedly indicated that Delaney knew of Stock Loan's violations during his investigative testimony. Among other things, Mr. Johnson testified that Delaney was among the people that "knew stock loan wasn't closing out fails to deliver on margin long sales by open market T+6,"[e] that he believed he had direct conversations with Delaney about stock loan's violative practice,[f] that he "chased Tom Delaney in the hallways" to explain the issues Stock Loan was having,[g] and that Delaney (and others) indicated that Stock Loan should follow industry practice as opposed to Rule 204.[h] Johnson's hearing testimony was less direct on the issue of Delaney's knowledge, but Johnson again confirmed that he had conversations with Delaney about Rule 204 because he was looking for guidance on how to comply with the Rule,[i] and that he "ma[d]e it clear to Mr. Delaney what the problem Stock Loan was having was."[j]

Brian Gover also provided evidence of Delaney's knowledge. In his investigative testimony, Gover explained that he discussed Stock Loan's policy of not closing out at market-open T+6 with Delaney, among others, in 2009.[k] Gover later confirmed and expanded on this testimony in a declaration, explaining that in a meeting with Delaney and Johnson in approximately late 2009 or early 2010, Johnson informed Delaney that Stock Loan did not consistently close out by market-open T+6, that Johnson and Delaney discussed steps Penson could take to comply, and that Johnson and Delaney rejected those options. *See* Gover Decl., attached hereto as Ex. 1. At the hearing,

Gover's testimony was less direct, but again provided evidence that Delaney was involved in a conversation where he was placed on notice of Stock Loan's failure to comply with Rule 204.[l] At the hearing, Gover placed this conversation in early 2010.[m]

In short, these witnesses each testified consistently with each other that Delaney was involved in conversations from which he knew (or was reckless in not knowing) that Stock Loan was not complying with Rule 204T and Rule 204.

In his supplemental EAJA brief, Delaney essentially concedes that each of these witnesses provided evidence of Delaney's scienter, but urges the Court to disregard this evidence because the Court did not credit these witnesses' hearing testimony. Supp. EAJA Br. at 9 ("Apart from the testimony of these witnesses which this Court has already determined to be less than credible, the Division has put forth no evidence that Delaney acted with the requisite scienter ....").[15] This concession is fatal to his EAJA claim. The fact that the outcome of the Division's knowledge case hinged substantially on the Court's assessment of the credibility of these witnesses (and, for that matter, Delaney) confirms that the case was substantially justified. *See, e.g.*, *Wilfong,* 991 F.2d at 368.

In sum, the testimony of Gover, DeLaSierra, and Johnson – and in particular the more direct investigative testimony and Gover's Declaration – provides substantial evidence of Delaney's knowledge or recklessness. Furthermore, the testimony was

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[15] The Court found that DeLaSierra's testimony that Delaney knew of the violations to be an "unsubstantiated belief." Further, while the Court found that Gover's testimony of a meeting was "[t]he strongest possible evidence ... to establish that Delaney had actual knowledge," the Court did not believe Gover's testimony that the conversation had occurred in 2010 and, instead, concluded that the meeting occurred in early 2011, around the time Delaney concedes he learned about Penson's Rule 204 issues, rather than in early 2010, as Gover testified. *See* I.D. at 39-40.

consistent with Delaney's own admissions that he knew Stock Loan was causing Penson to violate Rule 204T and Rule 204. As such, the Division was substantially justified in alleging and litigating its position that Delaney had knowledge of, or recklessly disregarded, the wrongdoing and his role in furthering it.

b. Substantial assistance

Both Delaney's initial and supplemental EAJA briefs focus entirely on scienter and motive, and indeed Delaney appears to concede that his EAJA claim rests entirely on his (incorrect) assertion that the Division was not substantially justified in alleging Delaney's scienter. *See* Supp. EAJA Br. at 8 ("The Division's Aiding and Abetting Claim Failed in its Entirety because the Division Failed to Prove the Requisite Scienter Element."). Regardless, the Division was also substantially justified in alleging and litigating that Delaney substantially assisted Penson's violations.

The primary allegations of Delaney's substantial assistance centered on his failing to inform Penson Chief Executive Officer Bill Yancey of the violations and concealing the violations from regulators, including the Commission's Office of Compliance Inspection and Examinations ("OCIE"). As such, the scienter and substantial assistance prongs were significantly intertwined: if in fact Delaney knew of the violations, he substantially assisted those violations by keeping his knowledge from senior management and regulators. Thus, because the Division's position on scienter was substantially justified, the Division's position on substantial assistance was also substantially justified.

i. Delaney's failure to tell FINRA and OCIE

Omissions to securities regulators can constitute substantial assistance of securities violations. *See SEC v. Fehn*, 97 F.3d 1276, 1293-94 (9th Cir. 1996) (lawyer who made material omissions in Commission filings substantially assisted primary violations). Not surprisingly, the Commission has held that Chief Compliance Officers who subvert regulatory examinations are liable for aiding and abetting the primary violations hidden thereby:

> We have made clear that "the failure to cooperate with a [Commission] examination is serious misconduct that justifies strong sanctions because of its potential to thwart the protection of shareholders and market participants."

In re vFinance Investments, Inc. et al., Rel. No. 34-62448, 2010 WL 2674858, *15 (July 2, 2010) (finding aiding and abetting liability for CCO who willfully interfered with an OCIE examination; brackets in original).[16] Indeed, the Commission has said that the deliberate deception of regulators is a threat to the effectiveness of the regulatory system that justifies the severest of sanctions:

> Here, the egregiousness of [Respondent's] dishonest behavior is compounded because he made his false statement to Commission staff during an ongoing investigation into possible insider trading violations. Providing information to investigators is important to the effectiveness of the regulatory system, and the information provided must be truthful. We have consistently held that deliberate deception of regulatory authorities justifies the severest of sanctions.

[16] *See also In re Peter J. Bottini et al.,* Rel. No. 34-66814, 2012 WL 1264509 (April 16, 2012) (settled order) (two compliance officers found liable for causing Rule 204(a) violations because, among other things, they misled SEC staff about their firm's Rule 204(a) practices); *In re Diane Brunell Kaechele*, Rel. No. 34-35459, 1995 WL 103909 (March 8, 1995) (settled order) (CCO's substantial assistance included "misrepresent[ing] and conceal[ing] the true nature of [] business operations from regulatory examiners").

In re Kornman, Rel. No. 34-59403, 2009 WL 367635, *7 (Feb. 13, 2009). Here, there was evidence that Delaney made omissions in at least two documents provided to regulators: Penson's "NASD Rule 3012 Summary Report" for the period April 2009 through March 2010 and a November 2010 letter to OCIE.

The NASD Rule 3012 Report asserted that Delaney was responsible for the contents of the document, and Delaney affirmed that assertion.[17] Delaney also testified that the Report was a key document for regulators.[n] The Report was intended to discuss Penson's "key compliance problems" for the period April 1, 2009 through March 31, 2010.[18] In fact, the Report contained a section noting "[t]he identification of any significant compliance problems" and a section describing "[t]he firm's key compliance efforts to date."[19] Given the substantial evidence of Delaney's knowledge of Stock Loan's non-compliance with Rule 204T and Rule 204, the Division was substantially justified in its position that Delaney's failure to disclose Penson's Rule 204 compliance issues, which were a "significant compliance problem," in the NASD Rule 3012 Summary Report substantially assisted Penson's violations.

Delaney acted in a similar manner with respect to OCIE. On October 27, 2010, OCIE sent a deficiency letter to Delaney reporting that it had found violations of Rule 204T(a).[20] Earlier that week, Delaney had received a FINRA deficiency letter specifically

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[17] Ex. 135; Hearing transcript (Delaney) at 673.

[18] Stipulated Finding of Fact 21.

[19] Ex. 135.

[20] Ex. 203. The OCIE examined the type of close-outs at issue in this case as well as others that were not at issue. Ex. 203, 539, 756. And during the exam, Penson had represented to OCIE that there was no report that monitored the type of transaction at issue in this case. Ex. 204.

informing him of Rule 204 violations in long sales of loaned securities.[21] Despite Delaney's knowledge that Stock Loan was not in compliance with Rule 204, and the recent notice he had received from FINRA about Rule 204 violations arising from long sales of loaned securities, Penson's response to OCIE did not disclose that Penson's Stock Loan was not complying with Rule 204.[22] Instead the letter represented that "the processes employed to close-out positions that were allegedly in violation of rule 204T were effective and performed as designed."[23] Given the substantial evidence of Delaney's knowledge of Stock Loan's non-compliance with Rule 204T and Rule 204, the Division was substantially justified in its position that Delaney's failure to correct the misleading language in Penson's November letter to the OCIE deficiency letter substantially assisted Penson's violations.

ii. Delaney's failure to tell Yancey.

Delaney admitted in investigative testimony that if he learned that Penson personnel were conducting business in a way that did not comply with regulations, he had a duty to report that information to senior management.[o] He also admitted in investigative testimony that did not tell Yancey about Stock Loan's violative business practices.[p] In fact, Delaney told Yancey that Stock Loan was not involved in Penson's Rule 204 problems.[q] Yancey confirmed these facts.[r] Given the substantial evidence of Delaney's knowledge of Stock Loan's non-compliance with Rule 204T and Rule 204,

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[21] Ex. 40.

[22] Ex. 101.

[23] *Id.* Delaney knew what the letter to OCIE said because he edited the specific provision at issue. *See* Exs. 206, 208.

the Divisions was substantially justified in its position that Delaney's failure to inform Yancey of those violative practices substantially assisted Penson's violations.

iii. Delaney's rejection of procedures that would have brought Penson into compliance.

In addition to concealing violations from Yancey and regulators, the Division had other evidence of Delaney's substantial assistance. In his declaration, Gover stated that, in late 2009 or early 2010, Delaney agreed with Johnson to reject procedures that would have brought Penson into compliance with Rule 204. *See* Gover Decl. ¶¶ 6-8. Gover's report of Delaney's affirmative act provides additional evidence – and thus additional substantial justification – for the Division's assertion that Delaney substantial assisted Penson's violations.

c. Aiding and abetting was substantially justified.

In sum, as the Court noted in the Initial Decision, each of the allegations of substantial assistance is predicated on Delaney's knowledge of Penson's non-compliance with Rule 204. *See* I.D. at 43. Given the substantial evidence of Delaney's knowledge of Stock Loan's non-compliance with Rule 204T and Rule 204 from Delaney's Wells submissions and other witnesses investigative testimony and statements, and the essentially undisputed fact that Delaney did not disclose that non-compliance to Yancey and to regulators, the Division's position that Delaney aided and abetted Penson's violations was substantially justified. This is particularly true given Delaney's position as the chief compliance officer – the Division was justified in bringing charges where evidence showed an individual in such a critical position knew of (or recklessly ignored) violations

of rules and regulations of the securities industry, but failed to act properly in response.

3. The Division's position on motive was substantially justified.

Both Delaney, in his EAJA application, and the Court, in its June 4, 2015 Order, focus on whether the Division's allegations of motive to violate Rule 204 were appropriate. As a threshold matter, the Division did not focus its case on Delaney's motive, but rather on the significant evidence of Delaney's knowledge (or reckless disregard) of Penson's Rule 204 violations, detailed above. Delaney's EAJA application attempts to ignore this fact, repeatedly suggesting the Division's case has always been primarily about motive. *See, e.g.* Supp. EAJA Br. at 9 ("The Division knew that its claim against Delaney for aiding and abetting was not viable without a motive...."). In fact, the term "motive" appeared only twice in the OIP. *See* OIP ¶ 7 ("Motivated by financial considerations ...), *id.* ("This financial motivation ...."). By contrast, the OIP was replete with references to Delaney's having been informed of Penson's violations.[24] Moreover, the Division's pre-hearing brief did not mention Delaney's motive or the financial motive for Penson's Rule 204 violations at all.

In any event, it would be improper to award fees and costs for Delaney's response to the Division's limited motive allegations, for at least two reasons. First, as the Commission has made clear, it is improper in an EAJA analysis to focus on this

[24] *See id.* ¶ 6 ("Delaney also knew, from 2008 through 2011, that Stock Loan's procedures did not comply with [Rule 204]"), ¶ 28 ("Delaney also knew at all relevant times that Stock Loan was not complying ...."), *id.* ("Stock Loan supervisors informed Delaney that they were not closing out ...."), ¶ 29 ("Delaney next discussed Stock Loan's non-compliant procedures ...."), ¶ 31 ("... Stock Loan Supervisors explained that Penson was not complying with Rule 204(a) ...."), ¶ 32 ("Delaney reviewed e-mail discussions ... about Stock Loan's non-compliant procedures"), ¶ 33 ("... Delaney again discussed the violations ..."), ¶ 34 ("As a result, Delaney knew Penson was violating Rule 204T(a)/204(a) ...."), ¶ 35 (... [E]ven through he knew about the violations ....").

motive allegation individually, rather than the Division's position as a whole. And second, even considering the motive allegations at an atomized level, the Division was substantially justified in alleging that there was a financial motive to violate Rule 204.

a. Awarding fees for responding to the Division's position on motive would contravene the Commission's directive to assess the Division's position as a whole.

As noted above, the proper EAJA inquiry is "whether the Division's case *as a whole* was substantially justified." *Flanagan*, 2004 WL 1538526, at *4. This is because EAJA "'favors treating a case as an inclusive whole, rather than as atomized line items.'" *Id.* (quoting *Comm'r, INS v. Jean*, 496 U.S. 154, 161-62 (1990)). Motive is just such an "atomized" issue.

In his supplemental EAJA brief, Delaney baldly asserts that the Division's aiding and abetting case "was not viable without a motive." Supp. EAJA Br. at 9. This unsupported claim is, simply put, wrong. As the Court recognized, motive is not an element of an aiding and abetting claim. *See* I.D. at 34.[25] Motive is, at most, one way a plaintiff can establish scienter for an aiding and abetting claim. *See, e.g.*, *SEC v. Lucent Technologies, Inc.*, 610 F. Supp. 2d 342, 363 (D.N.J. 2009) (refusing to grant summary judgment in favor of defendant even where no evidence of motive to commit fraud; "Motive is not an element of aiding and abetting claim. Rather, motive and opportunity

[25] *See also SEC v. U.S. Environmental, Inc.*, 155 F.3d 107, 111-12 (2d Cir. 1998), *cert. denied sub nom. Romano v. SEC*, 526 U.S. 1111 (1999) (What is at issue is the fraudulent conduct itself, not its motivation.); *Graham v. SEC*, 222 F.3d 994, 1005 (D.C. Cir. 2000) (absence of motive does not relieve one of liability); *SEC v. Goldstone*, 952 F. Supp. 2d 1060, 1242 (D. N.M. 2013) *citing SEC v. Int'l Chem. Dev. Corp.*, 469 F.2d 20, 26 (10th Cir. 1972) ("The federal securities laws do not shield parties simply because a fraudulent statement did not pad their personal pocketbook: The federal securities laws protect 'investors from fraudulent practices.'"); *Piper Capital Mgmt., Inc.*, No. ID-175, 2000 WL 1759455, at *44 (Nov. 30, 2000), aff'd Rel. No. 2163, WL 22016298 (August 26, 2003) (Motive is not an element the Division must prove.).

for committing fraud is one of two ways to plead scienter ...."). Even if there were no evidence of motive (which, as described below, is not the case), in light of the Division's evidence of Delaney's knowledge, the Division's position that Delaney aided and abetted and caused Penson's violations was substantially justified. *Cf. Flanagan*, 2004 WL 1538526, at *7 (finding that, even in the Commission agreed with the Court that four discrete charged in the OIP were not substantially justified, Division's case as a whole was still substantially justified and thus EAJA award denied).

b. The financial motive alleged was cost avoidance, not profits.

In his supplemental EAJA brief, Delaney claims – with no support – that "at least eight paragraphs" of the OIP alleged Delaney aided and abetted Penson's Rule 204 violations "for financial gain." Supp. EAJA Br. at 11. There is no basis for this claim. Although not a significant focus of the OIP, the OIP did allege that there was a financial motive to Penson's violations of Rule 204. There are, at best, four paragraphs in the OIP that link Delaney's misconduct to Penson's financial incentives to violate the rule. However, as the OIP makes clear, the Division allegations dealt primarily with cost avoidance:

> 7. Motivated by financial considerations, Delaney affirmatively assisted the violations resulting from the Stock Loan procedures. Delaney agreed with Stock Loan officers that Stock Loan would continue implementing the non-compliant procedures and he agreed to reject certain procedures that would have brought Penson into Rule 204T/204(a) compliance **because he did not want Penson to incur the associated costs**. . . . [W]here Penson was required to **absorb the costs of compliance** – as was the case with closing out CNS fails resulting from long sales of loaned securities – Delaney supported Stock Loan in implementing the intentionally non-compliant procedures.
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> * * *
>
> 31. . . . Delaney agreed with Stock Loan Supervisors that Penson would not implement options such as T+2 account level recalls or purchases into

inventory that would have brought Penson into compliance **because those options imposed costs on Penson**.

* * *

37. Indeed, in 2009 or early 2010 – about the same time Delaney began overseeing Rule 204 remedial efforts for Buy Ins's procedures – Delaney and Stock Loan rejected procedures that would have brought Penson into compliance because they did not want Penson to **incur the costs of those procedures**.

(Emphases added).[26]

This cost-avoidance motive is separate and apart from any profits motive and any profits calculation by Harris. And as detailed below, the evidentiary record supports these cost-avoidance allegations.

c. The Division was substantially justified in alleging a financial motive to violate Rule 204.

In the Initial Decision, the Court found that the Division had failed to prove a financial motive because the initial calculation of its expert witness, Dr. Larry Harris, that Penson received $6.2 million of profit from Rule 204 violations was erroneous, and in fact the calculable profit was only approximately $60,000. *See* I.D. at 34. However, as explained below, the Division did not base its financial motive allegation on Dr. Harris's erroneous calculation, which did not exist either at the time that Penson engaged in violations or at the time the OIP was instituted. Rather, there was significant other evidence – including statements of Delaney himself – that Delaney and others at Penson believed there were financial motives not to comply with the rule.

[26] Paragraph 39 of the OIP does allege that Delaney "consciously chose profits over compliance." However, when read in context, it is clear that this is a reference to the preceding paragraphs, which discuss Penson's cost-avoidance motive. *See* OIP ¶¶ 36-39.

i. Delaney admitted Penson's motive.

The Division's position on the motives to violate Rule 204 rests in large part on admissions made by Delaney in his Wells submission – evidence that, in contrast to Dr. Harris' calculation, did exist at the time the Division brought its case. Among other things, Delaney stated in his Wells submission that:

> [t]he people in Stock Lending had **huge financial incentives** to delay close-outs, which would allow their business unit to retain and even increase customers and compete aggressively in the marketplace. **Delaying, and even outright preventing buy-ins, allowed Stock Lending to profit by pleasing customers, reducing the fees associated with borrowing, and profiting from the arbitrage in share prices that continued to fall.** Stock Lending personnel's income, particularly Michael Johnson's income, was tied directly to the performance of the department.
> Delaney Wells submission, Ex. 157, at 29 (emphasis added).

Delaney made numerous similar statements in his Wells submission, including the following:

> For example, when asked about the close out requirements in Rules 204T and 204, Mr. Delaney knew that the close out issue might begin with Stock Lending, **which was the only group at PFSI that could have direct financial incentives not to close out some sales on time**, . . . **Because of its incentives,** Stock Lending shadowed and altered the process throughout.
> Delaney Wells submission, Ex. 157, at 16 (emphasis added).

> At all times, Mr. Delaney worked directly with PFSI's business units, management, and outside counsel to bring PFSI into compliance with regulatory issues, including those pertaining to short and long sales. . . . Mr. Delaney got resistance from **Stock Lending and management, who were driven by financial interests**, but that did not deter him.
> Delaney Wells submission, Ex. 157, at 21 (emphasis added).

> The fact is that the **financial incentives of departments like Stock Lending, the financial incentives of which ran contrary to compliance's goals**, made it impossible to change PFSI's practices overnight - or even over the course of two years - because **doing so would have caused PFSI to lose customers** in an environment where PFSI's competitors were also not complying.
> Delaney Wells submission, Ex. 157, at 22 (emphasis added).

> Stock Lending controlled what was bought-in to comply with Rules 204T, 203, and 204 and what was not. . . . The decisions on what to buy-in and what not to buy-in were **influenced by the enormous financial incentives that the people in the Stock Lending business unit had** to delay certain buy-ins.
> Delaney Wells submission, Ex. 157, at 29 (emphasis added).
>
> **Stock Lending personnel were financially incentivized to delay close-outs**, and they could and did cause delays in buy-ins (Heading).
> Delaney Wells submission, Ex. 157, at 31 (emphasis added).
>
> It was no secret that any **efforts to comply with Rules 204T, 203, and 204 were not well received by PFSI' s customers.** There are multiple email references that are part of the record from Stock Lending stating that their customers would be unhappy with a strictly enforced buy in policy. As a result, **Stock Lending had by far the most to lose by complying in terms of eroding profitability and customer base and, consequently, diminished income** for Michael Johnson and those working beneath him.
> Delaney Wells submission, Ex. 157, at 29 (emphasis added).

Delaney confirmed his belief that there was financial incentive to violate Rule 204 during his investigative testimony.[s] Standing alone, Delaney's statements concerning the motives to violate Rule 204T and Rule 204 provide substantial justification for the Division's position on motive.[27]

Moreover, even assuming Delaney was wrong about the financial incentives, and that, in fact, they were only the minimal $60,000 ultimately calculated, that does not change the evidence that Delaney believed, *at the time of the violations*, that there was "huge financial incentives" to violate Rule 204. Motive is assessed at the time the alleged acts occurred. *See, e.g.*, *Love v. Tyson Foods, Inc.*, 677 F.3d 258, 264 (5th Cir. 2012) (relevant inquiry analyzes motives as party was potentially engaging in violations.); *Fischbach v. District of Columbia Dep't of Corrections,* 86 F.3d 1180, 1183

[27] Again, the Court's decision to award Delaney's statements in his Wells submission "scanty weight" does not diminish the fact that they are admissions against interest by Delaney which the Division was entitled to credit.

(D.C.Cir.1996) (cautioning against the use of "20/20 hindsight" to determine motive.); *Great Chinese American Sewing Co. v. NLRB*, 578 F.2d 251, 255 (9th Cir. 1978) (per curiam) (Changed facts do not alter the motivation at the time of the occurrence.); *Quaker State Oil Refining Corp. v. NLRB*, 270 F.2d 40, 43 (3d Cir. 1959) (application of hindsight would not allow true assessment of motive). Thus, only information known to or available to the perpetrators at the time of the violations is relevant. That information, as shown by Delaney's Wells submission and testimony, demonstrates that the Division's position concerning the motives to commit and assist Penson's violations was substantially justified.

ii. Other evidence of Penson's motive.

Delaney's Wells submission was not the only evidence of the financial motivation to violate Rule 204. Incentives need not be directly quantifiable to be real and substantial. Indeed, in Delaney's investigative testimony, he recognized the potential for "an incentive from the Stock Loan group ... to keep relationships going with their key – with their key counterparties."[t] Similarly, Delaney testified that Penson also had incentive to delay closing out in order to generate "customer goodwill."[u] Delaney's testimony, especially in conjunction with his statements in his Wells submission, provided substantial justification of the Division's position on motive.

In addition, other witnesses also provided evidence of the tangible and intangible benefits from Rule 204T and Rule 204 violations. Perhaps most notably, Brian Gover provided evidence that Penson was not complying with Rule 204 for financial reasons, and that Delaney knew about this financial motivation. Gover's declaration states that, in the meeting between he, Johnson, and Delaney in which Johnson confirmed stock loan

was not complying with Rule 204, Johnson and Delaney discussed – and rejected – the option that Penson would purchase securities on its own account by market-open T+6 in order to comply with Rule 204. *See* Gover Decl. ¶¶ 6-7. Gover understood that "they rejected this option because of the associated costs to Penson." *Id.* ¶ 7.

Evidence from other witnesses further confirmed the intangible benefits to Penson from complying with Rule 204. Michael Johnson, the head of Stock Loan, testified during the investigation about the critical role Stock Loan played in financing Penson's business.[v] He also testified that complying with Rule 204T and Rule 204 would "ruin[] our reputation on the street" or cause Penson to incur costs it was unwilling to incur.[w] Brian Hall, a Stock Loan manager, testified during the investigation that counterparties "would threaten to discontinue doing business" if Penson complied with Rule 204T.[x] And Lindsey Wetzig, a Stock Loan employee, testified both during the investigation and at trial that if Penson complied with Rule 204 by buying its counterparties in, it would be "out of business."[y]

Taken together, Delaney's statements in his Well's submission, his own testimony about the tangible and intangible incentives to violate Rule 204T and Rule 204, and Stock Loan employees' testimony about the negative consequences they believed would arise from compliance demonstrate that the Division's allegation that there was a financial motive to violate Rule 204 was reasonable and substantially justified.

iii. Profit Calculation of Dr. Harris

Dr. Harris was retained by the Division to perform three tasks: explain the process for stock sale, clearing, and settlement, including how Rule 204 operates;

characterize the extent of Penson's Rule 204 violations (*i.e.* whether the violations were isolated or recurrent); and estimate the benefit to Penson from failing to close out failures to deliver by market-open T+6. *See* Harris Report, Ex. 239 at ¶ 10. The first two tasks were critical. Understanding the stock settlement process, and Rule 204's role in it, was important background information for understanding Penson's conduct in this matter. Moreover, characterizing the extent of the violations was important to proving the Division's allegations of the underlying securities law violations – proof of which both the aiding and abetting and causing claim required, and which Delaney strongly contested. *See* Delaney Prehearing Br. at 23-27. At the conclusion of the hearing, however, the Court found – indeed, the parties stipulated – to at least 1,500 Rule 204 violations over the three years at issue. *See* I.D. at 7. This was based, in part, on Dr. Harris' work.

With respect to the third task, Dr. Harris initially estimated a benefit to Penson of approximately $6.2 million. *See id.* ¶ 26. However, as Delaney's expert, Dr. Erik Sirri, pointed out, this calculation contained a mathematical error, the result of which was that Dr. Harris' calculation should have computed a benefit of only approximately $60,000. *See* Sirri Report, Ex. 454 at 26.

While regrettable, Dr. Harris's error was not something the Division relied on in bringing the case, was quickly acknowledged by the Division, and was never relied on thereafter. In short, it never caused the Division to take any position that was not substantially justified. Indeed, in his EAJA application Delaney does not identify a single instance of the Division, after learning of Dr. Harris' error (or at any point in this litigation), taking a position that was not scrupulously forthright.

Delaney suggests – with no evidentiary support – that the Division had Harris's calculations at the time it filed the OIP. Supp. EAJA Br. at 10-11. That is simply not the case. The Commission issued the OIP in this matter in May 2014. Dr. Harris's analysis did not exist at that point in time. The Division did not receive Dr. Harris's calculations until September 2014. Put simply, Dr. Harris's calculations did not exist at the time of the OIP, and thus could not have formed the basis for any of the Division's allegations. Nor did they exist at the time of Penson's violation, and thus could not have informed any motive for the violation.[28]

Delaney also claims that, once Dr. Harris's error was identified by Dr. Sirri, the Division somehow acted improperly by proceeding with a "strained" theory of scienter rather than amend the OIP or "bring[ ] this matter to this court's attention." Supp. EAJA Br. at 12. This argument fails for several reasons. First, the Division's theory of scienter was not "strained," even in light of Dr. Harris's calculation error. As detailed above, the Division had substantial investigative evidence that Delaney knew of Penson's Rule 204 violations. *See supra* Sec. II.C.2.a. Particularly given that motive is not an element of an aiding and abetting claim, that significant scienter evidence entitled the Division to continue forward with its case. Nor would there have been a reason for the Division to seek to amend the OIP – even on the limited allegations of motive -- since there was still evidence of financial motive to violate the Rule. *See supra* Sec. II.C.3.a.i-ii. Further, the Division did not rely on Dr. Harris's erroneous calculation in its prehearing brief, its opening statement, or otherwise at the hearing. Finally, and importantly, the Division did

[28] To be clear, the fact that the Division had not received Dr. Harris's calculations at the time it filed the OIP in no way diminishes the evidence of financial motive to violate the Rule that the Division *did* have at the time this case was charged, which is detailed above.

not seek to hide this matter from the Court. Indeed, Dr. Harris immediately acknowledged the error during his direct testimony, and confirmed he agreed that Dr. Sirri's calculation of benefit was correct.[29]

In sum, Dr. Harris's initial, erroneous $6.2 million calculation never caused the Division to take a single position that was not substantially justified. Dr. Harris' math error cannot be attributed to the Division or be the basis for an EAJA claim. The discovery of the error – and resulting changed testimony – is no different than any other witness changing his testimony. Moreover, the Division's primary motivation allegations relating to Delaney were about cost avoidance, not profits. And, as discussed above, the Division's motive argument was substantially justified in light of other evidence.

D. Delaney is not entitled to the fees and expenses he claims.

Even if Delaney could be said to have prevailed on a discrete substantive portion of the proceeding (which he did not), and even if the Division's position was not substantially justified (which it was), Delaney would still not be entitled to the excessive fees and costs that he seeks.

1. Delaney's original application is procedurally deficient.

As an applicant, Delaney bears the burden of proving his eligibility for an award under EAJA. *See Flanagan*, 2003 WL 22767598, at *2. Delaney erroneously filed his EAJA application under 28 U.S.C. §2412, a statute limited to "civil action[s]." *See Melkonyan v. Sullivan*, 501 U.S. 89, 89 (1991). In fact, as noted above, Delaney's EAJA application is governed by 5 U.S.C. §504 and the Commission's Rules of Practice

[29] *See* Hearing transcript (Harris) at 1001-1002.

regarding EAJA, 17 C.F.R. §§ 201.31-60. Having failed to identify the rules governing his application, Delaney failed to follow the procedural requirements of those rules.

Commission Rule of Practice 43 requires an applicant to adequately document his fees and expenses. Rule 43 states:

> The application **shall be accompanied by full documentation** of the fees and expenses, including the cost of any study, analysis, engineering report, test, project, or similar matter, for which an award was sought. A **separate itemized statement shall be submitted** for each professional firm or individual whose services are covered by the application, showing the hours spent in connection with the proceeding by each individual, a description of the specific services performed, the rate at which each fee has been computed, any expenses for which reimbursement is sought, the total amount claimed, and the total amount paid or payable by the applicant or any other person or entity for the services provided.

17 C.F.R. § 201.43 (emphasis added). Delany provided none of this documentation in his initial application. Because Delaney has failed to meet the requirements of a successful application for fees and expenses, his application should be denied.

2. Delaney's fees are unreasonable.

Delaney bears the burden of establishing the reasonableness of his fee request. *See Role Models America v. Brownlee*, 353 F.3d 962, 970 (D.C. Cir. 2004). As a threshold matter, Delaney's position on the fees he is entitled to for prevailing on the aiding and abetting claim has it backwards. Delaney claims, essentially, that he should be entitled to nearly all of his fees, since "only a minimal amount" of time was devoted to the negligence claim standing alone. *See* EAJA Br. at 5. But in fact, as Court recognized, "the facts and evidence are the same" on the negligence-based causing claim and the scienter-based aiding and abetting claim. I.D. at 49. And the Division prevailed on the causing claim. Thus, *at most*, Delaney would only be entitled to fees

incurred on issues related solely to the aiding and abetting claim – fees that, given the overlap in proof, would be minimal.

In addition, and as detailed below, both the rate and hours claimed are wildly excessive.

a. Delaney's original application

Delaney seeks reimbursement for over 4,000 hours of attorney and paralegal time since September 2014, at a rate of $190.06.[30] Delaney ignores that the Commission's EAJA rules cap any recovery at a maximum of $75 per hour. 17 C.F.R. § 201.36(b); *see also, e.g.*, *Blizzard*, 2005 WL 1802401, at n.27.[31] In addition, Delaney claims hours expended that are unreasonable on their face.

EAJA provides only for reimbursement of "reasonable" attorney's fees. *See* 5 U.S.C. § 504(b)(1)(A). To that end, Delaney's "supporting documentation 'must be of sufficient detail and probative value to enable the court to determine *with a high degree of certainty* that such hours were *actually and reasonably expended*." *Brownlee*, 353 F.3d at 971 (citation and quotations omitted) (emphasis added). As noted above, Delaney has provided no such detailed supporting documentation.[32] Even so, the information Delaney did submit shows the hours requested are grossly excessive.

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[30] Delaney notes that he anticipates that over 900 hours of attorney time is likely to be paid by the insurance company.

[31] 28 U.S.C. §2412(d)(2)(A) allows the court to determine "that an increase in the cost of living or a special factor, such as the limited availability of qualified attorneys for the proceedings involved, justifies a higher fee." Commission Rule of Practice 36 provides no such allowance.

[32] As a result of his failure to meet this requirement, the Division has been unable to analyze the reasonableness of specific fees claimed and is prejudiced by that inability. It would be unfair to the Division, and untimely, to allow Delaney to supplement his application with this information.

Delaney seeks reimbursement for 3,747 attorney hours spent on this litigation since September 9, 2014, when insurance coverage expired. The last pleading Delaney filed in this case – prior to his EAJA application – was a letter stating his position on the re-admission of his previously withdrawn expert report, which was filed on January 30, 2015. *See* Letter in response to Court's email correspondence dated January 28, 2015, filed January 30, 2015. There are 144 days, or approximately 20 ½ weeks, between September 9, 2014 and January 30, 2015. Assuming Delaney's attorneys worked every day of this period – including Saturdays, Sundays, and holidays – the hours requested average out to approximately 182 hours per week, or approximately 26 hours per day, spent on Delaney's case. On their face, these numbers demonstrate excessive – rather than reasonable – fees. *See, e.g.*, *Brownlee*, 353 F.3d at 973 (reimbursing only 50% of hours claimed based on "inadequate documentation, failure to justify the number of hours sought, inconsistencies, and improper billing entries").

b. Delaney's supplemental application

On June 4, 2015, the Court directed Delaney to submit "an accounting of the expenses incurred in responding to the Division's argument that he was motivated to aid and abet violations of Rule 204T/204 in order to dramatically increase Penson's profits." Delaney did not do so. Rather, his submission claims that his attorneys spent 1,850 hours – or approximately half of all the hours he sought reimbursement for in his initial application – on the profit motive issue. Even a cursory review of the fees submitted demonstrates that these fees are excessive and not limited to the profit motive issue.

As a threshold matter, a significant number of entries are "block billed" – numerous tasks are grouped together with no indication of what portion of the total

hours claimed relate to each task. This, alone, is reason to deny – or at least significantly reduce – those fees. *See, e.g.*, *Samirah v. Lynch*, No. 03 CV 1298, 2015 WL 3524790, * (N.D. Ill. June 1, 2015) (excluding all fees plaintiff submitted in block format and noting that, while block billing is not *per se* prohibited, "block billing is impermissible when it becomes impossible to tell how much time was spent on specific tasks"); *Kassenbaum v. Astrue*, No. 08-433-HO, 2011 WL 3704204, n.1 (D. Or. Aug. 23, 2011) ("It should be noted that block billing can result in further substantial reductions to fee requests"; citing case where block billed hours reduced by 50%).

Further, many of the block-billed entries contain tasks that are, on their face, irrelevant to the profit motive issue. For example, Delaney seeks reimbursement for attorney time spent preparing his motion for postponement of the hearing, researching AP procedure, and speaking with his *compliance* expert (who did not offer opinions related to the profit motive issue). Indeed, Delaney routinely and vaguely seeks fees for time spent with "experts," without any detail of whether that expert's work related to the profit motive issue. Delaney also appears to seek fees for the entirety of the time spent in the hearing and on post-hearing briefing, despite the fact that many issues other than profit motive were raised in this proceeding. The following are merely examples of entries that appear on their face unrelated to the profit motive issue:

- Make further revisions to subpoenas to SIFMA and FINRA (9/8/2014 ADL)
- Analysis of issues related to privilege for communications between SEC and FINRA (9/9/2014 JAJ)
- Research and analysis regarding AP procedure, due process and preserving appellate issues (9/9/2014 MLS; 9/10/2014 MLS; 9/17/2014 MLS)
- Review and proof draft motion for postponement (9/10/2014 LAM)

- Conference call with compliance expert; Drafting legal and factual questions for compliance expert; Factual research for call with compliance expert; Call with compliance expert (9/10/2014 BRB)

- Continue proofing motion for postponement (9/11/2014 LAM)

- Draft declaration and gather exhibits in support of motion for postponement; Review redlines from team and incorporate changes into motion for postponement; Incorporate redlines comments into draft declaration and search for additional exhibits per comment (9/11/2014 DLW)

- Finalize memo in support of motion to postpone hearing (9/12/2014 DLW)

- Legal research regarding challenges to SEC's use of administrative proceedings (9/17/2014 BRB)

- Revise subpoenas, ... Prepare for an conduct conference call with compliance expert (9/19/2014 ADL)

- Email all parties regarding service of SIFMA subpoena (9/27/2014 LAM)

- Redact portions of documents for production and use as exhibits (10/10/2014 JHU)

- Finalize report with compliance expert (10/14/2014 DLW)

- Review and redraft of compliance expert report; Comments to team about Florio report and revisions (10/14/2014 JAJ)

- Draft Notice of Compliance with Procedural Schedule Order and accompanying cover letter (10/17/2014 LAM)

- Continued review of JDA and effect of privilege on evidentiary issues (10/23/2014 JAJ)

- Search the record for findings of fact pertaining to T. Delaney's character (12/11/2014 LAM)

- Correct exhibit list and contact Secretary for SEC office re: exhibit corrections (12/12/2014 ADL)

- Call with client regarding settlement of PTL litigation. Review PTL settlement agreement (12/17/2014 BRB)

- Finalize PTL agreement and get executed signature from client (12/18/2014 BRB)

- Review and analyze issues related to administrative hearing process (1/6/2015 JAJ)
- Review Florio representation and issues; research procedural issue (1/20/2015 NAK)
- Review Patil order on negligence issues; Analysis of best way to respond re negligence; Review of Division's allegations as to negligence; Review emails concerning the order (1/23/2015 JAJ)[33]
- Case law research on notice requirements in administrative proceedings (1/30/2015 NAK)

Finally, numerous entries are so vague as to provide no basis at all to assess the fees or whether they were reasonable. For example, Delaney seeks reimbursement for the following:

- Work with witnesses and experts for trial (9/8/2014 MLS)
- Continued "to do" and assignment issues to plan for hearing (9/10/2014 JAJ)
- Work on trial preparation issues relating to witness testimony (9/18/2014 WAR)
- Planning of issues going forward; Review of experts and what is needed in reports (10/7/2014 JAJ)
- Prepare for Delaney trial (10/10/2014 BRB)
- Trial preparation (10/23/2014 DLW)
- Prepare for trial (10/25/2014 BRB)
- Assist trial team with legal and factual issues (11/5/2014 NAK)
- Legal research based on Division's arguments (11/24/2014 LAM)
- Review and planning of "to do's" related to briefing schedule (12/1/2014 JAJ)

[33] The Order referenced appears to be the Court's January 23, 2015 order permitting Delaney to identify additional evidence that he would have presented to defend himself on the issue of negligence. Delaney provides no explanation of how this issue relates to the profit motive issue. Delaney has claimed more than 80 hours dealing with this negligence issue in his supplemental application.

- Review post-trial issues; review statements (1/6/2015 NAK)

Clearly Delaney's counsel took no efforts to limit their request fees to those related to a profit motive. And apparently Delaney believes it is impossible to do so. Delaney concedes that the evidence in this case is so intertwined that it is not possible to determine what fees relate to any particular issue. Supp. EAJA Br. at 4.[34]

In his original submission, Delaney did not seek expert fees. In his supplemental brief he apparently attempts to do so. But nowhere does he identify the amount he seeks or what that amount is for. Indeed, Delaney appears to concede that these fees are soon to be reimbursed by insurance proceeds. Supp. EAJA Br. at 5.

In any event, the record belies Delaney's claim that his experts' "efforts were all, or virtually all, focused on attempting to identify the extent of the purported profits from any identifiable violations." Supp. EAJA Br. at 5. The primary task of Delaney's expert witness, Dr. Sirri, was to attack the Division's allegations that Penson frequently and repeatedly violated Rule 204. Indeed, Delaney's first mention of Dr. Sirri in his prehearing brief is to argue that point. *See* Delaney Prehearing Br. at 4 ("The trading data shows that the purported policy and practice to violate Rule 204T(a)/204(a) does not exist. Delaney's expert witness, Professor Erik Sirri, who was one of the drafters of Rule 204T(a)/Rule 204(a), has confirmed that Penson timely closed-out *all* potential long-sales-of-loaned-securities transactions during the relevant period at least *99.32%*

[34] The Division has prepared a response to each of Delaney's claimed fees, which is attached as Appendix 3 to this brief. As noted in that appendix, nearly every one of Delaney's fee entries suffers from at least one deficiency: many entries are block-billed; other entries are entirely vague, either about the task performed or about which "expert" was involved and whether that expert had anything to do with the profit motive issue; and other entries appear to be unrelated to the profit motive issue, either in whole (*e.g.*, time spent with Delaney's compliance expert) or at least in part (*e.g.*, claiming every hour at the trial and in preparing post-hearing briefing).

of the time.") (emphasis in original); *see also id.* at 23-26. Further, Delaney's prehearing brief cites to Dr. Sirri's report numerous times for points unrelated to the profit issue, most often to describe the mechanics of securities clearing and the history of Rule 204. Dr. Sirri's expert report follows a similar pattern: it spends the majority of its pages discussing "the background and mechanics of how securities trade, the clearance and settlement of trades, and Rule 204 of Regulation SHO," as well as attempting to rebut Dr. Harris's *overall* methodology of estimating the number of violations and attempting to argue that the number of violations was *de minimis*. In fact, just a few pages of Dr. Sirri's 34 page report discuss Dr. Harris' profit calculation. Sirri Report, Ex. 454, at 25 – 27.

Delaney also appears to seek fees for another expert, Dr. Rosa M. Abrantes-Metz. Supp. EAJA Br. at 7, 13. But again, Delaney provides no detail on what fees he seeks for Dr. Abrantes-Metz's work, whether those fees have already been paid by insurance, or how Dr. Abrantes-Metz's work related to the narrow issue of profit motive identified by the Court. From the limited information Delaney provides, it appears that Dr. Abrantes-Metz's work, like Dr. Sirri's, was focused in the first instance on (unsuccessfully) rebutting the Division's allegations of significant Rule 204 violations. Supp. EAJA Br. at 13 ("[H]er time was related to *identifying violations* in order to determine whether those violations were part of a parent of particularly profitable loans or if there was some pattern within the violations.") (emphasis added).

In short, Delaney's claim that his experts were focused exclusively (or nearly so) on the profit motive issue is not supported by the record. Rather, Delaney's experts focused a significant amount of time attempting to show, in Delaney's words, that

"[t]here [was] no credible evidence that ... a primary violation [of Rule 204] occurred." Delaney Prehearing Br. at 24 (citing to Sirri). Despite Delaney's arguments, however, the Division clearly prevailed on this issue: the Court found that there were a "large number of violations – at least 1,500 – associated in some way with Delaney's negligence...." and further concluded that "[i]t is not surprising that only a small percentage of all trades Penson cleared violated Rule 204, because the vast majority of all trades settle within the standard three-day settlement cycle." I.D. at 7, 59. Thus, Delaney has not shown how his expert fees related to the narrow profit motive issue identified by the Court.

Finally, while Delaney does not say how many hours of expert witness time he is seeking, or at what rate, fees for an expert witness may not exceed the rate at which the Commission pays witnesses with similar expertise. 17 C.F.R. § 201.36. Delaney has failed to show that he meets this requirement.[35]

3. Delaney's has not met his burden to show "reasonable" expenses.

Commission Rule of Practice 36(d) provides that Delaney is entitled to "reasonable expenses." 17 C.F.R. § 201.36(b).

a. Delaney's original application

Delaney seeks an EAJA award of over $198,000 for expenses. Many of Delaney's claimed expenses appear unreasonable and/or unrelated to the case. For example, Delaney claims nearly $20,000 in expenses for travel for Mark L. Smith. While the Division is aware that Mr. Smith participated in this matter at the pre-hearing stage in at least some capacity, it is entirely unclear how thousands of dollars of Mr. Smith's

[35] To the extent Delaney purports to seek expert witness fees at $950 per hour, such amount exceeds the rate at which the Division paid its expert in this case.

travel is a reasonable expense on this matter. Similarly, Delaney claims approximately $4,500 for expenses related to "[t]ravel and meals during stay in Philippines," and nearly $3,000 for expenses related to travel to Detroit. *See* EAJA Br., Ex. 2 (entries on 7/11/2014 and 7/17/2014). The Division is unaware of any witness in either of these locations.[36] Again, it is unclear how these claimed expenses are or could be reasonable. Delaney also claims nearly $5,000 in consulting fees from Oyster Consulting, LLC – an entity that, to the Division's knowledge, is not associated with any of the expert witnesses or other studies presented in this case. Nor did Delaney provide any description of these expenses sufficient to determine what these expenses are for and whether they were charged at a reasonable rate. In sum, Delaney has failed to show that a significant portion of his claimed expenses are reasonable.

b. Delaney's supplemental application

In his supplemental application, Delaney purportedly identifies over $146,000 in expenses as related to the profit motive issue. There is no explanation of how any expense relates to the issue of profit motive. For instance, Delaney gives no explanation of how witness fees for Kim Miller, Scott Fertig, or Mark Fitterman could possible relate to the profit motive issue. Likewise, Delaney has made no attempt to explain how every single delivery charge, court reporter fee, and service of process in the entire case can possibly be related to the single issue he was directed to provide an accounting for.

[36] Many other travel expenses have no location listed at all.

III. Conclusion

In sum, while Delaney may disagree that he aided and abetted Penson's violations of Rule 204T/204, and while the Court may have ruled in his favor on this claim, there is simply no evidence that the Division acted in an abusive or unjustified manner in charging and litigating its case, as a whole, that Delaney aided and abetted and caused Penson's violations. This is not the sort of case that EAJA was meant to address. For all of the reasons above, Delaney's EAJA application should be denied.

DATED: July 6, 2015.

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Certificate of Service

On July 6, 2015, the foregoing DIVISION OF ENFORCEMENT'S RESPONSE TO DELANEY'S APPLICATION FOR FEES AND COSTS was sent to the following parties and other persons entitled to notice as follows:

Securities and Exchange Commission
Brent J. Fields, Secretary
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Administrative the Court
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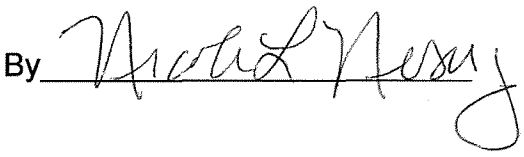
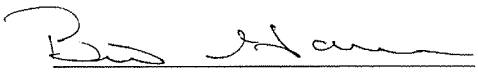
By 

Appendix 1: Examples of Evidence in the Investigative Record Supporting Division's Allegations Regarding Delaney's Scienter

OIP ¶	Allegations	Examples of Evidentiary Support
7	"Motivated by financial considerations, Delaney affirmatively assisted the violations resulting from the Stock Loan procedures. Delaney agreed with Stock Loan officers that Stock Loan would continue implementing the non-compliant procedures and he agreed to reject certain procedures that would have brought Penson into Rule 204T/204(a) compliance because he did not want Penson to incur the associated costs. . . ."	Gover Declaration (Jan. 7, 2014) ¶¶ 4-10 (Ex. 1): 4. Soon after I assumed responsibility for the Buy Ins Department in approximately the third quarter of 2009, Penson's Compliance Department conducted an internal audit of Penson's Rule 204 compliance. In the course of reviewing Buy Ins Department procedures as part of my new responsibilities as supervisor of the Buy Ins Department, and in the course of responding to the internal Rule 204 audit, I learned the Stock Loan Department was not consistently closing out failures to deliver resulting from long sales of loaned securities by market open T+6. 5. This practice appeared to be inconsistent with my understanding of Rule 204. Therefore, I requested a meeting with Michael Johnson ("Johnson"), the Senior Vice President of Stock Loan, and Thomas Delaney ("Delaney"), Penson's Chief Compliance Officer. 6. Shortly thereafter, Johnson, Delaney and I met face-to-face in Penson's offices in Dallas, Texas. In that meeting, Johnson confirmed that the Stock Loan Department did not consistently close out CNS failures to deliver relating to sales of loaned securities by market open T+6. He claimed that it was not industry practice to do so. He further claimed that nobody on the street bought in lending counterparties at market open T+6, and that the stock loan agreements did not allow for such buy ins. 7. In that meeting, Johnson and Delaney discussed whether Penson should purchase securities on Penson's own account by market open T+6 in order to comply with my understanding of Rule 204's obligation that long sales of loaned securities be closed out by market open T + 6. Johnson and Delaney rejected this option for complying with Rule 204. My understanding is that they rejected this option because of the associated costs to Penson.

OIP ¶	Allegations	Examples of Evidentiary Support
		8. In that meeting, Johnson and Delaney also discussed whether Penson should close out failures to deliver on long sales of loaned securities at or before market open T+6 by recalling the loans on T+2 instead of on T+3. Johnson and Delaney rejected that option, and Johnson claimed this was not feasible because he could not project on T+2 which securities would incur failures to deliver. 9. It is my understanding that sometime after this meeting Johnson and Delaney had discussions with legal counsel, which I believe took place within days of the meeting, although I did not participate in any meeting or telephone call. I am not aware that Stock Loan made any changes to its practice of not closing out CNS failures to deliver resulting from long sales of loaned securities by market open T+6. 10. As set out above, the meeting with Johnson and Delaney occurred in the context of (1) my assumption of responsibilities relating to the Buy Ins Department in approximately the third quarter of 2009 and my related efforts to understand the Buy Ins Department's procedures; and (2) the internal audit of Penson's Rule 204 procedures. As shown by an email to me from Penson's Compliance Department (Exhibit A), the internal audit occurred in December 2009. The December 14, 2009 date of the email in Exhibit A is consistent with my recollection that the meeting with Johnson and Delaney regarding Rule 204 close outs for long sales of loaned securities occurred by the end of 2009 or, at the latest, early 2010.  Brian Stuart Gover Date: 1/7/2014
28	"Delaney also knew at all relevant times that Stock Loan was not complying with the T+6 market-open close-out requirement for CNS fails resulting from long sales, including long sales of loaned securities.	DeLaSierra Investigative Testimony (Ex. 2). In summary: • When Rule 204T first became effective [first by emergency order on September 18, 2008, then again on October 17, 2008], the Stock Loan Department attempted to comply by buying in loan counterparties at market open T+6 and received severe pushback from the counterparties. [167:18-168:14] • In approximately October 2008, DeLaSierra and Johnson

OIP ¶	Allegations	Examples of Evidentiary Support
	In or around October 2008, in the context of Penson's efforts to respond to Rule 204T, Delaney met with Stock Loan supervisors and discussed the fact that Stock Loan was not complying with that requirement. Stock Loan supervisors informed Delaney that they were not closing out CNS failures to deliver on long sales of loaned securities until approximately close of business T+6, when they were able to effect buy ins against borrowers under the MSLA."	explained the situation to Delaney. [171:12-15] • At that time, DeLaSierra informed Delaney that the Stock Loan Department was not closing out failures to deliver on long sales of loaned securities by market open T+6. [168:17-21] • At that time, Johnson explained to Delaney that the Master Securities Loan Agreement prevented Stock Loan from buying in borrowing counterparties on the morning of T+6, so they were waiting until the afternoon to do so. [168:23-169:5]
29	"Delaney next discussed Stock Loan's non-compliant procedures for CNS failures to deliver resulting from long sales of loaned securities with Stock Loan supervisors in or around July 2009, when Rule 204T became permanent Rule 204. In this context, he had several discussions with Stock Loan supervisors about the intentionally non-compliant Rule 204(a) procedures for long sales of loaned securities. Based on these discussions, Stock Loan understood that Delaney supported their non-compliant approach."	Johnson Investigative Testimony (Ex. 3). In summary: • In July or August of 2009, in the context of Rule 204 becoming permanent [July 31, 2009], Johnson "clearly remember[ed] going to [Delaney] on four or five occasions saying, 'Tom, I need an interpretation of the new rule.'" [78:1-79:10] • In those discussions, Johnson discussed the practice of not closing out failures to deliver on long sales of margin securities by market open T+6 and the relevant street practices with Delaney. [122:1-16] • As a result of these discussions, Delaney issued an email on August 10, 2009 regarding Rule 204 that did not address the Stock Loan practice of not closing out failures to deliver on long sales of loaned securities by market open T+6. Johnson understood this email to "support[] the way we were doing things." [*Id.*]
31	". . . The Buy Ins supervisor then met with Stock Loan supervisors and Delaney. At this meeting, which occurred in late 2009 or early 2010, Stock Loan Supervisors explained that Penson was not complying with Rule 204(a) for long	Gover Declaration (Jan. 7, 2014) ¶¶ 4-10 (Ex. 1), *supra.* Gover Investigative Testimony (Ex. 4) (Gover met with Johnson and Delaney in 2009 and they discussed Stock Loan's non-compliance with Rule 204): 15:17 Q When did you take over the [Buy Ins] team? 18 A I believe it was third quarter of 2009. * * *

OIP ¶	Allegations	Examples of Evidentiary Support
	sales of loaned securities, and erroneously claimed Penson was following contrary industry practice. At this meeting, Delaney agreed with Stock Loan Supervisors that Penson would not implement options such as T+2 account level recalls or purchases into inventory that would have brought Penson into compliance because those options imposed costs on Penson."	131: 13 Q Well, help me understand the buy-in group's posture 14 with respect to that security where morning of T + 6 prior 15 market open, Penson's fail to deliver position, the reason for 16 the fail to deliver, the stock loan has loaned it out. 17 A Yeah. 18 Q What does buy-in do? 19 A Buy-ins is relying on the attestations that this has 20 been reviewed by compliance. It's been discussed with the 21 regulators. It's been reviewed by outside counsel, and that 22 the street practice is not to buy in if the shares are on 23 re-call. And that as long as the re-call is made, that the 24 obligation to satisfy the long sale is met. 25 Q So the buy-in group obviously checks that one off the 132: 1 list of we don't have to worry about this one for buy-ins this 2 morning? 3 A Correct. 4 Q And going forward, who tracks to make sure whether 5 the re-call comes back in and that is actually closed out? 6 A They're still going to see it up showing up on a long 7 sale, on a long sale short report. But if stock loan is 8 saying, yes, we re-call the borrow, we do not buy in. 9 Q So by saying security shows up the next day on the 10 long sale report, does buy-in go again to stock loan and say, 11 okay, you talk about -- 12 A The list is sent up to them everyday. Do they go and 13 say, hey, you said that you're going to re-call this or why 14 hasn't it been re-called yet, no, I don't think that that 15 relationship exists. 16 Q [When] did you learn about the stock loan policy about 17 not closing out long sale transactions at market of T + 6 if 18 there is a re-call posture? 19 A I would say it was probably within the first three to 20 six months of my taking over the team. 21 Q You knew about this policy before the end of 2009? 22 A I would have to say yes. 23 Q Was that common knowledge within the management 24 group? 25 A I don't know about common knowledge. It's pretty 133: 1 granular, so I don't know if somebody who -- if buy-ins or 2 stock loan did not fall under their organization, I don't think 3 it would have been something that would have been not hidden. 4 I just don't think it would be something that it would have 5 been involved in. 6 Q Do you recall discussing that with anyone? 7 A I do. 8 Q Who did you discuss it with? 9 A Mike Johnson, Brian Hall, Tom Delaney, Holly Hasty, 10 Summer. 11 Q And were all these discussions back in 2009?

OIP ¶	Allegations	Examples of Evidentiary Support
		12 A I believe so, thereabouts. 13 Q Anyone else you recall discussing this with? 14 A There was a call with outside counsel. 15 Q In 2009? 16 A Yeah. 17 Q Do you recall who outside counsel was? 18 A I do not. 19 Q Without telling me the substance, were there 20 discussions with inside house counsel? 21 A I don't recall if they were involved in that or 22 not.
32	"In July 2010, Delaney reviewed e-mail discussions between compliance and operational personnel about Stock Loan's non-compliant procedures for close outs of CNS failures to deliver resulting from long sales of loaned securities."	Delaney repeatedly testified he received and reviewed Exh. 158, a series of emails discussing the Stock Loan Department's non-compliance with Rule 204: Delaney Investigative Testimony, Ex. 224 384: 2 BY MR. WARNER: 3 Q And we've talked about this kind of scatter shot 4 as we've talked through your review of the witnesses' 5 testimony but I want to approach this more systematically. 6 Did you ever become aware that the Stock Loan 7 group was not closing out long sales in failures to deliver 8 resulting from long sales of loaned securities in accordance 9 with Regulation SHO? 10 A Yes. 11 Q When did you first become aware of that fact? 12 A This would have -- there was the July -- there was 13 the July email from Summer up to the compliance group. 14 Q July 2010? 15 A The July 2010. 16 Q Exhibit 158 that we looked at earlier? 17 A Yes, sir. * * * 391: 18 I look -- I would look at something like that [Exhibit 158] and 19 say, well, you know, if it's interesting he must have it 20 wrong because certainly the leaders in that department have 21 certainly -- and that's not the messaging that they've 22 received, that's not the messaging that I've received back 23 that's occurring at this point in time. But when we come 24 back and re-clarify that particular issue and drive back 25 down to the buy-ins department, no, buy-ins are buy-ins, T+6 392: 1 is T+6, market open is market open. It reinforces that same 2 messaging that consistently has been happening over and over 3 again that's on there. 4 So there's a red -- there is a reg flag that 5 appears there in that July 2010, but from my viewpoint 6 looking at it, reviewing the email, while I -- while I -- 7 mission accomplished in terms of my folks giving the right

OIP ¶	Allegations	Examples of Evidentiary Support
		8 advice, certainly the testing would continue after that, we 9 were -- that the controls -- we would continue to be looking 10 at those buy-ins still thinking that this is -- that there's 11 a buy-in issue here not a loan on long -- or a loan on long 12 sales. * * * 429: 4 Q Did you, in your meeting with Mr. Yancey on 5 August 2, 2010, explain to him the recent issue of the 6 compliance address with respect to Rule 204 compliance at 7 Stock Loan? 8 A I don't think that that was the -- that was 9 subject to what we had spoken to. It certainly may have 10 come up as an aside item. I don't think that that was the 11 main crux of what we were talking about. 12 Again, my perceptions, based on that July email, 13 had been that the matter -- the matter had been foreclosed 14 by the compliance guys back to buy-ins. So I don't 15 specifically recall that this was going to be an issue that 16 I was going to continue to escalate up or take action on. I 17 don't recall if Eric had made mention of that in the meeting 18 to Bill. He certainly may have. 19 Q Did you ever escalate the issues raised in Exhibit 20 158 to Mr. Yancey? 21 A Not personally, no.
33	"In late 2010 to early 2011, Delaney again discussed the violations with compliance and operational personnel."	Delaney Investigative Testimony, Ex. 224: 184:19 [Delaney] Mike Johnson, who was our global head of stock 20 lending at Penson -- of Worldwide, Inc. -- at some point 21 had either come into my office or made a phone call. I 22 don't recall which one. It could have been a combination 23 of both, and talking about this notion that his 24 interpretation of Reg SHO was that you could -- if you 25 were failing on a stock, and to make cover on the stock, 185: 1 that you were put in the penalty box, which meant that 2 instead of just going and getting a locate, you actually 3 had to go pre-borrow shares in order to loan those shares 4 out. You know, go effect the actual transaction and pre- 5 borrow the shares. 6 Q Could you slow down just a little bit. 7 A Yes, sir. So that process of the pre-borrowing 8 shares seemed to be the remedy in his mind to the fact 9 that the rule actually permitted you then not to cover on 10 those fails, as long as you can adhere to the set of 11 provisions set in the rule around the penalty box, around 12 that notion of pre-borrowing shares before you lend those 13 securities out. 14 I had a different view of what that rule 15 actually said at that point in time, and whether I was 16 right or Mike was right, it appeared to be an honest

OIP ¶	Allegations	Examples of Evidentiary Support
		17 difference of opinion with respect to how we were each 18 reading the rule at that point in time. 19 So I don't want to say that there was a concern 20 -- it was a concern that if I was right in my 21 interpretation, that there would have been a rule 22 violations at that point in time. 23 Certainly if Mike were right, then there 24 wouldn't have been a rule violation, but that was 25 something -- one of the issues related to Reg SHO that 186: 1 had been brought to my attention directly. 2 Q Do you recall when that took place? 3 A Well, lastly I believe this was late 2010, 4 sometime around then, but, again, that's my best shot in 5 the dark in terms of recollection of time. It could have 6 been earlier than that. But as I recall, it was 7 somewhere around that later 2010. 8 Q So let me repeat back a little bit of what you 9 said there, and you tell me if I got it right or not. 10 Okay? 11 A Yes, sir. 12 Q So sometime in approximately late 2010, Mr. 13 Johnson talked to you about his view of Reg SHO, and his 14 view was something to the effect that if Penson was in a 15 fail position on a security, but then penalty bought that 16 security, there would be no Reg SHO violation. 17 Is that the sum of what his view was? 18 A That's what I recollect his view to be.
34	"As a result, Delaney knew Penson was violating Rule 204T(a)/204(a) in connection with long sales of loaned securities. And, when Stock Loan erroneously claimed in discussions with Delaney that it was industry practice not to follow Rule 204T(a)/204(a), Delaney understood that industry practice was no excuse for failing to follow the securities laws."	Delaney Investigative Testimony, Ex. 224: 190: 2 Q Did Mike Johnson or anyone else from stock loan 3 make the argument to you that it was industry practice 4 not to close out failed securities at market open? 5 A I recall there being a -- it wasn't an 6 argument. More of a statement about nobody else has to 7 do this. Why do we? Or that our customers are yelling 8 and screaming about this, you know, why do we have to do 9 this? 10 Those are sort of the comments that I recall 11 being either sent to me or said in or around rooms where 12 I was attending in that room. 13 Q What was your response to those comments? 14 A You know, I don't mean to be cavalier about it, 15 in that the rule is the rule. And while I appreciate, 16 you know, the struggle that you're having, at the end of 17 the day I'm not a stock loan expert. I haven't worked a 18 stock loan desk and so I appreciate the fact that there 19 would have been people pushing back. It seemed that that 20 was definitely a possibility, but at the end of the day, 21 we had to follow the rule. And if we needed to go and

OIP ¶	Allegations	Examples of Evidentiary Support
		22 get other interpretations of the rule, then that was 23 certain always available to us to go find out, is there - 24 - what are we ultimately trying to accomplish and does 25 the rule allow for it in some way, shape or form or 191: 1 fashion. 2 Q As chief compliance officer, was the argument 3 that everyone else is violating the rule? Was there a 4 basis for Penson not following the rule? 5 A No. * * * 268: 3 Q Did you ever take any steps to confirm whether 4 the statements about industry practice relating to close- 5 outs for long sales was accurate? 6 A To be honest, the rule stated what the rule 7 stated, so whatever I was being told was industry 8 practice really didn't concern me in terms of -- if 9 everybody else -- the old adage is if your friends jumped 10 off a bridge, would you jump off too, I think would apply 11 here. To me, what the claim of the rest of the industry 12 does, didn't really interest me. What interests me is 13 what does the rule say and how are we going to comply 14 with the rule. 15 Q Well, I'm trying to reconcile what you're 16 saying there against what I'm seeing depicted about 17 Penson's policy. 18 How do I reconcile that? 19 A I don't know. That's not my policy. 20 As I read what it's stating here, the firm does 21 not believe -- if there was some catharsis in telling the 22 regulator we don't believe that this is industry practice 23 -- I'm fine with a statement to the regulators saying 24 what you believe or don't believe, but at the end of day, 25 you've to adhere to what the rule says. The rule says 269: 1 you do X, you do X. And if you believe it should be 2 otherwise, you are welcome to complain to your heart's 3 content to the regulator, and there's a process for that. 4 But just because you believe that everybody else does it, 5 to me doesn't excuse the fact that it's not being -- it's 6 not attending to the rule. 7 Q Was that your mind set back in the time when 8 you were the chief compliance -- 9 A That would have been my mind set then -- 10 I apologize. 11 Q Was that your mind set at the time you were 12 chief compliance officer at Penson? 13 A It would have been my mind set then and it's my 14 mind set as I sit here today.
37	"[I]n 2009 or early 2010 –	Gover Declaration (Jan. 7, 2014) ¶¶ 4-10, *supra.*

OIP ¶	Allegations	Examples of Evidentiary Support
	about the same time Delaney began overseeing Rule 204 remedial efforts for Buy Ins's procedures – Delaney and Stock Loan rejected procedures that would have brought Penson into compliance because they did not want Penson to incur the costs of those procedures."	Gover investigative testimony (Ex. 4), *supra*, regarding timing of meeting and discussion of Stock Loan non-compliance.
38 - 39	"Instead of taking steps to bring the Stock Loan Rule 204T(a)/204(a) procedures into compliance at any point during his tenure as CCO of Penson, Delaney agreed with Stock Loan Supervisors that Penson would continue implementing non-compliant Rule 204T(a)/204(a) procedures. Thus, Delaney consciously chose profits over compliance."	Gover Declaration (Jan. 7, 2014) ¶¶ 4-10 (Ex. 1), *supra*.

Appendix 2: Excerpted Witness Testimony

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[a] Q In these conversations in or around October 2008 with Mr. Delaney, did you explain that stock loan was not closing out failure to delivers by open market T+6?
A Yes.
Q And what did Mr. Delaney say?
A Mr. Delaney was aware, and he said he would get back to us. And then we'd had further conversations. I believe Mike Johnson had specifically mentioned the MSLA that the counterparties were pushing back on and saying the we were not honoring that, we could not buy it in the morning of T-6, we'd have to wait until the afternoon.
Q These conversations about the MSLA, they took place in or around October 2008 as well?
A Correct.
Q How do you know about those conversations?
A Some of them were had in the open. I mean, the pathway from Mike Johnson's office to Tom's was pretty worn, I would imagine. It was, as I said, chaotic, and we were trying to get a handle on this rule.
Rodolfo DeLaSierra – Jan. 10, 2013 Investigative Testimony, pp. 167-169, (Ex. 2).

[b] Q And if you can look at the second paragraph from the top, Mr. De La Sierra. And that paragraph, in response to Exception 13 about Rule 204, says, "With regard to the timing of long sale close-outs, the firm does not believe it is industry practice to close-out long sales prior to the market open on T+6."
And a couple of sentences down, it says, "Thus, the firm executes close-outs versus long sales at the conclusion of the DTCC trading window at approximately 3 o'clock Eastern Time daily."
Do you see where I read?
A I do see that.
Q Mr. De La Sierra, was that, in fact, the practice of Stock Lending at Penson?
A It was the practice.
Q And how long had that been the practice of Stock Lending at Penson Financial?
A From the inception of this rule, 204T.
...
Q We'll come back and talk about this more in a moment. But did Tom Delaney know what Stock Lending's practice was?
A He did.
Hearing- Day 1, pp. 201-202 (Oct. 27, 2014)

[c] Q You also talked, I -- I believe, with Mr. Lebenta or Mr. Washburn yesterday about your conversations, both that you overheard between Mr. Johnson and Mr. Delaney and that you personally had with Mr. Delaney regarding Stock Lending's practices when Rule 204T came out. Do you recall generally that testimony?
A Yes.
Q In -- in those conversations, did you or Mr. Johnson make it clear to Mr. Delaney that Stock Loan was not closing out at market open?
A Yes.
...
Q In the conversations, did Mr. Delaney ever ask whether Penson was still buying in for its own account even though the counterparties wouldn't take the buy-in?

A No, he never asked that.
Q In the conversations, did you or Mr. Johnson ever suggest that Penson was still buying in at the opening even though the counterparties wouldn't take it?
A No, we never told him that.
...
Q ... Based on your overhearing those conversations and participating in the conversations themselves, was there any doubt in your mind that it was clear that Stock Lending was not complying with the rule?
A We were not complying at the open of T6?
Q Correct.
A Correct.
Hearing- Day 2, pp.337-338 (Oct. 28, 2014)

[d]Q And was there any ambiguity that Mr. Delaney knew that Stock Loan was not closing out at market open T+6?
A No.
Hearing- Day 2, p. 339 (Oct. 28, 2014)

[e]I heard, I believe, a list of people that knew stock loan wasn't closing out fails to deliver on margin long sales by open market T+6, okay? And the people I heard you say were Tom Delaney, right.
A Um-hum, yes.
Michael Johnson - Jan. 11, 2013 Investigative Testimony, p. 74, (Ex. 3).

[f] Q Did you ever have direct conversations with Tom Delaney about stock loan's practice relating to closing out failures to deliver in margin long sales on open market T+6?
A I think I did.
Q When?
A I don't know. Don't know.
Q What was the general context for those discussions?
A Exactly what I said to you a minute ago.
....
MR. FONS: The conversations that you had with Tom, okay, that you think you had -- As you sit here today, understanding you don't know specifically when you had them, can you put them sort of in the context of would it have been sort of during the time that Rule 204T was there, versus the permanent rule, or the implementation of either of those rules? Can you put them in that context or not?
THE WITNESS: I think we chatted a few times about 204T and not being able to do that, and it was street practice. And then I believe at that point the firm was complacent, or Tom was, or someone was, and that, yeah, that's industry practice.
....
Q So I can go -- I think I know what you're talking about. I can go pull that. But if I'm understanding you right, you said your meetings with Tom Delaney were at or about the time he sent out that e-mail about Rule 204, right?
A For the final rule. For temporary, I believe we still had a couple walk-bys where we -- where the staff was telling me that they were having trouble buying in on the morning of T-6. And so those were the discussions. People in the firm knew. There was nothing hidden from them because we were doing the best we could to get these things cleaned up. I remember telling

them we have to be tight. I don't know how to get there. If you remember -- right. So that's where I was.
Michael Johnson - Jan. 11, 2013 Investigative Testimony, pp. 77-80, (Ex. 3).

[g] A Because I was raised that way by my mother. I wouldn't have hidden anything from anyone. If there was an issue, I'd let them know about it, and I would have done that. That's my MO. I chased Tom Delaney in the hallways. I would always let people know what was going on and what I was uncomfortable with, and I'd also let them know what I thought I did a great job at. So that's me. That's my DNA.
Michael Johnson - Jan. 11, 2013 Investigative Testimony, p. 90, (Ex. 3).

[h] A We knew we couldn't buy in on the morning of T-6, that they weren't letting us do that. So we -- but we knew we were cleaned up 98 percent of the time. So we knew we had an issue with the SEC rule, and we were saying street practice, and so was Tom Delaney, and so was their bosses.
Michael Johnson - Jan. 11, 2013 Investigative Testimony, p. 211, (Ex. 3).

Q So they did give you a clear answer, and the answer was follow industry practice, not SEC rules?
A The indication we got was to follow industry practice, stick with it, keep it tight.
Q And this came from compliance?
A Yes.
Q Who told you that?
A Tom Delaney and the powers to be.
Q When did Tom Delaney tell you that?
A I don't know. Probably in '09, '10. But it was inferred in that timeline, absolutely.
Q What was the context in which Tom Delaney told you to follow industry practice and not SEC rules?
A Don't know. It was conversational. And there were other conversations that my staff told me about, and that's how we stayed in that. But they all knew we were following industry practice. That's what we thought. We had no conception that there was a stock loan sentence about stock loan recall detail. We didn't know that at all. Never knew that.
Michael Johnson - Jan. 11, 2013 Investigative Testimony, pp. 216-217, (Ex. 3).

[i] Q All right. Well, let me ask you this: Did you have any conversations with Mr. Delaney, Mr. Johnson, about Rule 204?
A Yes.
Q Describe for the Court those conversations, please.
A I was looking for help on interpreting it, on what to do with Rule 204. Industry practice, whatever, has been what you've showed me prior. That's the way the whole industry operated, the three o'clock in the afternoon, for 40 years. 204 presented a new light in those, and I was searching for interpretation and guidance on how to comply.
Q And as you sit here today, in substance, what were the conversations between you and Mr. Delaney? What did you say to him?
A I don't know. They were fast.
Q Okay. And what do you mean by "fast"?
A Hallway conversations, quick conversations. I ran Global; so they were fast in coming, looking for support.

Q In those conversations, did you discuss with Mr. Delaney resistance that Stock Lending was getting to trying to buy-in, in the morning of T6?
A I believe so.
Q And what do you believe you discussed with Mr. Delaney on that point?
A I believe we talked about Lindsey Wetzig calling counterparties trying to get a definition of when to do this, and they said it was industry practice, and by us not doing it the old way, we were violating our MSLA agreement.
Q And you said, "by us not doing it the old way." What is that reference, sir?
A It's what you just said in this box that's sticking out. That's the way the industry has done it for years.
Q So by you not buying in the afternoon of T6; is that what you mean, sir?
A By buying in, we would always buy-in when -- when -- when -- when -- when it was at the end of market.
Q All right. Do you believe you communicated with Mr. Delaney that your practice was to buy-in at the end of market?
A I believe we communicated we had a conflict between those two.
Q Between the rule and the industry practice?
A Yes, sir.
Hearing- Day 2, pp. 517-519 (Oct. 28, 2014)

[j] Q And I want to make sure that the record is clear that when you are pressing for answers from Mr. Delaney, was it clear what the problem was -- what the problem Stock Loan was having was?
A Yes.
Q And was it clear -- did you make it clear to Mr. Delaney what the problem Stock Loan was having was?
A Yes.
Hearing- Day 2, p. 525 (Oct. 28, 2014)

[k] Q What did you learn about the stock loan policy about not closing out long sale transactions at market of T + 6 if there is a re-call posture?
A I would say it was probably within the first three to six months of my taking over the team.
Q You knew about this policy before the end of 2009?
A I would have to say yes.
Q Was that common knowledge within the management group?
A I don't know about common knowledge. It's pretty granular, so I don't know if somebody who -- if buy-ins or stock loan did not fall under their organization, I don't think it would have been something that would have been not hidden. I just don't think it would be something that it would have been involved in.
Q Do you recall discussing that with anyone?
A I do.
Q Who did you discuss it with?
A Mike Johnson, Brian Hall, Tom Delaney, Holly Hasty, Summer.
Q And were all these discussions back in 2009?[k]
A I believe so, thereabouts.
Brian Gover - Aug. 16, 2011 Investigative Testimony, pp. 132-133, (Ex. 4).

[l] Q Well, tell us -- why don't you tell us about those conversations, the conversations between you and --

A Sure.
Q -- Mr. Delaney --
A Yeah.
Q -- about Rule 20- -- 204 and Stock Loan.
A Well, I think the one that is probably germane to this conversation, or one of them anyways, we encountered an issue where we had a CNS obligation. We -- we -- we were short to CNS. And when we looked at our stock record, there were no -- there were no customers that were selling short that we could buy-in, and all of the excess stock was on loan. So it showed in a location of being stock on loan on the Stock Loan box. So we were presented with a situation where we had an obligation to buy-in, but the only party that we could buy-in would have been the Stock Loan department.
Q And so what happened?
A It was escalated to me by the buy-ins group, and we had a conversation -- had requested a conversation with compliance and Stock Loan. And it was basically -- the -- the message we were getting from Stock Loan is that you don't buy-in Stock Loan. And I'm looking at what I thought were our obligations under Reg SHO from my buy-ins group and saying, well, that kind of puts us in a bad position because I have an obligation to buy-in, but I've also got Stock Loan saying, you can't buy us in and there's nobody else that could buy-in. So that precipitated a discussion around the rule.
Hearing- Day 1, pp, 102-104 (Oct. 27, 2014)

Q Okay. And how was the problem presented in that conversation?
A I am paraphrasing. But it was, okay, Stock Loan is saying they don't get bought in, and then here's me holding 204 and saying I've read the reg, and I don't see anywhere it gives -- where it gives me an out for that. So there were some discussions about, well, in order to have the shares for a loan sale, they should -- they would have to be recalled to -- they have to be recalled earlier. They have to have -- we have to have the shares -- if we've got shares, this is really -- this is -- gets really complicated. So if I need to clarify, please stop me.
Q Okay.
A All right. So then it all ties back into like margins and hypothecation. So let's say you -- you're that customer that had a $5,000 margin debit with Penson and we had lent your shares out because somebody else thought IBM was going to go down in value. So you -- you bought the shares. They're yours. You don't have to pre-clear selling them because they're on a loan. But somebody else thought IBM was going to go down, so they wanted to borrow shares. And because we as a firm could make money on them, we'd lend the shares out to that party. You sell your shares. You -- you sell all $10,000 worth, however many shares that is. In order for us to make delivery, we have to recall those shares from whoever we lent them to. In order to have those shares in hand in time to make the -- the Reg SHO requirement of at the open, we would need to recall them earlier. Where the -- where the point of discussion was, the Stock Loan compliance and buy-ins was -- I think Stock Loan maintained that that wasn't industry practice and that the Stock Loan agreements, the MSLAs, weren't -- didn't support that. And so that's where we had a conflict.
Hearing- Day 1, pp. 104-106 (Oct. 27, 2014)

[m] Q And you spoke earlier about a conversation that you had with Tom Delaney and Mike Johnson. Can you put that into a time frame for us? You took over buy-ins in August or September and --
A I will attempt.
Q Okay.

A And I do it -- you know, there's kind of like there -- I can put time frames around issues around when I think that happened. I believe that we -- that we had a couple of conversations, one when I first took over buy-ins, which would have been, to my recollection, third quarter of 2009. I also believe that there was another conversation that occurred in -- sometime in the spring of 2010. And, you know, it's kind of like, well, okay, I know I took buy-ins about when I -- you know, about a couple of months after I took Stock Loan. I know I hired a VP at Stock Loan in August. So, you know, it's within that range.
And I can also -- you know, as I move through the continuum of my career progression at -- at Penson, I can say, okay, I know that I wasn't -- well, you know, I wasn't -- I wasn't focused on buy-ins during, you know, the latter half of 2010 because I was focused more on margins because we were -- so is that helpful? I mean, I -- I can't say on, you know, July 29th we had this meeting.
Q Sure.
A But to my recollection, that it was within the first six to nine months after my taking buy-ins that we had the conversations and the conflict on the Stock Loan over when the shares were recalled.
Hearing- Day 1, pp. 117-118 (Oct. 27, 2014)

Q Okay. And the last thing I want to ask you about is the meeting that you had with Mr. Delaney and Mr. Johnson, and I just wanted to kind of circle back around and say, is there anything that you heard on cross-examination that has changed your mind about when you think that meeting occurred?
A Not substantially, no. I mean, it was -- it felt chronologically like it was pretty close to when I had took over the team. I know that I had a lot of other things that started to get -- you know, grabbing my attention beginning late summer of 2010. And, you know, based on the exhibits that I had seen that accompanied my -- my declaration and then some of the other e-mails that I had seen, it seems pretty consistent with my recollection that it was, you know, somewhere between March and June of 2010.
Hearing- Day 1, p. 197 (Oct. 27, 2014)

[n] And typically the 3012 reports were always subject to examination from FINRA would come in. That was one of the key documents we would be turning over. With the notion of "What are you doing to test your own controls to make sure that things are operating as you are expecting them to operate?"
Tom Delaney - Aug. 29, 2012 Investigative Testimony, Ex. 224, p. 221

[o] Q As chief compliance officer for Penson, what was your responsibility if you were to find out the associated personnel were not conducting business in a manner that encompassed all laws, rules, regulations and interpretation?
A My responsibilities would have been to investigate those breaches and report those breaches -- "breach" may be the wrong word to use, but report my findings to members of senior management where those persons reported into.
Tom Delaney - Aug. 29, 2012 Investigative Testimony, Ex. 224, p. 178.

[p] Tom Delaney - Aug. 29, 2012 Investigative Testimony, Ex. 224, pp. 170, 282.

[q] He [Yancey], at that point, had made mention of the fact that well, this was something we need to get Mike Johnson in the office for when he saw those particular findings.

We, at that point in time, had explained that we didn't think at this point that there was a stock loan issue, that this was really appearing to be a buy-in issue. And we were working with buy-in folks, which don't report in to Mike Johnson but that -- and that we would continue to test this issue going forward.
Tom Delaney – Jul 31, 2013 Investigative Testimony, Ex, 224, pp. 329-330.

[r] Charles Yancey - Jan. 23, 2013 Investigative Testimony, Ex. 227, p. 84.

[s][O]bviously the financial incentives for the Reg SHO group not to [comply with Rule 204] would be -- I believe to be self-evident.
....
Q Well, you told me that Stock Loan has financial incentives to violate Reg SHO in a way that no one else at Penson does -- Reg SHO had; is that right?
A That's right.
....
Q During your tenure as CCO at Penson, did you understand that the Stock Lending group had these financial incentives relating to closeouts?
A Certainly I understood that.
Tom Delaney- July 31, 2013 Investigative Testimony, Ex. 224, p. 435,446,459.

[t] **[T]here certainly could have been an incentive from the Stock Loan group at that point in time to keep relationships going with their key -- with their key counterparties**. And **if they were getting yelled at for following rules and it was somehow going to impact their ability to drive revenue into the business unit**, that certainly could have been a process where **those financial incentives were aligned differently** than, say, the rest of the organization where the balance of the organization, other than there were some other sales groups that went out and got correspondence and things like that to come to the firm.
Tom Delaney- July 31, 2013 Investigative Testimony, Ex, 224, pp. 443-444 (emphasis added)

[u] How did delaying closeouts allow securities lending to retain in increased customers?
A So as I understand it, a couple of factors, that, again, there's these neg rates -- negative rates that -- potentially that they could be getting for the benefit of continuing to loan out that stock. Those negative rates -- the higher the negative rate the more revenue that Stock Loan would get for loaning those stocks out. So the longer that they had those stocks loaned out, especially stocks with a high negative rate, the more potential revenue that could come into the firm at this point in time. Secondarily, the more that they have -- that they're loaning stock out the more reliable they become as a stock lending facility to other counterparties and that -- that would make -- potentially make Penson the lender of choice relative to others if you're known as a more reliable lending facility.
Q Including the hard-to-borrow stuff and they won't call back, right?
A That's right.
....
I think sort of what I spoke to earlier, as if you got that reputation as being a solid lender and that you're not going to be recalling the stock, people are going to come to you for -- for the loans -- for their lending needs at this point in time. So if you're -- In this case, if you're intentionally not recalling it back in, not only are you enjoying those negative rates but you're also enjoying the customer goodwill that comes from having that reliable -- being that reliable lending facility.
Tom Delaney- July 31, 2013 Investigative Testimony, Ex, 224, p. 458-459 (emphasis added).

[v] Without my relationships, Penson probably would have gone up sooner because I had to really work hard to finance the company with stock loans.

....

Q Who are these people you're talking about?
A Other stock loan heads.
Q At other street firms?
A Yes.
Q And what did you need their relationships for?
A To do business, to finance -- you know, the main part of the Penson stock loan world was to finance the business.

....

It sounds like at the 30,000-foot level, Penson needed cash from stock-owned financing to run its business, and your relationships were important to Penson's ability to do that; is that a fair 30,000-foot summary?
A That would fair for Penson and any other brokerage firm that did margining. It would be equal across the board. It wasn't just a Penson-ism.

....

Q What was the role of stock loan at Penson?
A To finance the firm, and to lend stocks out, whether that generated income or not.
Q Finance firm, lend stock out?
A I think in a nutshell, generate cash would be a better answer and would sum those up into one category. Our job was to generate cash and finance the firm.
Michael Johnson - Jan. 11, 2013 Investigative Testimony, pp. 40, 42, 44, 177, (Ex. 3).

[w]We could not get a morning buy-in off to save our soul without ruining our reputation with the street.

....

So there was no place to go buy in. We couldn't do the trade, and that's what we raised up to compliance, et cetera, above us saying that we had that problem. There was -- if I did the buy-in, Goldman or somebody wouldn't accept it, and therefore, I'm stuck with trade, and we couldn't do that.
Michael Johnson - Jan. 11, 2013 Investigative Testimony, pp. 72, 150, (Ex. 3).

[x] Whenever the rule was -- even in its temporary form when it was first adopted, we attempted to close out for CNS fails on the morning of T+6 and met significant resistance from that.
Q From whom?
A From our borrowing counterparties. Not only did we receive significant resistance to it, but we did not -- we did not see that our -- that, conversely, that our lending counterparties were buying us in on that same timeframe. So, we went away from that pretty quickly. The response to it was so -- was severe in some cases, where you would actually have counterparties who would threaten to discontinue doing business if we closed out in that timeframe.
Brian Hall- July 7, 2011 Investigative Testimony, p. 20, (Ex. 5).

[y] This is a relationship, you're in business. If I buy Citi in who is uncovered because their client covered their short, they're not going to be very happy with me. If I do that -- you know, happen to do that a few times, they would probably shut me off. So, you know, as much as we try to -- and our reputation on the street is, A, we recall a lot because we're cleared for day traders, and

we buy in a lot. That's our reputation. We're known as, you know, we will drop the hammer, as everybody likes to say.
Q. How do you know that that's your reputation?
A. Just, you know, talking to people. You guys buy in a lot. You guys recall a lot. It's -- you know, affecting our business. Can you look at that? Is there anything you can do about it? Sorry. That's us. We recall and buy in. Our stock records swings back and forth because of all the day traders we cover for. One day we have 100,000, the next day we don't. We have to recall it. So there is a management process that we have to go through. We have to manage that relationship. If I -- **If I buy in T six at the open every day, we will be out of business. There is no question about it. We have tried to do it twice and if hasn't worked.**
Lindsey Wetzig - Aug. 18, 2011 Investigative Testimony, p.118-119, (Ex. 6) (emphasis added).

Q Were the relationships with those broker-dealers important to Penson Stock Lending?
A They were extremely important.
Q Why?
A If we did not have those relationships, we could not go out and borrow. We could not borrow or lend securities to perform stock lending.
....
Q Mr. Wetzig, when you were at Stock Lending, at Penson Financial Services, did you observe any pressure points on those relationships with other broker-dealers?
A I did.
Q What were those pressure points?
A More so on when we were trying to buy them out.
...
[W]e would recall the stock that we were loaning them, and they would essentially push back quite a bit when we tried to buy them out on that loan that they were not returning.
...
Q What about recalls, were recalling loans a pressure point at all with the broker-dealers that you had relationships with?
A They were.
Q Help us understand that. Why was that a pressure point?
A Well, due to the volatility of our retail customers that Penson cleared for, we would sit on a few recalls a day. So you're essentially -- we would loan one day and recall securities the next day, in many cases.
Q And -- and why was that something that bothered the correspondents, the broker-dealers?
A So if we recalled the stock we're essentially telling them that we're going to buy them in three days later, so they're going to have to let their customer know. And they're going to decide if they're going to get bought in or they're going to have to go try to find the shares elsewhere to borrow and then return shares to us.
Q You may have said this, and I apologize: But if Penson Financial Services didn't have these relationships with the broker-dealer, what -- what would happen?
A We probably would have -- we wouldn't have been able -- we wouldn't have been able to cover trades. We wouldn't have been able to borrow securities. We wouldn't have been able to loan to make revenue. So at some point, I would assume that the firm would have gone out of business.
Hearing- Day 2, pp. 357-360 (Oct. 28, 2014).

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

9/8/2014 ADL	Make further revisions to subpoenas to SIFMA and FINRA; Conduct legal research on causing/aiding and abetting violations, including elements, analysis of claims in administrative proceedings and court cases.	4.30	Block billing Not related to profit motive Vague
9/8/2014 MLS	Work with witnesses and experts for trial.	2.50	Vague
9/9/2014 LAM	Research Penson trading desk employees and collect contact information in preparation for administrative proceeding; Discussion with A.Lebenta regarding subpoena motions and expert analysis; Research cases and articles pertaining to CCO liability; Search testimony transcripts for information pertaining to discussions with individuals at Penson's trading desk in preparation for this administrative proceeding.	4.70	Block billing Not related to profit motive
9/9/2014 JAJ	Analysis of issues related to privilege for communications between SEC and FINRA; Evaluation of Gover direct and cross; Work on chronology of regulatory exams; Further review of stock loan testimony related to July 2010 and December 2010 time frames, especially looking at McCain and de La Sierra testimony; In-depth examination of stock loan WSPs; Continued analysis of Alaniz 3012 testing.	6.90	Block billing Not related to profit motive
9/9/2014 MLS	Draft witness examination outlines; Consult with experts on reports and testimony; Research on Rule 204 and SEC's liability theories; Research and analysis regarding AP procedure, due process and preserving appellate issues.	10.60	Block billing Not related to profit motive Vague
9/10/2014 LAM	Discussion with B.Baker, J.Hunter, M.Smith, A.Lebenta and L.Washburn regarding our experts and outlining topics of importance for expert reports; Phone call with Haynes Boone team and follow up discussion; Meeting with prosecution team to discuss strategy, timeline, next steps and assignment of tasks, relating to this administrative proceeding; Review and proof draft motion for postponement.	9.30	Block billing Not related to profit motive Vague
9/10/2014 ADL	Analyze and determine defense strategy, including outline motion practice strategy and potential grounds for motions; Continue legal research on primary violation re: review articles and rules on how DTC/NSCC operate.	11.40	Block billing Not related to profit motive Vague
9/10/2014 BRB	Conference call with compliance expert; Drafting legal and factual questions for compliance expert; Factual research for call with compliance expert; Call with compliance expert.	13.60	Not related to profit motive
9/10/2014 JAJ	Continued "to do" and assignment issues to plan for hearing.	1.30	Vague
9/10/2014 JAJ	Identify exact procedure for stock loan use of penalty box and extensions to close; Review emails related to "push back" from correspondents; Work on chronology regulatory exams, with focus on FINRA exit report and how SEC will use that in case; Focus on Pendergraft role with directing stock loan and benefits to Pendergraft from closing	6.20	Block billing Not related to profit motive

	or failing to close; Analysis of detailed case timeline to analyze SEC positions and most fruitful defenses; Analysis of OCIE exam chronology and communications from Penson to OCIE.		
9/10/2014 MLS	Draft witness examination outlines; Analysis of expert reports and testimony; Research and analysis regarding AP procedure, due process and preserving appellate issues.	9.70	Block billing Not related to profit motive Vague
9/11/2014 LAM	Continue proofing motion for postponement; legal research on primary violation; Finalize subpoena motion for Sungard; research legal counsel; Phone call with expert; follow up discussion with CSS team; Review motion redline edits; Legal research in AP limited docket for cases dealing with causing elements; Begin drafting subpoena motion to Apex Clearing Corporation; discussion with A.Lebenta regarding documents we are seeking; review supporting documents in database.	5.90	Block billing Not related to profit motive
9/11/2014 JHU	Team meeting regarding update on experts and witnesses; Research and download OCIE documents for upload for expert review.	7.70	Block billing Vague Not related to profit motive
9/11/2014 ADL	Continue legal research on primary violation re: review articles and rules on how DTC/NSCC operate, changes to procedures; Outline expert testimony strategy, including topics/areas of testimony for each expert witness and areas of consultation.	11.70	Block billing Vague Not related to profit motive
9/11/2014 DLW	Draft declaration and gather exhibits in support of motion for postponement; Review redlines from team and incorporate changes into motion for postponement; Incorporate redlines comments into draft declaration and search for additional exhibits per comments.	7.80	Not related to profit motive
9/11/2014 MLS	Analysis of expert reports and testimony; Review hot documents and respond to review inquiries for protocol adjustments; Research for and update trial matrix of elements and evidence.	8.70	Block billing Not related to profit motive Vague
9/12/2014 JHU	Document search and download FINRA documents; Research and respond to American Discovery queries; Upload documents for expert review; Create Sharefile sites for compliance experts and begin uploading documents for review.	8.30	Block billing Not related to profit motive
9/12/2014 ADL	Make further revisions to Motion to Postpone Hearing; Prepare for and conduct conference call with economist experts on primary violation analysis; Review and analyze ALJ order on Motion for Subpoenas to SIFMA and FINRA; Revise Declaration to Support M	8.80	Block billing Not related to profit motive
9/12/2014 BRB	Conference with E. Sirri.	2.00	Vague

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

9/12/2014 DLW	Conference call with experts; Strategy memo regarding expert testimony and limitations; Finalize memo in support of motion to postpone hearing.	7.50	Block billing Not related to profit motive
9/12/2014 MLS	Analysis of expert reports and testimony; Research on Rule 204 and SEC's liability theories; Research and analysis for pretrial motion practice.	9.00	Block billing Vague Not related to profit motive
9/14/2014 ADL	Continue legal research on causing claim and aiding and abetting, re: causation requirements; Continue outlining directions to experts for expert testimony summaries.	7.70	Block billing Vague Not related to profit motive
9/15/2014 JHU	Upload documents to Sharefile for compliance experts; Team strategy meeting regarding division of work and critical needs; Document search for and analysis of exhibit to B. Gover declaration.	6.50	Block billing Vague Not related to profit motive
9/15/2014 ADL	Continue to outline directions for expert witnesses; Prepare for and conduct conference call with stock loan expert, Ed O'Brien; Outline areas of testimony/proof for each witness for presentation of defense.	11.40	Block billing Vague Not related to profit motive
9/17/2014 BRB	Factual research regarding Brian Gover; Legal research regarding challenges to SEC's use of administrative proceedings; Review of cornerstone research initial opinions and data; Meeting with client.	16.40	Block billing Vague Not related to profit motive
9/17/2014 MLS	Prepare witness examinations; Analysis of expert reports and testimony; Research and analysis regarding AP procedure, due process and preserving appellate issues.	9.30	Block billing Vague Not related to profit motive
9/18/2014 WAR	Work on trial preparation issues relating to witness testimony.	1.40	Vague
9/19/2014 ADL	Revise subpoenas; Conduct legal research on possible remedies sought by Division and defenses to remedies; Prepare for and conduct conference call with compliance expert.	8.10	Not related to profit motive
9/19/2014 BRB	Review government accounting office report on regulation SHO; Review and clear additional American discovery query; Further refinement of review protocols by witness and theme.	9.10	Block billing Vague Not related to profit motive
9/19/2014 DLW	Phone calls with experts; Prepare second level review of documents regarding protocol.	3.60	Block billing Vague Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

9/22/2014	DLW	Prepare defense list; Prepare witness cross-examination outline; Phone call with experts.	6.40 Block billing Vague Not related to profit motive
9/24/2014	LAM	Document review in database; review Division's exhibits; Discussions with CSS team regarding witnesses and exhibits; research various legal issues including aiding and abetting cases and FINRA disqualification statutes.	7.70 Block billing Vague Not related to profit motive
9/27/2014	LAM	Discussions with J.Hunter, A.Lebenta, W.Romney and N.Kaplan regarding exhibits and defenses; review and organize exhibits and potential exhibits; Email all parties regarding service of SIFMA subpoena; Review and tag relevant documents in database as ex	8.10 Block billing Vague Not related to profit motive
9/28/2014	ADL	Continue review and analysis of documents for preparation of exhibit list; Revise outline of expert testimony.	10.80 Block billing Vague Not related to profit motive
9/30/2104	LAM	Review documents tagged as Defense Exhibits and pull relevant docs for administrative proceeding; Phone call with experts regarding analysis of SEC expert report; Read expert reports by SEC experts; Continue reviewing documents in database and pull pot	8.40 Block billing Not related to profit motive
9/30/2014	JHU	Conference call with experts at Cornerstone regarding SEC expert reports; Focused database search for privileged documents.	8.00 Block billing Not related to profit motive
9/30/2014	ADL	Continue to work on pretrial brief.	2.50 Not related to profit motive
9/30/3014	BRB	Review SEC expert witness reports; Review SEC expert witness reports; Preparation of exhibit list.	16.10 Block billing Not related to profit motive
9/30/2104	DLW	Phone calls with potential experts regarding SEC's expert report errors; Gather exhibits from those identified as yes or maybe.	7.50 Block billing Not related to profit motive
	NAK	Continue review of SEC expert reports and analysis.	3.00 Vague Not related to profit motive
9/30/2014	WAR	Review and analyze SEC's expert reports regarding referenced documents and potential exhibits; Review and analyze V&E documents for inclusion on exhibit list.	4.40 Block billing Vague Not related to profit motive
10/1/2014	ADL	Continue in depth analysis of SEC expert reports; Work on gathering and	9.50 Block billing

		analyzing documents for trial exhibits and exhibit list.		Vague Not related to profit motive
10/2/2014	BRB	Analysis of Harris report	7.00	Vague
10/2/2014	DLW	Phone calls with potential experts regarding SEC's expert report.	2.00	Vague
10/3/2014	ADL	Continue gathering and analyzing documents for trial exhibits and exhibit list.	10.90	Not related to profit motive
10/6/2014	BRB	Delaney expert exhibit preparation.	9.00	Vague
10/6/2014	DLW	Review OIP relating to Delaney to focus witness outline preparation; Begin outline of Dr. Harris cross-examination outline; Review past reports of Dr. Harris to provide context for cross-examination reports.	9.80	Block billing Not related to profit motive
10/6/2014	JAJ	Review and comment on expert reports; Continued work on timeline, including analysis of documents and how they fit into trial scheme; Analysis of cross-examination issues related to experts; Additional analysis of exhibits and structuring of trial issu	5.10	Block billing Not related to profit motive
10/6/2014	NAK	Trial preparation - Harris cross-examination with analysis of errors in his	3.90	
10/7/2014	ADL	Review exhibits produced by Yancey; Consult with expert witnesses re reports; Work on prehearing brief.	5.80	Block billing Vague Not related to profit motive
10/7/2014	DLW	Trail preparation, including reviewing SEC's exhibit list for possible cross-examination exhibits; Phone calls with experts regarding expert reports; Continue preparing demonstrative exhibits for cross-examination of SEC expert.	8.60	Block billing Vague Not related to profit motive
10/7/2014	JAJ	Planning of issues going forward; Review of experts and what is needed in reports.	1.80	Vague
10/8/2014	ADL	Analyze and revise draft of expert report (Sirri); Review testimony of Delaney, Alaniz, Poldrack in anticipation for trial.	8.20	Block billing Not related to profit motive
10/8/2014	DLW	Comment on outline of pre-trial brief; Finalize outline of cross-examination of Dr. Larry Harris; Phone call with co-defendant's counsel.	9.20	Block billing Not related to profit motive
10/9/2014	LAM	Phone call with experts regarding upcoming expert reports, the content of the	3.00	Block billing

		reports, and strategy for trial; Review testimony transcript of M. Johnson for details pertaining to certain events within the stock loan department, including concurrent ana		Vague Not related to profit motive
10/9/2014	ADL	Continue revisions to expert report (Sirri); Prepare for and consult with counsel for Yancey re rebuttal to Harris report; Outline cross examination of SEC expert, Harris.	5.10	Vague
10/9/2014	BRB	Preparation for telephone call with expert witness; Conference call with expert witness.	2.20	Vague
10/10/2014	LAM	Continue researching various issues pertaining to our defense and in preparation of expert reports for this administrative proceeding; Discussion with A. Lebenta regarding privilege issue in preparation of filing trial subpoenas; Review Respondent Yanc	8.60	Block billing Vague Not related to profit motive
10/10/2014	JHU	Upload Delaney exhibits for experts; Redact portions of documents for production and use as exhibits.	6.20	Block billing Vague Not related to profit motive
10/10/2014	ADL	Review trial subpoenas; Prepare for and consult with expert witnesses re reports; Work on prehearing brief.	8.20	Block billing Vague Not related to profit motive
10/10/2014	BRB	Prepare for Delaney trial.	7.00	Vague
10/10/2014	DLW	Trial preparations: reviewing and revising expert reports, including consultations with experts.	6.00	Block billing Vague Not related to profit motive
10/10/2014	JAJ	Continued review of expert reports, exhibits and testimony for trial purposes.	3.00	Vague
10/11/2014	BRB	Draft expert witness questions for trial.	6.00	Vague
10/11/2014	DLW	Trial preparation, including reviewing expert report drafts and comments; Trial preparation;	6.50	Block billing Vague Not related to profit motive
10/12/2014	ADL	Communicate with experts and revise expert reports.	4.80	Vague
10/13/2014	ADL	Continue to make revisions to expert reports; Prepare for and speak with	11.10	Block billing

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

		Counsel for Yancey re cross examination points for SEC's expert witness, and contents of expert reports.		Vague Not related to profit motive
10/13/2014	BRB	Call with Kevin Campion regarding Harris report; Call with Ira Hammerman at SIFMA; Work on pre-hearing briefs.	12.20	Block billing Not related to profit motive
10/13/2014	DLW	Conference call with experts regarding status of reports; Review expert witness report drafts; Prepare cross-examination files for witnesses; Prepare cross-examination outline for M. Johnson.	11.50	Block billing Vague Not related to profit motive
10/13/2014	JAJ	Continued review of testimony and exhibits to prepare for hearing.	3.00	Not related to profit motive
10/14/2014	ADL	Continue revisions to expert reports.	11.30	Vague
10/14/2014	DLW	Comment, revise and make suggestions to expert witness reports; Finalize expert witness reports with experts; Finalize report with compliance expert.	12.50	Vague Not related to profit motive
10/14/2014	JAJ	Review and comment on draft of expert report from Sirri; Review and redraft of compliance expert report; Comments to team about Florio report and revisions; Continued interchange of comment and revisions about expert reports throughout the night.	8.30	Not related to profit motive
10/16/2014	DLW	Delaney trial and witness preparation; Status update call with SEC and Yancey's counsel.	9.00	Block billing Vague Not related to profit motive
10/17/2014	LAM	Draft Notice of Compliance with Procedural Schedule Order and accompanying cover letter; Prepare trial subpoena for Dr. L. Harris, including cover letter and email service upon all parties; Draft section of pretrial brief pertaining to T. Delaney's res	7.50	Block billing Not related to profit motive
10/19/2014	ADL	Continue drafting prehearing brief; Revise expert report for Professor Sirri.	15.70	Block billing Not related to profit motive
10/19/2014	BRB	Review expert witness documents.	7.00	Vague
10/20/2014	ADL	Continue drafting and revising prehearing brief	8.60	Not related to profit motive
10/23/2014	DLW	Trial preparation.	12.00	Vague
10/23/2014	JAJ	Continued review of JDA and effect of privilege on evidentiary issues; Work	8.00	Block billing

		on expert testimony of our experts; Review and deconstruct issues related to SEC experts; Substantive edits and drafting to motion in limine to incorporate team suggestions.		Vague Not related to profit motive
10/24/2014	JAJ	Review and comment on dailies; Analysis of expert issues related to potential testimony.	5.00	Block billing Vague Not related to profit motive
10/25/2014	BRB	Prepare for trial.	3.20	Vague
10/27/2014	ADL	Prepare for and participate in trial.	16.30	Not related to profit motive
10/27/2014	BRB	Delaney trial.	11.00	Not related to profit motive
10/27/2014	DLW	Prepare for and participate in trial.	16.00	Not related to profit motive
10/28/2014	LAM	Review trial transcript; compare to investigative testimony; Search One-O for communications between L. Wetzig and T. Delaney regarding 204; Discussion with N. Kaplan and J. James regarding hearing and witnesses; footnote 55; Search One-O for documents	8.00	Block billing Not related to profit motive
10/28/2014	ADL	Prepare for and participate in trial.	13.60	Not related to profit motive
10/28/2014	BRB	Delaney trial	11.00	Not related to profit motive
10/28/2014	DLW	Prepare for and participate in trial.	16.00	Not related to profit motive
10/29/2014	ADL	Prepare for and participate in trial.	15.90	Not related to profit motive
10/29/2014	BRB	Delaney trial.	12.00	Not related to profit motive
10/29/2014	DLW	Participate in and prepare for trial.	16.00	Not related to profit motive
10/30/2014	LAM	Review trial transcripts and identify exhibits discussed during trial and how they relate to the trial outline and testimony of T. Delaney; Review testimony transcript for ruling on privilege documents and concurrent analysis relating to authorization	7.10	Block billing Not related to profit motive
10/30/2014	ADL	Prepare for and participate in trial	14.70	Not related to profit motive
10/30/2014	BRB	Delaney trial.	14.00	Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

10/30/2014	DLW	Prepare for and participate in trial.	16.00	Not related to profit motive
10/31/2014	ADL	Prepare for and participate in trial.	9.10	Not related to profit motive
10/31/2014	BRB	Delaney trial preparation	12.00	Not related to profit motive
10/31/2014	DLW	Prepare for and participate in trial.	16.00	Not related to profit motive
10/31/2014	JAJ	Review expert report to provide comments to trial team; Review emails related to witnesses; Review dailies to provide comments to trial team.	3.60	Block billing Vague Not related to profit motive
11/1/2014	ADL	Prepare for trial, prepare expert witness for trial, and prepare direct examination outline; Prepare expert witness for trial testimony (Sirri); Prepare direct examination outline for expert witness (Sirri).	13.80	Block billing Not related to profit motive
11/1/2014	DLW	Trial preparation and meeting with witnesses	8.00	Not related to profit motive
11/1/2014	JAJ	Review dailies for day 5 of hearing -Delaney testimony; Work on prep for Sirri testimony on Monday; Review emails related to evidentiary issues; Review expert reports to advise as to how to use our experts	4.80	Block billing Not related to profit motive Vague
11/2/2014	ADL	Prepare expert witnesses for trial testimony (Sirri and Florio); Prepare direct examination outlines for expert witness (Sirri).	11.10	Block billing Not related to profit motive
11/2/2014	BRB	Trial of administrative proceeding	8.00	Not related to profit motive
11/2/2014	DLW	Trial preparation; meet with expert witnesses	8.00	Not related to profit motive Vague
11/2/2014	JAJ	Continued review experts reports to determine how to use our experts; Advice as to calling Florio to testify; Isolate areas for Sirri testimony.	5.70	Block billing Vague Not related to profit motive
11/3/2014	LAM	Draft/revise Delaney's First Amended Prehearing Brief; email with L. Washburn regarding the same; incorporate edits and finalize for filing and service; Research One-O for documents relating to 3012 testing and Remediation logs; email with L. Washburn	6.40	Block billing Not related to profit motive
11/3/2014	BRB	Trial of administrative proceeding	10.00	Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

11/3/2014	DLW	Participate in trial and witness preparation.	12.00	Not related to profit motive
11/3/2014	JAJ	Review emails related to shaping expert testimony and issues as to other witness testimony; Review dailies of today's testimony; Assist with preparation for tomorrow's testimony.	5.10	Block billing Vague Not related to profit motive
11/3/2014	NAK	Assist re cross-examination Harris and issues with trial team; Review Poppa Lardo report for cross-examination.	2.50	Block billing Not related to profit motive
11/4/2014	BRB	Trial of administrative proceeding	10.00	Not related to profit motive
11/4/2014	DLW	Trial prep and participate in trial	12.00	Not related to profit motive
11/5/2014	LAM	Analyze OIP and prehearing briefs in preparation of upcoming stipulation discussion; Review testimony from hearing in anticipation of closing argument.	7.00	Block billing Not related to profit motive
11/5/2014	ADL	Prepare for and participate in trial; Prepare for stipulation conference and closing, including analysis of Order Instituting Proceedings, Pretrial Briefs, trial transcripts and exhibits.	14.70	Block billing Not related to profit motive
11/5/2014	BRB	Preparation for and participating in trial	9.00	Not related to profit motive
11/5/2014	DLW	Participate in trial; prep for final trial day	12.00	Not related to profit motive
11.5.2014	JAJ	Review OIP, prehearing briefs and settlement agreements to identify areas where we can and cannot stipulate; Analysis of issues related to number of potential violations; Review testimony related to financial motive; Review dailies.	7.80	Block billing Not related to profit motive
11/5/2014	NAK	Review OIP for final argument counterpoints with exhibits and dailies excerpts; Assist trial team with legal and factual issues	5.00	Block billing Not related to profit motive
11/6/2014	LAM	Review L. Washburn's draft outline and testimony transcripts from the hearing in preparation of closing argument; Continue reviewing testimony transcripts and corresponding exhibits in preparation for upcoming closing argument, stipulation discussion a	5.90	Block billing Not related to profit motive
11/6/2014	ADL	Continue to prepare for stipulation conference and closing, including analysis of Order Instituting Proceedings, Pretrial Briefs, trial transcripts and exhibits,	13.40	Block billing Not related to profit motive

		and closing outline; Prepare for and conference with counsel for Yancey re: stipulations;		
11/6/2014	BRB	In trial and preparation for witnesses	10.00	Not related to profit motive
11/6/2014	DLW	Participate in trial; final day of testimony; begin preparation for stipulation conference.	8.00	Block billing Not related to profit motive
11/6/2014	NAK	Assist trial team with stipulation issue - legal; Review dailies for final powerpoint, including annotations for slides Review final hearing draft argument with suggestions and edits.	5.90	Block billing Not related to profit motive
11/7/2014	ADL	Prepare for and attend stipulation conference.	9.60	Not related to profit motive
11/7/2014	BRB	In trial and preparation for stipulation meeting.	10.00	Not related to profit motive
11/7/2014	DLW	Participate in trial stipulation conference; begin prep for closing arguments.	10.00	Not related to profit motive
11/8/2014	ADL	Work on closing argument, including power point presentation.	11.40	Not related to profit motive
11/8/2014	DLW	Review record and prepare for closing argument	14.00	Not related to profit motive
11/8/2014	JAJ	Review transcripts and exhibits to find cites for closing argument; Review dailies for final argument.	6.50	Not related to profit motive
11/9/2014	LAM	Phone call and email correspondence with A. Lebenta regarding closing argument; Review and edit the closing argument powerpoint presentation in preparation for upcoming closing.	5.20	Not related to profit motive
11/9/2014	ADL	Work on closing argument, including power point presentation; Prepare for cross examination of Kim Miller.	14.70	Block billing Not related to profit motive
11/9/2014	BRB	Reviewing closing argument presentation.	2.00	Not related to profit motive
11/9/2014	DLW	Finalize closing argument powerpoint.	15.00	Not related to profit motive
11/9/2014	NAK	Review dailies; Assist trial team with final argument, outline, exhibits.	4.70	Block billing Not related to profit motive
11/10/2014	ADL	Prepare for and attend trial, including closing arguments	10.00	Not related to profit motive
11/10/2014	DLW	Participate in final day of trial.	10.00	Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

11/11/2014	LAM	Review closing argument transcripts and conduct caselaw research.	3.50 Not related to profit motive Vague
11/24/2014	LAM	Review post-hearing briefs and daily rough transcripts in preparation for upcoming filing; Legal research based on Division's arguments.	5.70 Vague Not related to profit motive
11/24/2014	ADL	Work on post-trial brief.	2.50 Not related to profit motive
11/25/2014	LAM	Draft Findings of Fact and Conclusions of Law section for post-hearing brief; Review final hearing transcripts.	6.50 Not related to profit motive
11/25/2014	ADL	Work on post-trial briefing.	1.80 Not related to profit motive
11/26/2014	LAM	Post-Hearing brief.	3.90 Not related to profit motive
12/1/2014	LAM	Continue researching and drafting post-hearing brief.	3.60 Not related to profit motive
12/1/2014	JAJ	Review and planning of "to do's" related to briefing schedule.	1.50 Vague
12/2/2014	LAM	Begin structural outline for post-hearing brief.	2.20 Not related to profit motive
12/3/2014	LAM	Compile and analyze transcript excerpts in preparation of post-hearing arguments.	5.10 Not related to profit motive
12/4/2014	LAM	Drafting/revising post-hearing brief.	4.50 Not related to profit motive
12/5/2014	LAM	Continue reviewing materials in preparation of post-hearing brief.	7.00 Not related to profit motive
12/5/2014	ADL	Continue review of trial transcripts for transcript corrections and for post-hearing briefing/findings of fact and conclusions of law.	2.40 Not related to profit motive
12/7/2014	ADL	Continue review of trial transcripts for transcript corrections and for post-hearing brief and proposed findings of fact and conclusions of law.	4.90 Not related to profit motive
12/9/2014	LAM	Continue reviewing hearing transcripts for corrections and compile list for circulation; Discussion with A. Lebenta and L. Washburn regarding findings of fact and conclusions of law for post-hearing brief.	4.30 Block billing Not related to profit motive
12/9/2014	ADL	Review trial transcript corrections by Division's and Yancey's counsel, and conference with Yancey's counsel; Continue review of transcripts for further	3.20 Block billing Not related to profit motive

		corrections of transcripts and exhibits, and post-hearing briefing and proposed findings of fact.		
12/9/2014	BRB	Transcript review and correction and review post-hearing brief.	5.00	Not related to profit motive
12/10/2014	ADL	Continue to work on transcript corrections, including review of stipulations for transcript corrections and proposed additional stipulations; Work on post-trial briefing, and proposed findings of fact and conclusions of law.	4.90	Block billing Not related to profit motive
12/11/2014	LAM	Search the record for findings of fact pertaining to T. Delaney's character.	1.40	Not related to profit motive
12/12/2014	LAM	Continue drafting findings of fact for post-hearing brief; Discussion with A. Lebenta and B. Baker regarding post-hearing brief.	4.30	Not related to profit motive
12/12/2014	ADL	Correct exhibit list and contact Secretary for SEC office re: exhibit corrections; Further analyze and respond to stipulated findings of fact and conclusions of law from Yancey and Division. Conference with Yancey's counsel, re: stipulations; Outline t	8.10	Block billing Not related to profit motive
12/12/2014	JAJ	Review draft Findings of Fact and comment.	2.00	Not related to profit motive
12/13/2014	LAM	Continue working on post-hearing brief findings of fact.	6.10	Not related to profit motive
12/13/2014	ADL	Continue to outline proposed findings of fact; Continue drafting post-hearing brief.	6.40	Not related to profit motive
12/13/2014	BRB	Revising findings of fact and conclusions of law.	3.00	Not related to profit motive
12/14/2014	LAM	Continue working on post-hearing brief and findings of fact, including coordinating via email with Clyde Snow team on assignments of topics for findings of fact and conclusions of law.	4.40	Not related to profit motive
12/14/2014	ADL	Continue drafting post-hearing brief; Analyze and respond to proposed stipulations.	6.70	Not related to profit motive
12/14/2014	JAJ	Review outline of Findings of Fact and related emails.	2.50	Not related to profit motive
12/15/2015	LAM	Continue reviewing transcript for findings of fact and conclusions of law; Compile outline of relevant language from transcript record for post-hearing brief, and discuss the same with B. Baker and A. Lebenta.	9.10	Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

12/15/2014 JAJ	Review and analysis of Findings of Fact issues.	1.30	Not related to profit motive
12/16/2014 LAM	Begin drafting Delaney's proposed findings of fact for the post-hearing brief; Continue working on post-hearing brief support from testimony transcript.	9.90	Not related to profit motive
12/16/2014 ADL	Continue to draft post-hearing brief.	9.60	Not related to profit motive
12/16/2014 DLW	Begin reviewing Statement of Facts for post-trial brief.	2.00	Not related to profit motive
12/17/2014 LAM	Continue working on findings of fact and support for post-hearing brief; Finalize draft of proposed findings of fact, and discuss the same with A. Lebenta, L. Washburn and B. Baker.	11.30	Not related to profit motive
12/17/2014 ADL	Continue drafting post-hearing brief and proposed findings of fact.	11.40	Not related to profit motive
12/17/2014 BRB	For the review of transcripts for support for findings of fact. Call with client regarding settlement of PTL litigation. Review PTL settlement agreement; Providing and drafting post-hearing brief.	15.60	Block billing Not related to profit motive
12/17/2014 DLW	Review and redraft proposed Findings of Fact.	6.00	Not related to profit motive
12/18/2014 ADL	Continue drafting post-trial brief.	15.60	Not related to profit motive
12/18/2014 BRB	Review and revision of post-hearing brief. Finalize PTL agreement and get executed signature from client; Conference with L. McGee regarding brief; Drafting remedies section of post-hearing brief.	17.20	Block billing Not related to profit motive
12/18/2014 DLW	Continue redrafting post-trial brief and Findings of Facts.	7.50	Not related to profit motive
12/19/2014 LAM	Edit and revise post-hearing brief; Check citations in final post-hearing brief; Review and analyze Division's post-hearing brief; Review Yancey's post-hearing brief; Compile all relevant documents in preparation for filing post-hearing brief.	10.50	Block billing Not related to profit motive
12/19/2014 JHU	Edit, finalize and submit post-hearing brief, findings of fact, conclusions of law.	2.50	Not related to profit motive
12/19/2014 ADL	Continue to draft and revise post-hearing brief, proposed conclusions of law, proposed findings of fact.	9.90	Not related to profit motive
12/19/2014 BRB	Final review and revision of post-hearing brief.	12.00	Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

12/19/2014 DLW	Final drafting and editing of brief; Review post-trial briefs of SEC and Yancey.	6.50	Not related to profit motive
12/22/2014 LAM	Review Division's findings of fact and conclusions of law in preparation for reply brief.	1.70	Not related to profit motive
12/22/2014 DLW	Begin review of Commission's and Yancey's Findings of Facts.	4.00	Not related to profit motive
12/23/2014 LAM	Preparation for reply to Division's post-hearing brief.	3.00	Not related to profit motive
12/23/2014 DLW	Continue review of Division of Enforcement Findings of Fact	4.50	Not related to profit motive
12/29/2014 LAM	Review and analyze the Division's Proposed Findings of Fact; Begin compiling response to Division's Proposed Findings of Fact, including citations to the record for disputed allegations.	6.10	Not related to profit motive
12/30/2014 DLW	Annotate Division's Findings of Fact and compare to record citations.	4.50	Not related to profit motive
12/30/2014 LAM	Continue preparing reply to Division's post-hearing brief, including compiling support for disputed findings.	4.20	Not related to profit motive
12/30/2014 ADL	Review and analyze Division's filings for preparation of reply brief.	3.90	Not related to profit motive
12/31/2014 ADL	Conduct legal research for reply post-trial brief re: effect of attorney admissions, causation for aiding and abetting.	2.90	Not related to profit motive
12/31/2014 DLW	Annotate Findings of Fact.	3.50	Not related to profit motive
1/2/2015 ADL	Continue review of Division's Finding of Fact and Conclusions of Law.	2.40	Not related to profit motive
1/2/2015 DLW	Complete review and annotation of division's proposed Findings of Fact and briefing.	4.00	Not related to profit motive
1/4/2015 ADL	Continue review and analysis of Division's Findings of Fact and Conclusions	7.40	Not related to profit motive
1/5/2015 LAM	Meeting to analyze Division's Proposed Findings of Facts and discuss proposed objections; Discuss reply to Division's Post-Hearing Brief and continue analyzing Findings of Fact; Review the record for citations that support objections to Division's Prop	8.10	Not related to profit motive
1/5/2015 ADL	Continue to review and analyze outline response to Division's Post Hearing Brief, Findings of Fact and Conclusions of Law; Conduct legal research on	7.20	Block billing Not related to profit motive

	recklessness standard in aiding and abetting and on due process/right to notice of legal theories, resp		
1/5/2015 JAJ	Work on Findings of Facts by reviewing Division's proposed findings and our original proposed findings; Review emails related to the same; Review Yancey proposed findings in preparation for working on Delaney's; Analysis and outlining of Division post-	5.20	Not related to proft motive
1/5/2015 NAK	Office conference JAJ and DLW re reply; review post-trial brief.	1.00	Not related to profit motive
1/6/2015 LAM	Reply to Division's Post-Hearing Brief; Phone call with Yancey's counsel regarding reply briefs and follow-up meeting; Begin drafting responses to Division's Findings of Fact and discussion with B. Baker regarding the same.	8.40	Not related to profit motive
1/6/2015 JHU	Meet with B. Baker regarding post-hearing reply brief needs.	1.00	Not related to profit motive
1/6/2015 ADL	Prepare for and conduct call with Yancey's counsel re: analysis of Division's Post-Trial Brief, strategy for response, coordinating responses to Division's Findings of Fact and Conclusions of Law.	1.90	Not related to profit motive
1/6/2015 JAJ	Work on objections to Findings of Fact; Review and analyze issues related to administrative hearing process; Review transcript sources for Division's proposed Findings of Fact	6.00	Block billing Not related to profit motive
1/6/2015 NAK	Review post-trial issues; review statements	2.00	Vague
1/7/2015 LAM	Discuss and analyze Division's Findings of Fact with B. Baker; Continue compiling responses to Division's Findings of Fact, including support for counterstatements.	7.20	Not related to profit motive
1/7/2015 BRB	Drafting and revising response to Findings of Fact and Conclusions of Law.	3.00	Not related to profit motive
1/7/2015 JAJ	Continued work on responses to Division Findings of Fact; Research on remedies issues for post-trial brief; Look for testimony cites related to Division's Findings of Fact.	6.50	Block billing Not related to profit motive
1/8/2015 LAM	Continue responding to Division's Findings of Fact for Post-Hearing Brief Reply	5.40	Not related to profit motive
1/8/2015 BRB	Additional revision to Findings of Fact.	1.60	Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

1/8/2015	JAJ	Continued research on transcript cites for responses to Delaney Findings of Fact; Work on remedies section for post-trial brief.	3.00 Block billing Not related to profit motive
1/9/2015	LAM	Post-Hearing Reply Brief.	8.40 Not related to profit motive
1/9/2015	JHU	Team meeting regarding Finding of Facts assignments.	1.30 Not related to profit motive
1/9/2015	ADL	Work on response memorandum to post trial brief, outline argument/memorandum.	4.30 Not related to profit motive
1/10/2015	LAM	Review documents in preparation of our reply to Division's Post-Hearing Brief.	3.80 Not related to profit motive
1/10/2015	ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief and Findings of Fact.	3.70 Not related to profit motive
1/11/2015	LAM	Continue responding to Division's Findings of Fact for the Reply Brief.	6.20 Not related to profit motive
1/12/2015	ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief, Findings of Fact.	8.40 Not related to profit motive
1/12/2015	DLW	Begin review of opposition to SEC's Findings of Fact; Meeting regarding Findings of Fact.	7.50 Not related to profit motive
1/12/2015	JAJ	Continued work on my sections relating to objections to Findings of Fact; Research of transcripts related to Findings of Fact issues.	5.50 Not related to profit motive
1/13/2015	LAM	Continue responding to the Division's Findings of Fact, and discussions with B. Baker, A. Lebenta and J. James regarding the same.	8.50 Not related to profit motive
1/13/2015	ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief, Findings of Fact.	12.30 Not related to profit motive
1/13/2015	BRB	Revising Findings of Fact; Drafting and revising Post-Hearing Brief.	11.00 Not related to profit motive
1/13/2015	DLW	Draft opposition to Findings of Fact 63-65.	4.50 Not related to profit motive (Division note: Findings of Fact 63-65 related to Delaney's credibility)
1/13/2015	JAJ	Work on Findings of Facts objections; Research on SEC cases as to remedies and requirements for SEC to make showing of risk of future violations;	6.50 Block billing Not related to profit motive

	Review former work on objections to reflect current format; Review DLW work on Findings objections and mak		
1/14/2015 ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief, Findings of Fact.	14.20	Not related to profit motive
1/14/2015 BRB	Revising Findings of Fact; Drafting and revising Post-Hearing Brief.	13.00	Not related to profit motive
1/14/2015 JAJ	Continue drafting my part of objections to Findings of Fact; Review early draft of our reply brief; Add in transcript cites; Review and comment on LAM draft response to Yancey Findings of Fact; Review and respond to emails concerning finalizing brief.	6.50	Block billing Not related to profit motive
1/15/2015 BRB	Drafting, revising and reviewing Post-Hearing Brief.	5.20	Not related to profit motive
1/16/2015 ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief, Findings of Fact, and Conclusions of Law.	7.70	Not related to profit motive
1/17/2015 ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief, Findings of Fact.	5.70	Not related to profit motive
1/17/2015 JAJ	Work on remedies section.	0.80	Not related to profit motive
1/18/2015 ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief.	5.60	Not related to profit motive
1/18/2015 JAJ	Finalize remedies section; Review reply brief.	2.20	Not related to profit motive
1/19/2015 ADL	Continue to work on post trial filings, re: Response to Division's Post-Hearing Brief, Findings of Fact, and Conclusions of Law.	7.40	Not related to profit motive
1/19/2015 DLW	Review and provide comments on reply brief.	3.50	Not related to profit motive
1/20/2015 ADL	Continue to work on post trial filings, re: revise and finalize Response to Division's Post-Hearing Brief, Findings of Fact, and Conclusions of Law; Conduct initial review of Division's Responsive Post-Hearing Brief.	7.30	Block billing Not related to profit motive
1/20/2015 DLW	Final comments on reply brief.	2.00	Not related to profit motive
1/20/2015 JAJ	Work on final version of post-hearing brief.	2.00	Not related to profit motive

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

1/20/2015 NAK	Review Florio representation and issues; research procedural issue.	2.00	Not related to profit motive
1/23/2015 LAM	Review the Order issued by the ALJ, and discuss with A. Lebenta and L. Washburn in preparation for our response.	3.50	Not related to profit motive
1/23/2015 DLW	Begin reviewing Court's order and preparing outline of responsive pleading.	5.00	Not related to profit motive
1/23/2015 JAJ	Review Patil order on negligence issues; Analysis of best way to respond re negligence; Review of Division's allegations as to negligence; Review emails concerning the order.	2.80	Not related to profit motive
1/23/2015 NAK	Review ALJ order; office conference with JAJ and DLW; read Aloha Airline case.	1.30	Not related to profit motive
1/24/2015 LAM	Work on responding to ALJ Patil's Order, including reviewing the record for discussion of negligence, case law on due process in administrative proceedings, and discussion with L. Washburn regarding the same.	4.40	Not related to profit motive
1/24/2015 DLW	Research and draft response to Court's proposed filing regarding negligence; Review transcripts for motion response.	10.00	Not related to profit motive
1/25/2015 DLW	Finish drafting proposed response motion to judge's order regarding negligence.	6.50	Not related to profit motive
1/25/2015 JAJ	Review DLW's draft letter to Patil.	1.00	Not related to profit motive
1/26/2015 DLW	Phone call with Haynes and Boone regarding negligence filing; Review motion to make changes suggested by Haynes and Boone.	3.30	Not related to profit motive
1/26/2015 LAM	Draft, research and discuss Delaney's response to ALJ Patil's Order dated January 25, 2015.	7.30	Not related to profit motive
1/26/2015 ADL	Review Division's Response to Motion to Strike and Motion to Enter Proposed Findings.	0.50	Not related to profit motive
1/26/2015 JAJ	Review drafts of letter to Patil on negligence issues; Review Division's reply to our post-hearing brief; Analysis of Aloha and other cases and if needs to be included in letter; Analysis of additional information need; Review transcript searches relat	6.80	Block billing Not related to profit motive
1/26/2015 NAK	Review draft; conference with team and Haynes and Boone; research.	2.50	Block billing

Appendix 3: Response to Delaney's Claimed Attorney Hours/Fees Related to Profit Motive Issue

			Not related to profit motive
1/27/2015 LAM	Draft, review and finalize Response to the Court's January 23 Order re: unpled negligence theory.	7.50	Not related to profit motive
1/27/2015 ADL	Analyze and revise Response to Order dated January 23, 2015 re: issue of negligence	5.80	Not related to profit motive
1/27/2015 DLW	Finalize draft of filing on negligence; Review order from ALJ; review prior orders of ALJ.	3.20	Not related to profit motive
1/28/2015 LAM	Begin drafting letter to Court pursuant to ALJ email, and discussion of the same with N. Kaplan and J. James; Discussion with CSS team regarding readmission of expert report and other evidence, and begin researching the record to support position for l	7.80	Not related to profit motive
1/28/2015 JAJ	Analysis of issues related to admission of Florio report; Reread Florio report; Examination of relevance of Florio report to negligence issues.	4.50	Not related to profit motive
1/29/2015 NAK	Review comments on SEC objections to our statement of facts; office conference with ADL; office conference with LAM; review draft letter; office conference with JAJ.	2.50	Block billing Not related to profit motive
1/30/2015 LAM	Finalize responses to Division's Proposed Supplemental Findings of Fact, and prepare for filing; Case law research on notice requirements in administrative proceedings; Review Division's and Yancey's responses and filings.	7.70	Block billing Not related to profit motive

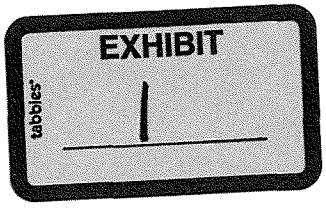
DECLARATION OF BRIAN STUART GOVER

I, BRIAN STUART GOVER do hereby declare under penalty of perjury, in accordance with 28 U.S.C. § 1746, that the following is true and correct, and that I am over 18 years of age and I am competent to testify to the matters stated herein:

1. From approximately April 2007 through at least December 2011, I was a Vice President of Operations at Penson Financial Services, Inc. ("Penson"). From approximately the third quarter of 2009 through at least December 2011, I was responsible for overseeing Penson's Buy Ins Department.

2. From at least the third quarter 2009 through December 2011, Penson's Buy Ins Department and the Stock Loan Department were responsible for complying with certain aspects of Penson's obligations under Rule 204 of Regulation SHO ("Rule 204"). The Buy Ins Department had primary responsibility for Rule 204 close outs of Continuous Net Settlement ("CNS") failures to deliver for long sales when the failure to deliver resulted from Penson's failure to receive the shares from the seller.

3. When the CNS failure to deliver resulted from open stock loans, however, the Stock Loan Department had primary responsibility for the Rule 204 close out. The Stock Loan Department loaned securities held in customer margin accounts to third parties. When the customer sold those securities, Stock Loan typically recalled the loans in order to deliver on the customer sale. (I will refer to such circumstances throughout this Declaration as "long sales of loaned securities.") Depending on Penson's CNS position, if the recalled shares were not returned by settlement date, Penson sometimes incurred a CNS failure to deliver due to the open stock loans. From at least the third quarter 2009 through December 2011, the Stock Loan Department had primary



responsibility within Penson for Rule 204 close outs of such CNS failures to deliver relating to long sales of loaned securities.

4. Soon after I assumed responsibility for the Buy Ins Department in approximately the third quarter of 2009, Penson's Compliance Department conducted an internal audit of Penson's Rule 204 compliance. In the course of reviewing Buy Ins Department procedures as part of my new responsibilities as supervisor of the Buy Ins Department, and in the course of responding to the internal Rule 204 audit, I learned the Stock Loan Department was not consistently closing out failures to deliver resulting from long sales of loaned securities by market open T+6.

5. This practice appeared to be inconsistent with my understanding of Rule 204. Therefore, I requested a meeting with Michael Johnson ("Johnson"), the Senior Vice President of Stock Loan, and Thomas Delaney ("Delaney"), Penson's Chief Compliance Officer.

6. Shortly thereafter, Johnson, Delaney and I met face-to-face in Penson's offices in Dallas, Texas. In that meeting, Johnson confirmed that the Stock Loan Department did not consistently close out CNS failures to deliver relating to sales of loaned securities by market open T+6. He claimed that it was not industry practice to do so. He further claimed that nobody on the street bought in lending counterparties at market open T+6, and that the stock loan agreements did not allow for such buy ins.

7. In that meeting, Johnson and Delaney discussed whether Penson should purchase securities on Penson's own account by market open T+6 in order to comply with my understanding of Rule 204's obligation that long sales of loaned securities be closed out by market open T + 6. Johnson and Delaney rejected this option for

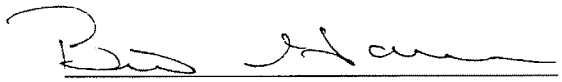
complying with Rule 204. My understanding is that they rejected this option because of the associated costs to Penson.

8. In that meeting, Johnson and Delaney also discussed whether Penson should close out failures to deliver on long sales of loaned securities at or before market open T+6 by recalling the loans on T+2 instead of on T+3. Johnson and Delaney rejected that option, and Johnson claimed this was not feasible because he could not project on T+2 which securities would incur failures to deliver.

9. It is my understanding that sometime after this meeting Johnson and Delaney had discussions with legal counsel, which I believe took place within days of the meeting, although I did not participate in any meeting or telephone call. I am not aware that Stock Loan made any changes to its practice of not closing out CNS failures to deliver resulting from long sales of loaned securities by market open T+6.

10. As set out above, the meeting with Johnson and Delaney occurred in the context of (1) my assumption of responsibilities relating to the Buy Ins Department in approximately the third quarter of 2009 and my related efforts to understand the Buy Ins Department's procedures; and (2) the internal audit of Penson's Rule 204 procedures. As shown by an email to me from Penson's Compliance Department (Exhibit A), the internal audit occurred in December 2009. The December 14, 2009 date of the email in Exhibit A is consistent with my recollection that the meeting with Johnson and Delaney regarding

Rule 204 close outs for long sales of loaned securities occurred by the end of 2009 or, at the latest, early 2010.



Brian Stuart Gover

Date: 1/7/2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of)
) File No. D-03163-A
PENSON FINANCIAL SERVICES, INC.)

WITNESS: Rodolfo (Rudy) DeLaSierra
PAGES: 140 through 246
PLACE: Securities and Exchange Commission
1801 California Street
Suite 1500
Denver, Colorado 80202
DATE: Thursday, January 10, 2013

The above-entitled matter came on for hearing, pursuant to notice, at 9:04 a.m.

Diversified Reporting Services, Inc.
(202) 467-9200

APPEARANCES:

On behalf of the Securities and Exchange Commission:
JONATHAN WARNER, ESQ.
JEFFREY ORAKER, ESQ.
JEFFREY LYONS, ESQ.
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Denver, Colorado 80202
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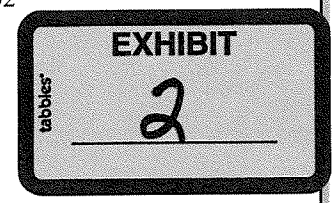

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PROCEEDINGS

MR. WARNER: We're on the record at 9:04 a.m. Mr. DeLaSierra, please raise your right hand.

Whereupon,

RUDY DELASIERRA

having first been duly sworn, was examined and testified as follows:

EXAMINATION

BY MR. WARNER:

Q Please state your full name and spell your name for the record.

A Rodolfo DeLaSierra, R-O-D-O-L-F-O. DeLaSierra is D-E-L-A-S-I-E-R-R-A.

Q I'm Jon Warner. With me are Jeff Oraker, and Jeff Lyons, and by phone Jay Scoggins. We are officers of the Commission for purposes of this proceedings.

Mr. DeLaSierra, this is an investigation by the United States Securities and Exchange Commission in the matter of Penson Financial Services, Inc., to determine whether there have been violations of certain provisions of federal securities laws. However, the facts developed in this investigation might constitute

violations of other federal or state civil or criminal laws.

Now, prior to opening the record, I gave you a copy of the formal order of investigation in this matter. It'll be available to you for you to review throughout the proceeding today. Mr. DeLaSierra, have you had an opportunity to review the formal order?

A Yes.

Q Also before we started I gave you a copy of the Commission Supplemental Form 1662 which has been marked as Exhibit 1.

Mr. DeLaSierra, have you had an opportunity to review Exhibit 1?

A Yes.

Q Do you have any questions about this notice?

A No, sir.

Q Mr. DeLaSierra, are you represented by counsel?

A Yes.

MR. WARNER: Counsel, please identify yourself, along with your firm, address and telephone number.

MR. FONS: Randall Fons from the law

firm of Morrison & Foerster, 5200 Republic Plaza, Denver, Colorado 80202. Phone number is it (303)592-2257.

MR. WARNER: And your associate, please.

MR. LANHAM: John Lanham, also with Morrison & Foerster reachable at the same address and information.

MR. WARNER: Mr. Fons and Mr. Lanham, are you representing Mr. DeLaSierra as his counsel today?

MR. FONS: We are.

MR. WARNER: Please mark this as the next exhibit. Here are the stickers.

(SEC Exhibit No. 116 was marked for identification.)

BY MR. WARNER:

Q Mr. DeLaSierra, I'm placing in front of you an exhibit we've marked as Exhibit 116. It's a subpoena. Is this a copy of the subpoena you're appearing pursuant to here today?

A Yes.

Q Now, Mr. DeLaSierra, we've been through this before, and I want to first off note that I appreciate you coming back up to talk to

me again. I acknowledge that the time and cost that goes into that for you. And I want to preface this by saying we're not going to retread old ground today. I want to focus on information that we received and became aware of after we talked to you last time. I may have to go over some old points just for context. I'm going to focus on the new stuff, okay?

A Okay.

Q And let me talk a bit about the process we're going to be involved in here today. I want to remind you that the oath you took this morning is a solemn oath, just like the oath you take when you're in court. And any answer in violation of this oath carries the same consequences as it would in court; do you understand this?

A Yes.

Q And as you know, everything we say today is being taken down by the court reporter, and it will be returned to us in the form of a transcript. To make sure that transcript is clear, we need to follow some guidelines. First you'll need to respond to all my questions verbally and not with a nod or a head shake; do

you understand that?

A Yes.

Q Each of us needs to do our best to avoid talking over each other. So if you could do your best to wait until I get to the end of a question before answering, I'll do my best to wait until you get done with your answers before I ask the next question, okay?

A Understood.

Q When people read the transcript in the future, they're going to assume that you understood each question. So please let me know if you don't understand a question, okay?

A Okay.

Q We control the record here, which basically says we say when we go to take breaks or not. But that said, we're generally happy to take breaks as needed. So please let me know if you need to take a break, okay?

A Okay.

Q Is there any reason you won't be able to answer my questions fully and accurately today?

A No.

Q Mr. DeLaSierra, since we last spoke, I

A No.
Q What was the policy in that context?
A We didn't get bought in by our buy-ins group. We would buy in our counterparties. So this is what leads me to believe that this is -- I guess we're referencing the e-mail again. But this leads me to believe that this issue here is talking about a receive that has created this fail. It's not a stock loan recall due up to T-6, the morning of T-6.
Q You don't see this as a Rule 204 issue?
A Not pertaining to stock loan, no.
Q Well, let's move to the front of Exhibit 91. The header on all of the e-mail, the subject in front has been RegSHO, right?
A Yes.
(Discussion off the record.)
BY MR. WARNER:
Q And so let's -- what I'm hopefully trying to understand here, Mr. DeLaSierra, is an interaction that is implicated at the top Exhibit 91 where we have Eric Alaniz -- do you know who Eric Alaniz is?
A Yes, I do.

Q Who is Eric Alaniz?
A He was a compliance personnel at Penson.
Q We have Eric Alaniz telling Summer Poldrack and Tom Delaney and others that he was going to have a conversation with Rudy and Brian?
A Right.
Q And I understand Rudy there to mean you. So I wanted to see if Mr. Alaniz had an interaction with you that's indicated here in this e-mail.
A Right.
Q So I've been trying to set the contest for that.
A Right.
Q So let's start with, do you recall having conversations with Mr. Alaniz in or about July 2010 relating to Rule 204?
A Not particularly. I mean, this specific situation, no.
Q There are indications in Exhibit 91 that Mr. Alaniz was going to have a conversation with you in which he was going to tell you that stock loans T+6 closeout obligation was to be closed out -- be flat by the end of the day. Did

Mr. Alaniz ever communicate to you that the T+6 close obligation for long sales was to be flat by the end of the day?
MR. FONS: Can I stop you for one second? Again, I apologize. You may be right that that's what this is, but I don't see a T+6 obligation referred to in here with regard to being flat by the end of the day. So I don't know whether that's -- I actually don't know whether that's the way to interpret that or not.
A Right. I see it as him saying that yes, that there -- that he -- that we will close it out by the end of the day, we'll be flat by the end of the day, which we were closing out at market close.
BY MR. WARNER:
Q Closing out the fails positions for a Rule 204A obligation?
A Correct.
MR. FONS: Is that the T+6 obligation?
THE WITNESS: Yes.
MR. FONS: Then I apologize.
BY MR. WARNER:
Q Do you ever recall having a

conversation with Mr. --
A I do not specifically to this, not. But, like I said, he could have spoken with Brian or -- but I don't recall specific conversation on this with Eric Alaniz.
Q Do you having a conversation with Eric Alaniz at any point relating to the notion that stock loan was okay to wait until the end of the day on T+6 to close out failure to delivers?
A No.
Q How about with anyone else, like clients?
A During this time frame?
Q Ever while you were at Penson.
A Yes. Initially when Rule 204T came out.
Q Tell me about that conversation.
A Well, we were having many. It was a chaotic time for that rule when it was announced, and that's when we attempted to buy in on the morning of T-6. We got severe push-back from the counterparties, and that's when we -- myself and/or Mike Johnson explained the situation to Tom Delaney.
Q This would have been around October

2008, when Rule 204 came out?
A I assume so, yes.
Q You say you assume so because I told you date was October 2008?
A Correct, yeah. It was whenever the rule came out, correct, yes.
Q And you were involved in that conversation; is that right?
A A few times, yes.
Q And Mr. Delaney was involved with that conversation?
A Yes.
Q Mr. Johnson was involved?
A Yes.
Q Anyone else you can recall?
A No.
Q In these conversations in or around October 2008 with Mr. Delaney, did you explain that stock loan was not closing out failure to delivers by open market T+6?
A Yes.
Q And what did Mr. Delaney say?
A Mr. Delaney was aware, and he said he would get back to us. And then we'd had further conversations. I believe Mike Johnson had

specifically mentioned the MSLA that the counterparties were pushing back on and saying the we were not honoring that, we could not buy it in the morning of T-6, we'd have to wait until the afternoon.
Q These conversations about the MSLA, they took place in or around October 2008 as well?
A Correct.
Q How do you know about those conversations?
A Some of them were had in the open. I mean, the pathway from Mike Johnson's office to Tom's was pretty worn, I would imagine. It was, as I said, chaotic, and we were trying to get a handle on this rule.
Q Was there anyone else from compliance involved in these conversations in or around October 2008?
A Specifically with securities lending personnel? I don't think so.
Q How about Holly Hasty?
A I don't recall.
Q And Eric Alaniz?
A No.

MR. FONS: With Holly Hasty, when you don't recall, you don't recall her being there, or you don't recall if she was there?
THE WITNESS: I don't recall her being in the conversations. There was probably lots of conversations even away from -- from me and Mike, but --
BY MR. WARNER:
Q I'm going to ask you to interpret something in this e-mail for me again, 91. This is because I flat don't understand what's going on there. If you can help explain that, great. If you can't, then you can't.
Let's look at the top of the second page in Exhibit 91. It's a one-sentence paragraph there in the middle. It's just Summer Poldrack sent an e-mail to Holly Hasty and Jerry Reilly on July 15, 2010. She says, "But stock loan executes our customers at market open to satisfy their loans and RegSHO requirements, but they are not allowing us to do the same." Do you know what she's talking about?
A Not at all. It's not accurate.
Q How is it not accurate?
A That's not what we were doing.

Q Explain what were you doing.
A We buying in at the close for -- any of our recalls, we were buying in at the close. And I'm not -- I'll be honest, I don't know what she's even referencing here, "stock loan executes."
Q I'm trying to understand when she says, "Stock loan executes our customers."
A We wouldn't -- we weren't buying into customers. Buy-ins buys into customers, any buy-in counterparties.
Q All right. You talked about conversations with Mr. Delaney in or around October 2008 about stock loans, processes relating to closing out failures to deliver caused by stock loans, right?
A Correct.
Q Did Mr. Delaney have the ability to change those policies if he thought they were incorrect?
A Yes.
Q What could he have done?
A He could have asked us to change the policy.
Q Would you have responded?

A Would we have responded? Yes.
Q Why is that?
A Because he was the compliance office.
Q Chief compliance officer?
A Chief compliance officer, correct.
Q If any time between October 2008 and October 2011 Bill Yancey had known about this policy, could he have changed it?
A Yes.
Q How?
A I would assume. I don't know what Bill's powers were, so -- he was the president, so that's all I can say. He was the president, so I would assume he has that sort of say.
Q If he had directed you as stock loan management to change the policy, would you have changed it?
A Yes.
Q How about Bart McCain in the time frame October 2008 to October 2011? If he had known about the stock loan policies we've been talking about, could he have affected a change?
A He could have, yes.
Q How?
A The same way. I don't know that he

would have been involved there. But if he told us to change something, the securities lending group would have done that.
Q Why is that?
A Because he was an executive at the firm.
Q How about Brian Gover? If he had been aware of this policy that we've been discussing about closing out failures to deliver after open market on T+6, could he have affected a change in the stock loan policies?
A By just coming to the securities lending? Probably not. I mean, you were talking Brian Gover, and he was the vice president of operations, not as in compliance because he later took that role.
Q Right.
A Okay. Then yes, not as the vice president of operations. He would have probably gotten compliance involved.
Q How about Eric Alaniz? If he'd been aware of the stock loan policy of closing out failures to deliver after open market on T+6, could he have affect a change?
A I'm not sure if he could have. I

don't know.
Q Now, since we last met I've had a chance to talk a little bit with Mike Johnson, and I want to explore with you some of the information he provided to me.
A Okay.
Q He talked about meetings with you and Tom Delaney in the summer of 2009 when Rule 204 became permanent to discuss Rule 204. Do you recall those meetings?
A Not specifically, no.
Q Generally?
A Yes. We probably had several meetings during that time frame, yes.
Q What happened at those meetings?
A As I recall, he was just reiterating that 204T had gone permanent.
Q When you say "he," who do you mean?
A I'm sorry. Tom Delaney was reiterating that to 204T was now permanent.
Q Did you discuss stock loan's practice of closing out failures to deliver after open market on T+6?
A Probably not. It was already known from the October time frame, October of 2008.

Q According to Mike Johnson, you had discussions with Eric Alaniz in connection with a 3012 audit?
A Yes.
Q Tell me about those discussions.
A The 3012, I believe he had -- the end result of that was for us -- stock loan to create a penalty box, and that's what we did. We had a misunderstanding of it, so from that point on we created it and maintained the penalty box list.
Q And according to Mike Johnson, you told Mr. Alaniz in connection with these 3012 audit discussions that stock loan was not closing out failures to deliver caused by stock loan before open market T+6. Is that accurate?
A I can't recall.
Q Now, when we met last, we talked about stock loan at times extending buy-ins on Rule 204 recalls; do you live that?
A Yes, I do.
Q Sometimes instead of closing out even on the afternoon of T+6, you would allow fail to continue to T+7 or T+8, right?
A Correct.
Q Mr. Johnson told me that he didn't

in place to ensure delivery of long sales by close of market settlement date?
A On settlement date? No.
Q Does Apex have any policies in place to ensure delivery of long sales by settlement date?
A We're talking T-3?
Q Yes.
A Okay. So no.
MR. WARNER: All right. Mr. DeLaSierra, we have no further questions at this time. We may, however, call you again to testify in this investigation. Should this be necessary, we will contact Mr. Fons.
Mr. DeLaSierra, do you wish to clarify anything or add anything to the statements you've made today?
THE WITNESS: I have nothing to add.
MR. WARNER: Mr. Fons, do you wish to ask any clarifying questions?
MR. FONS: Nothing.
MR. WARNER: We are off the record at 11:34 a.m.
(Whereupon, at 11:34 a.m., the examination was concluded.)

PROOFREADER'S CERTIFICATE

In the Matter of: PENSON FINANCIAL SERVICES, INC.
Witness: Rodolfo (Rudy) DeLaSierra
File Number: D-03163-A
Date: Thursday, January 10, 2013
Location: Denver, CO

This is to certify that I, Donna S. Raya, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

_____ _____
(Proofreader's Name) (Date)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

I, Leo R. Kniebel, hereby certify that the foregoing transcript consisting of 105 pages is a complete, true, and accurate transcript of the testimony indicated, held on January 10, 2013, in the matter of Penson Financial Services, Inc. I further certify that this proceeding was recorded by me, and the foregoing transcript has been prepared under my direction.

DATE: January 22, 2013.

Official Reporter:_____
Leo R. Kniebel, CSR

Diversified Reporting Services, Inc.
1101 Sixteenth Street, N.W.
2nd Floor
Washington, DC 20036

In the Matter of: PENSON FINANCIAL SERVICES, INC.
Witness: Rodolfo (Rudy) DeLaSierra
File Number: D-03163-A
Date: Thursday, January 10, 2013
Location: Denver, CO

This is a letter to inform you that we do not release our tapes and notes. I do maintain them for a period of one (1) year.

Sincerely,

_____

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of)
) File No. D-03163-A
PENSON FINANCIAL SERVICES, INC.)

WITNESS: Michael H. Johnson
PAGES: 1 through 228
PLACE: Securities and Exchange Commission
1801 California Street
Suite 1500
Denver, Colorado 80202
DATE: Friday, January 11, 2013

The above-entitled matter came on for hearing, pursuant to notice, at 9:06 a.m.

Diversified Reporting Services, Inc.
(202) 467-9200

APPEARANCES:

On behalf of the Securities and Exchange Commission:
JONATHAN WARNER, ESQ.
JEFFREY ORAKER, ESQ.
JEFFREY LYONS, ESQ.
JAY SCROGGINS, ESQ. (Via telephone)
Securities and Exchange Commission
Denver Regional Office
1801 California Street, Suite 1500
Denver, Colorado 80202

On behalf of the Witness:
RANDALL J. FONS, ESQ.
JOHN R. LANHAM, ESQ.
Morrison Foerster
5200 Republic Plaza
370 17th Street
Denver, Colorado 80202
(303)592-2278

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PROCEEDINGS

MR. WARNER: We're on the record at 9:06 a.m. Mr. Johnson, please raise your right hand.

Whereupon,

MICHAEL H. JOHNSON

having first been duly sworn, was examined and testified as follows:

EXAMINATION

BY MR. WARNER:

Q Mr. Johnson, please state your full name and spell your name for the record.

A Michael H. Johnson, M-I-C-H-A-E-L, H, J-O-H-N-S-O-N.

Q I'm Jonathan Warner. With us by phone is Jay Scoggins. Also we have Jeff Oraker and Jeff Lyons. We are officers of the commission for purposes of this meeting or the proceeding.

This is an investigation by the United States Securities and Exchange Commission in the matter of Penson Financial Services, Inc., to determine whether there have been violations of certain provisions of the federal securities laws. However, the facts developed in this investigation might constitute violations of

other federal or state civil or criminal laws.
Now, prior to opening the record, I gave you a copy of the formal order of investigation in this matter, and it will be available to you throughout our proceeding today. Mr. Johnson, have you had an opportunity to review the formal order?
A Yes.
Q I also gave you a document we've marked as Government Exhibit No. 1. This is a copy of the Commission Supplemental Informational Form No. 1662. Mr. Johnson, have you had an opportunity to review Exhibit 1?
A Yes.
Q Do you have any questions about this notice?
A No.
Q Mr. Johnson, are you represented by counsel?
A Yes.
MR. WARNER: Counsel, please identify yourself, along with firm name, address, and telephone number.
MR. FONS: Randall Fons, law firm of Morrison & Foerster, 5200 Republic Plaza, Denver,

80280. Phone number is (303)592-2257.
MR. LANHAM: John Lanham, also with Morrison Foerster, reachable at the same contact information.
MR. WARNER: Mr. Fons and Mr. Lanham, are you representing Mr. Johnson as his counsel today?
MR. FONS: We are.
(SEC Exhibit No. 122 was marked for identification.)
BY MR. WARNER:
Q Mr. Johnson, I'm placing in front of you Exhibit No. 122. This is a copy of the subpoena. Is Exhibit 122 a copy of the subpoena pursuant to which you are appearing here today?
A Yes.
Q Mr. Johnson, let me take a moment to talk about the process we're involved in here today. I want to remind you that the oath you've taken this morning is a solemn oath and just like the oath you take when in court. And any answer in violation of this oath carries the same consequences as it would in court; do you understand this?

A Yes.
Q And everything we're saying today is being taken down by a court reporter and will be returned to us in the form of a written transcript. To make things clear on the record, we need to follow a few guidelines. First, you need to response to all of my questions verbally, not with a head shake or a nod, so the court reporter can accurately record your testimony; do you understand this?
A Yes.
Q Each of us needs to do our best to not speak over each other. So I'll do my best to listen to the end of your answers before I come up with the next question, and I would appreciate it if you'd wait until the end of my questions, no matter how painfully obvious the conclusion is, before you jump in with your answer; is that okay?
A Yes.
Q Now, when people read the transcript in the future, they're going to assume that you understood each of my questions. So if at any point you don't understand one of my questions, please let me know, okay?

A Yes.
Q Now, we control the record here, which means we say when we take breaks. Having said that, we're happy to take breaks as needed. So if at any point you need to take a break, please let me know and we'll maybe finish up a question or a quick line of questioning and take a break, okay?
A Okay.
Q Is there any reason, Mr. Johnson, why you won't be able to answer my questions fully and accurately today?
A No, I can answer them right.
Q Mr. Johnson, have you ever been deposed in connection with any court proceedings?
A Been in arbitrations.
Q How about state or federal court?
A I don't think so. I just did two arbitrations.
Q Tell me about those arbitrations.
A They were against Penson, I think, and customer, one in Boston, Empire Financial, I believe. And then the other one was on Penson versus a short seller, Jackson Sue in Dallas. I don't remember the name of his company.

A I think -- well, I think my job title changed a few times because I don't know my title when I was hired. So it could have been vice president ABP, VP, senior VP. At some point after RegSHO, I became global head once Bill Yancey was hired as president of PFSI. I would say -- because he gave me one review, and that's the only review I got. So he gave me the review, and then I got shuffled to PWI. I was no longer an employee of PFSI. And I was told to help the European/Asian type side of the business. So at that point I only had two employees working for me.

Q Were you involved in the securities lending?

A Yes, all securities lending on a global basis. But only two people out of the 35 people reported to me directly, and that lasted until the firm put a knife in their chest in June or May, and then we were quickly shuffled back to PFSI. Phil moved every employee out of the holding company at some point while Mike Macarolli was there doing this Apex deal. But we got shuffled right over.

Q So we covered a lot of ground there.

A Yes.

Q I'm going to parse through that a little bit.

A Excuse me. It's how my brain works. My memory -- I apologize. I'm trying very hard to remember stuff.

MR. FONS: You're fine. He'll break it down.

BY MR. WARNER:

Q I didn't intend that mockingly. I actually enjoy take it from 30,000 feet down to more granulars, and that was perfect.

So let's talk about the transition from being head of securities lending --

(Discussion off the record.)

BY MR. WARNER:

Q All right. Let's focus in on the transition from head of securities lending at PFSI to the global head of PWI. Can you tell me how that happened?

A I think Phil and I -- I think they made a lot of global heads at some point, and I think I was -- I think that I wanted to do more because it was boring. So I talked to Phil, and he said, "Fine, you need to get involved,"

because London was never making profit, and they wanted to get involved with stock loan out there on a conduit basis.

And then I kind of oversaw Canada, New York conduit, although New York conduit reported into PFSI, and then I was involved in Australia. That's how that evolved, I believe.

Q When you say "global head," do you mean global head of security lending?

A Yes.

Q Did you have oversight over anything other than securities lending?

A No. I was not included in any other company, corporate, global at all. All I did was oversee securities lending from 90,000 feet in the air on a global basis.

Q And I thought I head you say you held this position as global head of securities lending up until the point that Penson transitioned to Apex; is that right?

A Somewhere in there, yes. I believe they moved us into PFSI at some point, but like in the year of that -- when everything was going bad, we were moved quickly over to PFSI. Phil that. Not that -- when I say "all," all Penson

PWI employees.

Q Some time in 2012?

A I think so. In the end of '11 or '12. It was in there somewhere.

Q What were your duties as global head of securities lending for PWI?

A There were no written duties or job description. I just flew around on airplanes and made executive platinum three years in a row on American just looking, trying to make sure everything was being done right. Go to London. I had to learn their rules, manage them, talk to them when I didn't like something, continue to the next country really to keep the relationships and stuff, the business. Without my relationships, Penson probably would have gone up sooner because I had to really work hard to finance the company with stock loans. And so that was my job.

I had an office in Dallas. I was hardly ever in it. And when I was, there was group vetting of issues. But really, it was Brian Hall and Rudy DeLaSierra to make sure I knew what was going on and vet off in some argument, but we always worked as a team to make

sure we were trying to do what we had to do correctly in our minds. So that's how it worked. And I would do the same -- take that same thing and go to London head and what are you doing, I don't like it, tell me why, and then I'd go meet with their office people and try to -- London had a lot of issues. And because I'm a specialist in brokerage in international, I was always flown up there to kind of help with their out of balances. And that would not be stock loan related. But I was sent out with somebody a lot named Jerry Reilly.

Q I thought I heard you say that your relationships were important to Penson's viability?

A Penson was a crap firm. And in order to do business, you had to maintain your relationships, and these people trusted you. You put your reputation on the line every day, and we did that, and we worked hard to keep it honest and keep it going, and to try to do what we thought was right as a unit or as global units to help Penson out. It was my obligation to the shareholders and customers and the correspondents to do the best I could.

Q Help me understand what you mean by your relationships and how those relationships were important to Penson's success.

A I've been in the business 20-something years. I've never had an issue. I've never sat at this table before. People trusted me. They know I work hard and I follow the rules. I took my regulatory responsibilities at Fidelity to the Nth degree. I was tough. People knew that. I don't have a reputation on Wall Street other than silent and good. And that's what I mean by that.

So when I said, "People, come on, Penson's having issues, but still do business with us, what do you need from us, I'll get that for you," they trusted me.

Q Who are these people you're talking about?

A Other stock loan heads.

Q At other street firms?

A Yes.

Q And what did you need their relationships for?

A To do business, to finance -- you know, the main part of the Penson stock loan world was to finance the business. Can I break

that down for you?

Q Please do.

A So the rule says that margin securities, when the account has a debit, you hypothecate the debit balance by 140 percent. So why does that rule say that? It says that because when you go to the bank to put up the securities that are in margin to borrow money to finance that margin debit, you're only going to get, to this day, 80 percent on the dollar. It used to be 70.

So the rule to this, and to hypothecate 140 off the debit so you had enough securities to go borrow the money, because a lot of firms didn't have billions of dollars in cash on hand to lend that out. They didn't own banks back then. They didn't have that access. So they would have to go to a bank and put it up and borrow for the sake of covering the margin there.

Stock loan came around I believe in the '70s into the '80s, and you could lend that 140 percent excess out. But in stock loan you got 100 percent of the money for that. So you have less risk, you got 100 percent on the dollar, you had to put out less to get more to

fund your debit balance. That's how that works.

Q So I'm going to recap that in my clumsy terms, and you tell me if I miss something meaningful, okay?

A I'll try.

Q I'll try too. It sounds like at the 30,000-foot level, Penson needed cash from stock-owned financing to run its business, and your relationships were important to Penson's ability to do that; is that a fair 30,000-foot summary?

A That would fair for Penson and any other brokerage firm that did margining. It would be equal across the board. It wasn't just a Penson-ism.

Q Did Penson's stock lending activities have any purpose other than financing?

A And when you say "financing," I might say create liquidity, just so you know. The purpose was, you lent out the excess stock too if you had enough. So if you put it out at 100 percent, you still had excess securities to lend. Especially when the world went to hell and interest rates went to zero like they are today, stocks became what's called premium stocks. You

Q Who else was there?
A John Kenney, head of operations.
Q Who else was there?
A Bart McCain.
Q Who else?
A Brian Gover.
Q Who else?
A Rudy, me.
Q DeLaSierra?
A Yes. Brian Hall, I believe, myself. And I don't remember anyone else. Compliance was there because Tom Delaney was there.
Q Was Hollie Hasty there?
A I don't know.
Q How about Eric Alaniz?
A I never had a meeting with Eric Alaniz in my life, and so I'm not really sure. He was too down the pole. I don't think he would be at that meeting.
Q Was Jerry Reilly there?
A I don't know. Gover was there, so he reported to Gover. So I'm not sure if that would have warranted Jerry to come in.
Q And I believe I heard you say that at this meeting you discussed the difficulties stock

loan was having in closing out failures to deliver on long sales by open marked T+6; is that right?
A I'm not sure we discussed the difficulties. I think at this meeting we were talking about implementing and doing stuff and getting things in order for the financial stocks, and possibly talking about Rule 204T at that time. I don't think we talked about difficulties yet. I think it was just starting, if my memory serves me. I think the difficulties came from the staff at some other point in time, and those were raised up to the proper people and asking for help and review.
Q Let's just go there at this point. Can you tell about any detail you're talking about there?
A Well, there was nothing -- what was there to implement? There was a rule, and the rule said you have to buy in a CNS fail to deliver, versus stock loan, versus a margin long sale on T-6 in the morning. I believe that we discussed that as a team with Tom Delaney, possibly Phil, possibly Bill Yancey. But I believe that was vetted out, and we went and did

our first buy-ins and were told to go F ourselves from the street on day 1. You can't do that. That's against your master securities lending agreement as produced by SIFMA. We said the rule says you have to do that, and I'm saying I didn't do the day-to-day. I might not have been there for all of this. I had to have conversations with Rudy. But that would transpire, and then we would -- they told us you can't do it.

So I know that Rudy and Brian had meetings with Tom Delaney and people. I know I was involved with walking into Tom's office on many occasions saying they're not letting us buy in. I know I had two discussions with John Kenney later about John saying, "Hey, you can't do that." And I said, "John, we go to buy in on the morning of T-6, and they won't let us. They tell us to go to hell. So we tightened up as best as we could, John, to stay as tight as we could with what we know about this rule." We've asked Tom Delaney for help, we've asked Hollie Hasty for help. They all sat our distance here in my department. If I was sitting here doing stock loan where you sit there, you were doing compliance. They sat there, and they listened to

it constantly.
Q So you're saying a distance of 2 to 3 feet?
A Yes, from Matt Battaini's desk, and they'd be 6 fee from Red's desk, which is Lindsey Wetzig, sorry. And then yes. So it was there. We never hid the fact of that. As FINRA sent one-off inquiries about stocks, I've seen in some e-mails here, you would see the response was industry practice, industry practice, industry practice for buying in at end of T-6 rather than the morning.

We could not get a morning buy-in off to save our soul without ruining our reputation with the street. No one on the street ever, ever said that there was a way to do that, Footnote 55. Never heard of it in my life. No one from compliance they knew ever said stop doing what your teams are doing till we sort it out. They all bought industry --

MR. FONS: Practice?

THE WITNESS: Yes, thank you, practice. My mantra was, keep it tight, keep it tight. And when we worked with you, Jon, to look at the data, we were tight. 98.6 or something

percent of the time, everything cleaned up before T-6 in the morning. And I'm rusty on those numbers now. But we had a tight process in place. They knew that we weren't. Nobody ever, in any review I ever saw, we never got a review on this, other than one review by Eric Alaniz on penalty box items. And in there he lists long sales. He does not say go to the rule and look at Footnote 55. He doesn't reference that. So again, over these year, no one tells us Footnote 55. If someone told me Footnote 55, we would have stopped and rebuilt the systems because the systems are not geared for anything other than T-3 settlement.

MR. FONS: So I'm going to stop you because we've gone a little far afield from where Jon started.

THE WITNESS: Okay, sorry.

MR. FONS: That's okay. Tell me about the conversations, I think, something along the line, tell me about the conversations that you had with folks about the difficulty of having to recall -- or having essentially, to buy in by the deliver on the morning of T+6. He's going to ask you all those other things.

THE WITNESS: Okay. That's kind of my conversations, so maybe I have to wait for another question to break it down because those are conversations --

MR. FONS: That's fine. And as Jon said before, you've given a lot.

THE WITNESS: Sorry.

MR. FONS: That's fine. We're short of the 30,000 point. Jon will sort of dig down on some of that, but you're fine.

BY MR. WARNER:

Q Don't apologize. This is -- I gave an open-ended question and I'm going to follow up on stuff, so we're right where we want to be.

I heard, I believe, a list of people that knew stock loan wasn't closing out fails to deliver on margin long sales by open market T+6, okay? And the people I heard you say were Tom Delaney, right.

A Um-hum, yes.

Q John Kenney?

A Yes, but I think long after we were in the problem.

Q And we'll go back and figure out the time frames and everything. Let's just go

through the list. So Tom Delaney, John Kenny, next on the list is Hollie Hasty?

A I believe she was aware, either by myself or Rudy.

Q Phil Pendergraft?

A I believe he had some knowledge of it, yes, either by myself, or directly from Bill Yancey and Tom Delaney.

Q Anyone else outside of stock loan that you believe had knowledge that the stock loan department was not closing out failures to deliver on margin long sales by open market T+6?

A Eric Alaniz.

Q He's compliance?

A Yes. Kim Miller. And that's based on the responses we would give to them in that penalty box, as well as in one-offs.

Q Anybody else you put on that list?

A Brian Gover, I'm pretty sure.

Q Anyone else?

A Summer Poldrack.

Q How about Bill Yancey?

A Yes. Rudy's entire team and my team, yes.

Q How about Bart McCain?

A I'm going to say yes, but -- yes. I'll say yes.

Q I'm going to go back to each one and explore why you think they knew it and when they would have known so we can -- if you have caveats or reservations, I want to know those as well.

A Okay.

Q Anyone else you would put on a list of people you believe knew that the stock loan department was not closing out failures to deliver on margin long sales by open market T+6?

A I don't remember any other names.

Q All right. Let's start with Tom Delaney. Why do you believe Tom Delaney knew that the stock loan department was not closing out failures to deliver on margin long sales at open market T+6?

A I know that when Lindsey did the recalls and tried to buy in, it didn't happen. It was escalated, I believe, to Brian and Rudy and then to me. I believe Brian and Rudy had conversations with his staff and/or himself based on them telling me that. I believe that Rudy had ongoing conversations on the subject matter with Tom in morning meeting with Bill Yancey, I

believe, because I know Rudy has told me that. I believe that I had fly-bys with Tom saying, hey, I need an interp. I need something. We're tight as heck. It seems like this is industry standard. The SIFMA contractors were never changed. I have a legal obligation to those contracts. Here's a rule. So what are we doing? And there was some outcome from that that led us to keep doing what we were doing.

Q Did you ever have direct conversations with Tom Delaney about stock loan's practice relating to closing out failures to deliver in margin long sales on open market T+6?

A I think I did.

Q When?

A I don't know. Don't know.

Q What was the general context for those discussions?

A Exactly what I said to you a minute ago.

MR. FONS: Can I ask something?

MR. WARNER: Sure.

MR. FONS: The conversations that you had with Tom, okay, that you think you had --

THE WITNESS: Yes.

MR. FONS: As you sit here today, understanding you don't know specifically when you had them, can you put them sort of in the context of would it have been sort of during the time that Rule 204T was there, versus the permanent rule, or the implementation of either of those rules? Can you put them in that context or not?

THE WITNESS: I think we chatted a few times about 204T and not being able to do that, and it was street practice. And then I believe at that point the firm was complacent, or Tom was, or someone was, and that, yeah, that's industry practice. Then as 204 became permanent, I clearly remember going to him on four or five occasions saying, "Tom, I need an interpretation of the new rule."

That's the e-mail we see that's just quite vague and doesn't talk about margin long sales. So it led to the complacence of still not being able to buy in and street practice, street practice, in all of our minds. And that e-mail was issued by Tom Delaney based on me pushing for an interp of the final rule.

MR. FONS: So whatever e-mail you're

talking about, and they may or may not show it to you, whatever e-mail you're talking about, again, all I want -- I'm just talking about timing.

THE WITNESS: Yes.

MR. FONS: That's about the time of the implementation of the permanent rule?

THE WITNESS: I think so.

MR. FONS: Is that what you said?

THE WITNESS: Yes, sir.

MR. FONS: Okay.

BY MR. WARNER:

Q So I can go -- I think I know what you're talking about. I can go pull that. But if I'm understanding you right, you said your meetings with Tom Delaney were at or about the time he sent out that e-mail about Rule 204, right?

A For the final rule. For temporary, I believe we still had a couple walk-bys where we -- where the staff was telling me that they were having trouble buying in on the morning of T-6. And so those were the discussions. People in the firm knew. There was nothing hidden from them because we were doing the best we could to get these things cleaned up. I remember telling

them we have to be tight. I don't know how to get there. If you remember -- right. So that's where I was.

Q Any other communications you recall with Mr. Delaney relating to stock loans closing out or failures to deliver in margin long sales after open market T+6?

A From me, no. I know that Brian and Rudy did have separate meetings, whether with him or his staff, on the subject matters, and sometimes they used my office when I wasn't there. But I think over the course of time, there were conversations walking by each other, or I went to his office.

Q How do you know that Brian Hall and Rudy DeLaSierra had these separate meetings with Mr. Delaney?

A I don't know if it was with Mr. Delaney or with his staff. They would tell me. They would tell me meetings were had, especially after the Eric Alaniz penalty box audit where we weren't doing it right. We thought if you were in the penalty box, that was better than nothing, and apparently we messed that up, so we fixed that immediately. But in that audit, you see

was my staff. So was Rudy DeLaSierra. This was an comfortable time in trying to keep straight and putting our heads around it. So there was no way that other individuals did not know about it. They fully knew because I would bring it up. So would Rudy, so would Brian, so would Lindsey.

Q And I'm thinking particularly about your relationship or communications with Phil Pendergraft.

A I would have said it to him. He may have asked me about it, and I explained it, and he said, "Okay, that's what I'm leaning towards," but I don't remember.

Q Okay. So let me characterize this back to you what I've understood you to say, and you tell me if I got it right, okay?

If I heard you right, you're saying you don't specifically recall discussing this issue with Mr. Pendergraft. But given the nature of the issue and your relationship with Mr. Pendergraft, you believe you would have; is that --

A Yes.

Q And what is it about your relationship with Mr. Pendergraft that makes you think you

would have raised this issue with him?

A Because I was raised that way by my mother. I wouldn't have hidden anything from anyone. If there was an issue, I'd let them know about it, and I would have done that. That's my MO. I chased Tom Delaney in the hallways. I would always let people know what was going on and what I was uncomfortable with, and I'd also let them know what I thought I did a great job at. So that's me. That's my DNA.

Q How about Mr. Son?

A He sat next to Phil. So if I had the conversation, there was a likelihood he was sitting there. The men sat together in the same office.

Q Let's talk about John Kenney and his knowledge of the stock loan group's practice of not closing out failures to deliver on margin long sales by open market T+6.

A I think John called me on two occasions towards the latter part, probably well before we went to Congress trying to find out what was going on, so maybe eight months before, or maybe a year before. But there were two phone calls, and he probably got his information from

Brian Gover. And the phone calls were, "Hey, Mike, you know, you have to buy in on T-6."

And I said, "John, I got you. I understand that. I don't know how to do that. Every time we go do a buy-in I get yelled at, and the won't take it. So if I attempt a buy-in, I'm going to put the firm in financial risk. So therefore, we have tight controls, John, around all of this to minimize the latency. As well as, John, we've had outside conversations, period, and we still continue down this road. The team has. So tell me, John, how to get there." And he hung up on both phone calls as a normal good-by and never came back with any other comment or whatever to tell me how to get in line. Neither did Tom Delaney or no one, period.

Q You talked about going to Congress. What does that mean?

A We went to -- I guess you call it Congress. I walked the halls of the Senate with Bill Yancey, lawyers, lobbyists, and we met with 16 people, maybe, in a day to say we have the Honorable Securities and Exchange Commission up our rumps on this rule. We have contracts that

say this. We gave a PowerPoint presentation to everyone that we saw saying how do we fix this. The rule, in our opinion, is not in compliance with our contracts, blah-blah-blah, and that's what we did.

And then I believe that the Securities and Exchange Commission was invited to those meetings as well. And at the very last minute, somebody in market surveillance declined those meetings. And then from there, I believe there were meetings I wasn't involved in with the Securities and Exchange Commission, and somebody other than you pulled out Footnote 55 at a meeting, and the minute it got to me, I shut down the systems and starting coding to fix it, authorize that to get done.

I think what's important is that I stopped lending to try to get it going because that was the right thing to do, period.

Q When did you walk the halls of the Senate with this illustrative crew?

A I'm going to say it was October of 2011. I'm guessing. But I think it was the fall. It was cold. And that was the first I ever spent that much time with Bill Yancey in six

I printed it out off of my machine. And there's no Bates label on the bottom, but the Bates label for this document is PFSI 1423355.

With all that said, Mr. Johnson, do you recognize Exhibits 125?

A Yes.

Q What is it?

A The e-mail from Tom Delaney on 204.

Q Is this the e-mail you were talking about this morning?

A Yes.

Q And you said there were meetings between and you Mr. Delaney in or about August of 2009 to discuss Rule 204?

A There were conversations with Mr. Delaney to get me an interp on 204, and this is what came from it.

Q I looked through this document, and I didn't see anywhere where it discusses close-outs of long sales in margin securities. Did you see something in there on that issue?

A If it doesn't tell me to do that, yes. There's no information. So that's the interpretation we got, and it doesn't really help me, right? So that's it.

Q Maybe you answered this, but how was Exhibit 125 relevant to your practice of not closing out failures to deliver on long sales and margin securities by open market T+6?

A It doesn't give me any direction to do that. So therefore, it doesn't help me to figure out what street practice is, or that there's margin long sale rule versus stock loan. That's omitted here. It's not here. To in essence, this supports the way we were doing things.

Q But you had discussions about those very issues with Mr. Delaney in or about the time that he sent this e-mail to you?

A I told Tom I wanted an interpretation, so yes. So based on what we were doing versus asking for an interp, this is the interp we got.

Q I want to talk a bit about Penson's WSPs relating to stock loan. Who was responsible for developing Penson's WSPs relating to stock loan?

A I think compliance.

Q Who from compliance?

A Don't know.

Q Did you have any role relating to the development of Penson's stock loan WSPs?

A I think we would have received, or Brian did, a format, and then we would write something and then send it back to them to type up and put into the WSP format. It wasn't something that we were familiar with or regularly did. I think we did it once.

Q What was your role personally?

A I read whatever was being written from the department. I read it and reviewed it.

Q Did someone from the stock loan department take the lead on drafting the WSPs for stock loan?

A I think so.

Q Who?

A Brian Hall.

Q Anyone else involved in that process?

A I don't recall.

Q Who was responsible for ensuring that, for instance, stock loan WSPs were reasonably designed to achieve compliance with RegSHO?

A I have no idea. Compliance.

Q Did anyone from stock loan have that responsibility?

A I don't remember ever being designated with that, so I don't know. I don't think so.

Q Did you give yourself that responsibility?

A My responsibility was to enforce what was handed to me, and then in internal interpretations and what was directed of me. So that's what we did based -- as the last example you just put in front of me.

Q While you were the global head of securities lending at PWI, did you view yourself as having a responsibility to insure that PFSI's stock loan WSPs were reasonably designed to achieve compliance with RegSHO?

A No. I think compliance was responsible for telling us what to do.

MR. FONS: So again, I need you to focus on his question. His question is, do you believe that you had responsibility for ensuring that the compliance policies were reasonably -- sorry, the written supervisory procedures --

MR. WARNER: For stock loan.

MR. FONS: -- for stock loan were reasonably crafted to assure compliance with the regulations? Do you believe that was your responsibility?

THE WITNESS: No. I don't know the

your efforts to implement Rule 204T, did you understand that Rule 204T required failures to deliver in long sales in margin securities to be closed out at open market T+6?

A Yes.

Q At the time of those meetings, did you believe it was industry practice not to close out failures to deliver on long sales of margin securities by open market T+6?

A Can you say that beginning again? I'm sorry.

Q Sure. At the time of these meetings we've been talking about --

A Yes.

Q -- with Mr. Hall, DeLaSierra, and Wetzig trying to implement Rule 204T, did you understand that it was industry practice not to close out failures to delivers and long sales in margin securities at open market of T+6?

A That's what we thought, yes.

Q What was your basis for your belief about industry practice?

A I know. I'm just not feeling well, and I'm not trying to be disrespectful.

Q Okay.

A The lunch made me worse. Can you say that again?

Q Sure. What was your basis for the industry practice that we just discussed? The basis of your belief about the interest practice we just discussed?

A The basis was the staff doing their jobs and the current experience of them trying to do their jobs in that environment.

Q Why did you decide to follow your understanding of industry practice instead of your understanding of what Rule 204T required?

A We couldn't get the buy-in off. When Lindsey tried to do it, they told him you can't buy us in till the afternoon. So we did do the buy-in in the afternoon of T-6 on most occasions. But they wouldn't let us do it.

So there was no place to go buy in. We couldn't do the trade, and that's what we raised up to compliance, et cetera, above us saying that we had that problem. There was -- if I did the buy-in, Goldman or somebody wouldn't accept it, and therefore, I'm stuck with trade, and we couldn't do that. So that's why we thought street practice, because

the -- we weren't receiving any buy-ins. If my memory is correct, I believe that the staff said there's only one or two over a four-year span that we got bought in in the morning, and so we weren't seeing it.

So it led us to believe that that is correct, and we're doing street practice. And then from those meetings, other conversations, et cetera, we kept going about that. We didn't know. We didn't know to recall on T-2, or that there was a sentence somewhere that said stock loan specifically in the frequently asked questions of the SEC how to do that. It never came across our desks.

Q So one solution to your problem would have been to issue the recalls a day earlier, right?

A Now that I know that, yes.

Q That was one possibility. Did that occur to you at the time?

A No. No. You can do it two days earlier, which I believe everyone should do today, is issue on T-1 instead of T-2. But yes, I wish I knew that.

Q Why do you think everyone should issue

the recall on T-1?

A I think that there's some weirdness in the rule, and it's hard with all these systems to catch everything. So if you start on T-1 to do it, it gives you that extra day to catch a mistake. For example, the rule doesn't talk to like as a trade, or something like that. So if it happens and goes in, you wouldn't see it's a violation. It's a very hard rule, I believe -- and I think I'm an expert now, thank you -- to adhere to. And there's so much systems and jargon that I think you need to start on T-1, and that way you have T-2, and that way you're hopefully 99.9 percent pure on T-6 in the morning, yeah.

Q At the very least, have the right to buy in a borrowing counterparty, right?

A Yeah. It gives you to opportunity to buy it in on T-4, and gives you some time in case there's booking error, in case there's a mistake, and we didn't know that.

Q So one of the possible solutions to the problem you faced with trying to comply with Rule 204A would have been to issue the recall earlier, right?

booked.
Q I want to talk about how stock loan fits in the broader context at Penson. We talked about some of this, I think, at the outset when you were trying to explain to me stock loan revenues and all of that stuff. But help me understand, how did stock loan help Penson meet its business objectives?
A That question is too broad to answer. I don't understand the question.
Q What was the role of stock loan at Penson?
A To finance the firm, and to lend stocks out, whether that generated income or not.
Q Finance firm, lend stock out?
A I think in a nutshell, generate cash would be a better answer and would sum those up into one category. Our job was to generate cash and finance the firm.
Q What are the ways that stock loan generated cash?
A Lending.
Q The two categories you're talking about, one, lending out shares in order to bring in cash, right?

A I think you can -- can I think a second?
Q Please. Anything -- any insight, I can appreciate.
A I appreciate you trying. I'm going to remember this. Now I have to find this in my brain.
Stock loan is stock loan. You lend stock. Forget about what it is. You lend stock. When you lend stock, you get cash. That cash comes in. Some firms don't lend stock all day long because they have too much cash, so they don't need it, so they won't do a loan.
At Penson we always needed cash. So rather than go to the bank, it was cheaper to do stock loan because you would generate a hundred percent on the dollar, so we just lent stock. Now, we could lend out the IBMs at what's called our financing rate to pay for that, or we lent out hot stocks and generated revenue. But put the revenue aside. You still generated cash on a premium loan. So it was about generating cash to finance the firm.
With no fault of our own in the financial crisis, that put a lot of premium rates

on those transactions which, in essence, generated revenue as well because you weren't paying for the cash anymore. You were receiving money for the stock. That will turn around the minute the FED raises their rates to a quarter, to 50 bits positive. You'll see premium stocks go -- starting to go away, and then people will lend and get cash. Now they'll have to take that cash and use it to fund their business and/or invest that cash in commercial paper overnight or something to earn that revenue they're not going to get in the premium when that goes away.
Q Stock loan also fulfilled the role of supporting selling, right?
A We gave locates, yes.
Q It also would borrow to cover short positions by short sellers, right?
A To facilitate deliveries, yes, providing liquidity to the firm.
Q That also generated revenue for the firm, right?
A Well, if we borrowed stock, we would pass that. Because everything's premium, we would charge that to the customer. When interest rates were positive, we borrowed stock, we gave

them cash, they would pay us interest. So when you say "generate revenue," it's just part of that. It's not why we do it on the borrow side. We borrow to facilitate delivery to clean up the fails, to stay in compliance with rules, to not have 35-day-olds fails, to keep fungibility. That's the business. Now, if there's revenue earned on the movements of that, because of that there's also a cost to it.
So you can't focus on the revenue side. For example, the fail to deliver on the books, I've already credited the customer. He's paid. He's got credit. I have a fail. I haven't got my money. So I don't have that yet. So now I have to go borrow, I have to pay cash to get that security, and I'm going to make that delivery to get my cash back, to get that cost. That's a cost on my books, so that's always there. So it's not all revenue. It just looks very revenuated (sic) because of the premium stocks and the negative rebates. And yes, you will do that to general revenue, absolutely, if you have the excess.
Q So I think I've heard two ways stock loan generates revenues. One is to get the

for long sales in margins and securities there was a conflict between your understanding of what the rules required and what industry practice was, right?

A Yes.

Q When there's a conflict between industry practice and SEC rules, which one trumps?

A Whichever one compliance -- whatever compliance tell me to do. I'm not in the position to interpret that. I went for help. So I don't know how to answer that question. I went for guidance, because if SEC trumped, which it most likely should, they still wouldn't let me buy them in. So I was in a quagmire there trying to figure how to do this. And that's when everything led towards the it's industry practice, and it's against the contracts. And I didn't see anything for -- I wasn't and given anything to make a better decision there.

Q If SEC rules trump, why did you follow industry practice or your understanding of industry practice?

A Compliance. I rely on them to tell me how to do the trump or do the rule, and they went

along with industry practice. They didn't show me the rule or interpret it or go get me something that said I have to do this. If they did that, we wouldn't be here today, or we might have been here only talking three months of problems.

Q Based on your years in the securities industry, if a compliance officer tells you it's okay to violate an SEC rule, do you think it's okay to violate the SEC rule?

A He didn't tell me to violate an SEC rule. We looked at all of our stock loan contracts and the legal documents that we had in place, and the people we would try to buy in telling you can't because of the stock loan contracts and those legal conclusion, so they were butting, and that's how we got there. If somebody told me, Mike, go violate an SEC rule, I'd quit.

Q Did you understand your practice in the stock loan group relating to close-outs of long sales of margin securities was violating SEC rules?

A We didn't use the word "violation." We understood that we were tight as hell and

pretty close not in line, and that industry practice was governing that, and that today, obviously, I know it was wrong.

Q I'm not sure I understood your answer. Did you not understand that you were violating SEC rules?

A We knew we couldn't buy in on the morning of T-6, that they weren't letting us do that. So we -- but we knew we were cleaned up 98 percent of the time. So we knew we had an issue with the SEC rule, and we were saying street practice, and so was Tom Delaney, and so was their bosses. And so did I know I was violating it? I know I wasn't in full compliance with it because I wasn't violating the entire rule. I was trying to comply. The staff was trying to comply. And we really did our damned best to do that, and nobody said stop. The people that are in charge to tell me how to comply and to stop never did so. So we were doing it to our best, knowing that they weren't telling us anything. The minute somebody showed Footnote 55, I stopped it, and ceased and desisted myself.

Q Didn't you have the ability to stop the practice?

A How? I still have to do business. I still have to do recalls. I don't know how to tell Goldman Sachs to let me buy them in on T-2 -- on T-3 in the morning. I didn't know how to do that. I reached out to the people that get paid to do that for me. I don't interpret rules. It's not in my -- I run stock loan.

Q You told us several times today it's in your DNA to do the right thing.

A Um-hum.

Q If so, why did it take you three years of grappling with the apparent conflict between industry practice and industry rules to shut the securities lending process and try and figure it out?

A Because I knew we were not fully in compliance, and the management team above me and in compliance didn't say stop. They said keep it tight. And there's other reasons for that. So we did that. So I didn't go about it alone. I had the blessing of compliance, Bill Yancey. They were all in the know. We were trying to keep it tight. They knew. If they didn't know or told me no, I would have hung up my cleats, probably, and gone home, or the staff would. My

staff were in the same boat. They were smart people. They had their licenses. We were all in the same boat together. But I do think that it is compliance's role, based on them in a nutshell, legal's role, and the WSPs that were in effect for compliance, to tell me what to do and to do that. And do you know what, they should have said just stop, cease and desist, this doesn't make sense, and they didn't. And we kept trying our best, and we would still periodically test the waters and try to do a buy-in. The systems used in Wall Street are all settle date. Settlement date, settlement date, settlement date.

So not once did I ever, or did anyone on my team, or did anyone at Penson say, huh, T-2. We don't look at that data. It's in nebulous land. It's in the clouds, all that data. What's coming in through the settlement system and in DTC, it's a settlement date basis. So not once did it jargon us. Did other firms with bigger compliance and bigger legals get it right? Probably. Did some firms other than Penson get it wrong and still doing it wrong today? I believe so.

We tried to stay in that line. I believe it was compliance's and the powers to be to tell me to cease and desist, and I stand by that, because I did my best. I didn't try to get more revenue. I didn't try to bring in more. I brought it in really tight and put a bear claw around it and did my best to stay because that was the advice and the information I was getting from the people that were supposed to guide me through that.

Q You talked about struggling for a long time to get a clear interpretation from compliance about how you're supposed to comply with Rule 204, right?

A Yes.

Q Did you ever escalate to Bill Yancey your inability to get a clear answer from the compliance department?

A Well, we got that compliance note from Tom Delaney, and I'm sure Bill was aware of that. So that's it. And so we just fell on -- I think where we're all stuck here is, we fell on industry standard. The way he wrote that and everything else that culminated in made us all believe that it's industry standard. And based

on other things, that's what we were led to believe.

Q Did you ever escalate your inability to get a clear answer from compliance to Bill Yancey?

A No. No, not in that patch when we talked about it. But to escalate it, that was the answer. And based on other facts that I can't disclose, this is the route that the firm went in.

Q Did you ever escalate your inability to get a clear answer from compliance to Bill Pendergraft?

A I don't think so.

Q Why not?

A Because they were compliance, and that was how they were telling me to do it. So I felt I was doing the right thing.

Q You're telling me compliance wouldn't give you a clear answer about what you were supposed to do?

A Well, they told us that the morning of T-6. And then they didn't put in there interp the T-2 and Footnote 55. So we said they won't let us do it, it's industry standard. And if you

read other e-mails and stuff like that, especially from Tom Delaney, you'll see where they're all citing industry practice. So we're all in the same industry practice boat together.

Q So they did give you clear direction, and it was to follow industry practice --

A I believe so.

Q So they did give you a clear answer, and the answer was follow industry practice, not SEC rules?

A The indication we got was to follow industry practice, stick with it, keep it tight.

Q And this came from compliance?

A Yes.

Q Who told you that?

A Tom Delaney and the powers to be.

Q When did Tom Delaney tell you that?

A I don't know. Probably in '09, '10. But it was inferred in that timeline, absolutely.

Q What was the context in which Tom Delaney told you to follow industry practice and not SEC rules?

A Don't know. It was conversational. And there were other conversations that my staff told me about, and that's how we stayed in that.

But they all knew we were following industry practice. That's what we thought. We had no conception that there was a stock loan sentence about stock loan recall detail. We didn't know that at all. Never knew that.

Q What's your current role? What are you doing currently?

A I'm the head of securities lending for Scottrade.

Q Why did it take you three years to tell Lindsey Wetzig to just buy in on Penson's own account to cover the fails to deliver resulting from stock loans?

A Because there was no fire. There was no -- we were industry practice. That came out of your review and everything that was culminating at the time. So I had to take an action to say, fine, we're definitely -- there's something wrong here. I still don't know what it is. Buy it in, cover the risk. But up until your review and the pressure coming back from that, there was no pressure from compliance or anything telling me to do it otherwise.

Q So believing you were not fully compliant with SEC rules did not prompt you to

tell Lindsey Wetzig to buy in on Penson's own account; is that right?

A I never thought of it. I don't think anyone on my staff did either.

Q But believing you were outside of industry practice prompted you to direct Lindsey Wetzig to buy in on Penson's own account; is that what happened?

A No. Knowing that we needed to get this thing fixed and we still didn't know what to do, that clicked my brain one day.

Q We went through a series of e-mails in Exhibits 126 through 128 involving back and forth between you and Mr. Pendergraft about stock loan revenues, and Mr. Pendergraft said things to you like what is behind this decline, and this trend is becoming alarming. Are you telling me those kind of communications from Phil Pendergraft, the head of firm, placed no pressures on you?

A No. It is what it was. The firm created its own reason for decline, et cetera, in their financials. It wasn't in my control. We came in and worked honestly and hard every day to do our job. There's nothing I can do about that.

Q You told me that Phil Pendergraft had

almost complete fiat in determining what your pay was, right? It was his role to decide what you got paid?

A Yeah.

Q Mr. Pendergraft's apparently disapproval or concern about stock loan performance did not put pressure on you?

A No, never. I have a saying, don't chase money, and I taught that to my team. We don't chase money. We got what we got. My base salary was sufficient. I never felt pressure. I make 98 percent less today than I made then to do this role and sit in that role every day and wonder if it's still worth it at that salary. So I didn't do it for the money.

Q During the time frame 2008 through 2011 when you were facing this conflict between your view of industry practice and your understanding of SEC rules, did you ever consider asking the SEC what you should do?

A I would have expected compliance to do that and to tell me that, yes. I never thought to call them myself. I wouldn't know how to do that. I did ask FINRA when they were in doing their exams what do I do, there's a disconnect.

And their comment, the auditors who were there, and I don't remember their names, told me that they're in disagreement with you-all and weren't going to help me, and they walked away. So I did go to a regulator asking for some help, how to get in line here, and they didn't help me.

Q To who?

A FINRA.

Q Who did you speak with at FINRA?

A I don't know. There were two auditors on-site, and I honestly don't remember their names.

Q When was this?

A I would say it was on multiple occasions, but in 2010 and '11.

Q And what did you ask them about?

A I said, hey, are you hearing some noise with the SEC stuff? We're getting pressure. I don't know how to comply. What are other firms doing, what do we do? And they said there's a disconnect in stock loan and how it's done, and we disagree with the SEC, and sorry, Mike, we can't make comment.

Q During the time you were stuck between this apparent contradiction between your

different format, than Exhibit 63, 442515 through 442523?
THE WITNESS: Yes, sir.
MR. FONS: In this instance, you said you thought you and Rudy may have reviewed and edited with regard to 66. And with regard to 73, you said you didn't recall ever seeing that document before?
THE WITNESS: Yes.
MR. FONS: What's going on there? Because they seem to be the same sort of document.
THE WITNESS: I got confused. I thought that this was the first pages. And so I need to change my answer to that. I've not seen this, no, because it would be the same answer of the last 10 pages that I said no.
MR. FONS: So when you said you thought this was the last 10 pages of this, just for the record, I'm just going -- okay, you tell me if I'm wrong. What you thought when you said that you and Rudy may have reviewed and edited the portion of Exhibit 66, which is 498627 through 498632 --
THE WITNESS: Yes.
MR. FONS: -- You thought you were talking about the first several pages of Exhibit 73?

THE WITNESS: Yes.
MR. FONS: Which you had previously told Jon you were involved in, which 442494 through 442512? You thought that's what you were looking at with regard to Exhibit 66?
THE WITNESS: Yes.
MR. FONS: So as you sit here today, do you recall you or anyone else in stock loan reviewing or editing 498627 through 498632?
MR. WARNER: Of Exhibit 66?
MR. FONS: Of Exhibit 66.
THE WITNESS: No.
MR. FONS: That's all I had.
MR. WARNER: We are off the record at 3:56 p.m.
(Whereupon, at 3:36 p.m., the examination was concluded.)
* * * * *

PROOFREADER'S CERTIFICATE

In the Matter of: PENSON FINANCIAL SERVICES, INC.
Witness: Michael H. Johnson
File Number: D-03163-A
Date: Friday, January 11, 2013
Location: Denver, CO

This is to certify that I, Donna S. Raya, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

_____ _____
(Proofreader's Name) (Date)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

I, Leo R. Kniebel, hereby certify that the foregoing transcript consisting of 226 pages is a complete, true, and accurate transcript of the testimony indicated, held on January 11, 2013, in the matter of Penson Financial Services, Inc. I further certify that this proceeding was recorded by me, and the foregoing transcript has been prepared under my direction.

DATE: January 22, 2013.

Official Reporter:_____
Leo R. Kniebel, CSR

Diversified Reporting Services, Inc.
1101 Sixteenth Street, N.W.
2nd Floor
Washington, DC 20036

In the Matter of: PENSON FINANCIAL SERVICES, INC.
Witness: Michael H. Johnson
File Number: D-03163-A
Date: Friday, January 11, 2013
Location: Denver, CO

This is a letter to inform you that we do not release our tapes and notes. I do maintain them for a period of one (1) year.

Sincerely,

_____

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. D-03163-A
PENSON FINANCIAL SERVICES, INC.)

WITNESS: Brian Stuart Gover
PAGES: 1 through 208
PLACE: Securities and Exchange Commission
Ft. Worth Regional Office
801 Cherry Street
Fort Worth, TX 76102

DATE: Tuesday, August 16, 2011

The above-entitled matter came on for hearing, pursuant to notice, at 9:12 a.m..

Diversified Reporting Services, Inc.
(202) 467-9200

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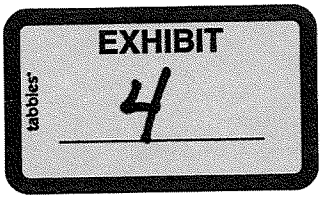

PROCEEDINGS

MR. WARNER: On the record at 8:12 -- 9:12 a.m. Mr. Gover, please raise your right hand.

Whereupon,

BRIAN STUART GOVER

was called as a witness, and having been first duly sworn, was examined and testified as follows:

EXAMINATION

BY MR. WARNER:

Q Please state your full name and spell it for the record.

A Brian Stuart Gover, B-r-i-a-n S-t-u-a-r-t G-o-v-e-r.

Q Thank you. You can lower your hand. Thank you. I am Jonathan Warner. And this is Jay Scoggins. We are officers of the Commission for the purposes of this proceeding today. This is an investigation by the United States Securities and Exchange Commission in the matter of Penson Financial Services, Inc. to determine whether there have been violations of certain provisions of the federal securities laws. However, the facts developed in this investigation might constitute violations of other federal or state, civil or criminal laws. Prior to opening the record, I gave you a copy of the formal order of investigation in this matter. And it will be available to you for your review throughout the proceedings today. Mr. Gover,

have you had an opportunity to review the formal order?
A Yes, I have.
Q I have also placed in front of you what has been previously marked as Exhibit 1. Mr. Gover, have you had a chance to read Exhibit 1?
A I have.
Q Do you have any questions concerning this notice?
A No, I don't.
Q Mr. Gover, are you represented by counsel?
A I am.
MR. WARNER: Counsel, would you please identify yourselves for the record.
MR. MacPHAIL: Mike MacPhail, Holme, Roberts and Owen LLP, 1700 Lincoln Street, Suite 4100, Denver, Colorado 80203.
MR. WARNER: Mr. MacPhail, are you representing Mr. Gover as his counsel today?
MR. MacPHAIL: Yes.
MR. LOGAN: Jeff Logan, Penson Worldwide, vice-president, Deputy General Counsel, Penson Worldwide, 1700 Pacific, Suite 1400, Dallas, Texas 75201.
MR. WARNER: What's your phone number, Mr. Logan?
MR. LOGAN: 214-953-3205.
MR. WARNER: Mr. Logan, are you representing Mr.

Gover as his counsel today?
MR. LOGAN: Yes.
Q Mr. Gover, I am handing you Exhibit No. 33. Is this a copy of the subpoena you are appearing pursuant to here today?
A Yes, it is.
Q I want to take a moment at the outset to talk about the process we are involved in today. I want to note at the outset that the oath you have taken this morning is a solemn oath, just like the oath you take if you were testifying in court. And any answer to that oath carries the same consequences as it would in court. Do you understand that?
A I do.
Q Now, as you have noted, everything we say today is taken down by a court reporter and we'll be returned in the form of a written transcript. To make sure we have a clear record, there are a few guidelines we need to follow. First of all, you need to respond to all of my questions verbally. You need to avoid head shakes or nods so the court reporter can accurately record your testimony. You understand that?
A I do.
Q I would also appreciate it if you could do your best to answer when appropriate yes or no rather than uh-huh or huh-uh for clarity of the record. Okay?
A Okay.

Q We also need to do our best to avoid talking over each other. I will do my best to wait until the end of your answer before I ask the next question and ask you that wait for me to finish my questions before you answer even if you know where I am going. Is that okay?
A That's okay.
Q Okay. Thank you. Now when people read this transcript in the future they're going to assume that you understood my questions. So I invite you and ask you if at any point one of my questions isn't clear, please let me know and I will do my best to clarify. Okay?
A Okay.
Q Now, Jay and I control the record here, but we are happy to take breaks to accommodate you as needed. I will try to take a break every hour or so. Mike does a good job of reminding me if I lose track of that. So if at any point you need a break, please let me know. Okay?
A All right.
Q My one request there is that we not leave questions hanging during breaks. So I would ask that if there is a question pending, we answer the question before we take the break. Okay?
A Okay.
Q Now is there any reason why you won't be able to answer my questions fully and accurately today. Medication or

other things that would impair your ability to understand and respond?
A No.
Q Mr. Gover, setting aside or keeping in mind conversations you've had with counsel, I don't want you to answer this question by giving me the substance of anything you've said or heard from your counsel. I would like to know whether you discussed your testimony here today with anyone?
A No.
Q Have you discussed the fact that you're coming to testify with anyone?
A Yes.
Q With whom have you discussed that?
A My boss, John Kenny, the COO; the CEO of Penson, Bill Yancey; the CAO of Penson, Bart McCain; Jeff Logan; my wife, summer Poldrack, Summer Poldrack, P-o-l-d-r-a-c-k.
Q Anyone else?
A Not that comes to mind.
Q Brian Hall?
A No. Well, actually, yes. He knows -- He knows that I was called to testify.
Q Okay. Did you discuss with anyone the types of questions you might anticipate hearing today?
A Aside from counsel, no.
Q You didn't talk to Summer Poldrack about the

A That would be Tom Delaney and Holly Hasty.
Q Is Tom Delaney an attorney?
A I don't believe he is an attorney. At the time he was the CCO of Penson.
Q Is Holly Hasty an attorney?
A I don't believe so.
Q When did you have discussions with Tom Delaney on those issues?
A I cannot -- I couldn't articulate specific dates. It would have been sporadically through the period of when the -- when I was first made aware of the findings and probably until shortly before he would have left.
Q Were you involved of OCIE's exam prior to the findings coming to Penson?
A Not to my recollection in any material way. Compliance may have asked me for data or asked my teams for data, but I wasn't interviewed. I wasn't -- I didn't respond directly to the best of my knowledge to either Compliance or the SEC on these.
Q So your conversations with Tom Delaney would have come at the time of or after OC sent its deficiency notice to Penson. Is that right?
A There could have been conversations before then relating to the items that the Commission was investigating.
Q But specifically about the issues that OC raises

deficiency notice, your conversations with Tom Delaney would have come at the time Penson received the notice or after. Is that right?
A I don't know. I really -- Being asked to recall conversations with from a couple of years ago and the chronology and when the actual findings were presented to them, I don't know.
Q Maybe I can jog your memory as we go through the actual timeline there. Do you recall the substance of your conversations with Tom Delaney?
A Again, not specific conversations. You know, there were -- there were certainly conversations regarding the buy-ins group, how we were persecuting on Reg SHO and what was considered -- what would be best practice, what would it take to be compliant.
Q When did Tom Delaney leave Penson?
A I am going to estimate four months ago.
Q Do you know why he left Penson?
A He was recruited and received another offer.
Q Do you know where he is now?
A I don't know the name of the firm. It's here in Fort Worth, I believe.
Q And you said you discussed the SEC inquiry relating to Reg SHO with Holly Hasty?
A Yes.

Q When did those discussions take place?
A Again, I would be estimating, but I believe there were conversations that occurred probably within the past year.
Q What topics did you discuss with Holly Hasty?
A And again, I can't -- I don't know definitely that these were topics that I discussed with Holly, and these would be normal kind of operational how do we address this, how do we make sure that this is fixed or how do we verify that it's operating correctly. So it would be things along the lines of, you know, what are our Reg SHO buy-in processes, what are the results of any internal audits.
Q Does Penson regularly conduct internal audits of its Reg SHO compliance procedures?
A I believe we have had two since I have had the team.
Q When did you take over the team?
A I believe it was third quarter of 2009.
Q What do you mean by internal audit?
A Compliance -- We have two audit groups. We have an internal audit group that is primarily doing SOX types audits. And then we also will have compliance come and do internal audits of various functions such as buy-ins, margins, new accounts.
Q What do those audits consist of?

A Generally they're going to pull -- they're going to make requests for representative data on populations. And then they're going to verify the -- how those items were handled.
Q Do those audits include review of the policies and procedures, the buy-ins group uses, for example?
A Yes.
Q About when did the first of these two audits that you recall take place?
A I believe it was within three months of my taking the team. So I would say third or fourth quarter of 2009. Again, I am estimating.
Q Do you recall who led that audit?
A Eric Alaniz.
Q Who is Eric Alaniz?
A He is a compliance officer. A-l-a-n-i-z.
Q Is Mr. Alaniz an attorney?
A I don't believe so.
Q Do you know what issues or topics Mr. Alaniz reviewed as part of the audit he was leading?
A Yes. In broad terms it was identification of items that would be subject to Reg SHO and validating where those items appropriately closed out.
Q Did Mr. Alaniz find any problems or deficiencies with Penson's Reg SHO compliance?
A Yes, he did.

A They certainly have an individual responsibility. I am responsible as that team reports to me.
Q Who actually drafts the WSPs in that context?
A I can -- From other teams where I have written WSPs and generally it was the departmental manager who's over that team.
MR. MacPHAIL: Summer Poldrack?
THE WITNESS: No. At the time I think Summer -- When those WSPs were written, it probably would have been the prior director.
Q Well, does Penson regularly review and update its WSPs?
A Yes.
Q So whose job is it at the buy-in department context to review and make sure that the WSPs that apply to buy-in are complete and accurate?
A Either department manager Summer. That would be my responsibility as the VP that she reports to. It would be compliance responsibility to make sure that they are being reviewed and accurate. That would be internal audit to make sure that we are updating our procedures and that they are adhering to the SOX requirements.
Q I can think of at least two reasons why you would have a fail to deliver and a long sale the morning of T + 6. First scenario I am thinking of is one where the customer has

placed a long sale or come morning T + 6 the customer hasn't delivered the security to Penson, so Penson has delivered to CNS. Is that --
A That would be a reason.
Q Okay. I can think of second reason, and that would be that customer has placed a long sale order. Stock loan has lent out that security to a borrowing counter party, and the borrowing counter party has returned the security in time for the long sale transaction to close out morning of T + 6. Correct?
A That's correct.
Q Can you think of other scenarios in which you would have a fail to deliver on a long sale morning of T + 6?
A Yeah. Failing to receive. Meaning not because of any action to customers, but because the contra party in that trade, whether it was assigned out by CNS and the allocation of the continuous net settlement or if it's a DVP, but just the other party is not delivering in to you, so you can't make a forward deliver unless you can borrow. That's the bulk of them.
Q Now, if you have a situation where morning of T + 6 buy-in looks and sees that there's a fail to deliver because stock loan has loaned out that security to someone, what steps does buy-in take to make sure Reg SHO 204 close-out requirements are met?

A My understanding is that stock loan is responsible for re-calling those shares to meet the buy-in requirement.
Q So how do buy-in and stock loan communicate about that security?
A Stock loan gets the list of items that we are failing on a long sale. And they would on -- They would go back and re-call the shares.
Q Do they, in fact, do that?
A I think that's -- I honestly don't know. I know there's been discussions as to whether or not their obligation was to re-call the shares for the morning to have the shares in hand for the morning of T-6.
Q Well, help me understand the buy-in group's posture with respect to that security where morning of T + 6 prior market open, Penson's fail to deliver position, the reason for the fail to deliver, the stock loan has loaned it out.
A Yeah.
Q What does buy-in do?
A Buy-ins is relying on the attestations that this has been reviewed by compliance. It's been discussed with the regulators. It's been reviewed by outside counsel, and that the street practice is not to buy in if the shares are on re-call. And that as long as the re-call is made, that the obligation to satisfy the long sale is met.
Q So the buy-in group obviously checks that one off the

list of we don't have to worry about this one for buy-ins this morning?
A Correct.
Q And going forward, who tracks to make sure whether the re-call comes back in and that is actually closed out?
A They're still going to see it up showing up on a long sale, on a long sale short report. But if stock loan is saying, yes, we re-call the borrow, we do not buy in.
Q So by saying security shows up the next day on the long sale report, does buy-in go again to stock loan and say, okay, you talk about --
A The list is sent up to them everyday. Do they go and say, hey, you said that you're going to re-call this or why hasn't it been re-called yet, no, I don't think that that relationship exists.
Q What did you learn about the stock loan policy about not closing out long sale transactions at market of T + 6 if there is a re-call posture?
A I would say it was probably within the first three to six months of my taking over the team.
Q You knew about this policy before the end of 2009?
A I would have to say yes.
Q Was that common knowledge within the management group?
A I don't know about common knowledge. It's pretty

granular, so I don't know if somebody who -- if buy-ins or stock loan did not fall under their organization, I don't think it would have been something that would have been not hidden. I just don't think it would be something that it would have been involved in.

Q Do you recall discussing that with anyone?

A I do.

Q Who did you discuss it with?

A Mike Johnson, Brian Hall, Tom Delaney, Holly Hasty, Summer.

Q And were all these discussions back in 2009?

A I believe so, thereabouts.

Q Anyone else you recall discussing this with?

A There was a call with outside counsel.

Q In 2009?

A Yeah.

Q Do you recall who outside counsel was?

A I do not.

Q Without telling me the substance, were there discussions with inside house counsel?

A I don't recall if they were involved in that or not.

Q Taking in the scenario where the fail to deliver to CNS is due to a fail to receive --

A Uh-huh.

Q -- how does buy-in treat that scenario?

A We would issue a buy-in to the party that is failing to deliver to us. Or if the party that we're failing to deliver to issues a buy-in to us, we would pass that buy-in along to the party that is failing to deliver to us.

Q Do you get pushback from customers in this context?

A Customers, no. I mean, no.

Q Are you trying to buy in?

A Not generally. We don't -- It's a rarity that my group would even speak to a customer.

Q Correspondent?

A Occasionally.

Q As frequently as you do in the short sale context?

A No.

Q Why is this?

A I think the incidence of long sale buy-ins are less than the short sale buy-ins.

Q Do you go through the same process of setting up a list to stock loans when you borrow to cover these long sale buy-ins?

A I believe so.

Q Go back to Exhibit 35, which is the OCIE report. To your knowledge does Penson have a procedure in place to monitor for patterns or indications that locates are repeatedly resulting in fails to deliver?

A Not to the best of my knowledge, meaning I don't know if they do -- if we do or do not.

Q Do you know whether Penson has a policy or procedure to determine if particular accounts have a pattern of failing to deliver?

A I do not know if we do or do not.

Q Now, look at the middle of page Penson 0722235 in Exhibit 35. This incident says staff found. Do you see that?

A I see several of them that say that.

Q Staff found that Penson failed to close out 15 of 50, open paren, 30 percent, close paren, security position sample in violation of Rule 204T. Do you see that?

A I do see that.

Q Does that number surprise you, 30 percent?

A Yeah.

Q Is it higher than you expect?

A It would be higher than I would find acceptable, certainly.

Q Do you have an explanation for why this is such a high fail rate from the sample?

A I do not. This is fail examine in 2008. It was before I had the team. And I really don't have any knowledge of its operations at that time.

Q Staff found that in two of the 15 positions the firm

conducted further short sales on T + 4 without pre-borrowing the securities as required by in violation of 204T. Do you see that?

A I do.

Q What policies or procedures does Penson have in place to guard against allowing additional short sales without pre-borrowing for securities that are in a fail to deliver position?

A I am not intimately familiar with the policies and procedures in stock loan. My understanding is that they put the items into a penalty box and do not give further locates on them. Now what we can do to stop a customer from short selling, not much because we're not the executing broker. We're not the introducing broker. These are generally being done on front end platforms that are not Penson front ends. We are clearing the trades. We're not executing the trades.

Q So if the customer claims to find a locate elsewhere --

A My understanding is we do not support locates away, so that wouldn't be a valid -- that wouldn't be a valid reason for them to go and say, hey, I sold short because I got a locate from Goldman or something. My understanding is we don't have the ability to support that.

Q Is there a way of confirming that the in-take of the trade file, that a locate was obtained for a particular short

A It is telling what the frequency of their focus filing is.
Q Correspondents?
A Correspondents. What their net cap regulatory requirement is, what 120 percent of that net cap requirement, how much excess net cap they have, what their previous was, what the Delta is from their previous, what their good faith deposit requirement is and what their actual good faith deposit requirement is. It's a busy one.
Q Thank you. You said it's abysmal?
A A busy one.
Q I thought you said abysmal.
A No. It's not that bad. It's just kind of doing extra monitoring of the health of your correspondents so you don't get caught flatfooted, and all of a sudden one of them is filing for a BDW or something.
MR. WARNER: Let's go off the record at 4:15 p.m.
(A break ensued from 4:15 p.m. to 4:29 p.m.)
MR. WARNER: Back on the record at 4:29 p.m.
Q Mr. Gover, did you have any discussions with the staff relating to this SEC inquiry while we were off the record?
A I did not.
Q One question to clear up an issue going back to the

PFS 642 report. Do you know whether the PFS 642 report tracks only securities that are in a T + 4 posture, or is it grandfathered in securities that are T + 4?
A I don't know definitively. I believe it would also include T + 4 and older. You can probably -- Angel could answer that one very quickly for you when you talk to her.
MR. WARNER: Do you have any questions?
Q Now, Mr. Gover, we have no further questions for you at this time. We may, however, call you again to testify in this investigation and, should this be necessary, we will contact Mr. MacPhail. Mr. Gover, do you wish to clarify anything or add anything to the statements you have made today?
A No.
MR. WARNER: Mr. MacPhail, do you wish to ask any clarifying questions?
MR. MacPHAIL: No.
MR. WARNER: We are off the record at 4:30 p.m.
(Whereupon, at 4:30 p.m., the examination was concluded.)
* * * * *

PROOFREADER'S CERTIFICATE

In the Matter of: PENSON FINANCIAL SERVICES, INC
Witness: Brian Stuart Gover
File No.: D-03163-A
Date: Wednesday, August 17, 2011
Location: Ft. Worth, Texas

This is to certify that I, Susan Davis, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

_____ _____
Susan Davis Date

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

I, Rhonda Mears, Certified Shorthand Reporter, hereby certify that the foregoing transcript of 206 pages is a complete, true, and accurate transcript of the testimony indicated, held on August 16, 2011, at the Securities and Exchange Commission, in the matter of Penson Financial Services, Inc.
I further certify that this proceeding was recorded by me and that the foregoing transcript has been prepared under my direction.

Date: _____
Official Reporter: _____
Rhonda Mears
Diversified Reporting Services, Inc.

Diversified Reporting Services, Inc.
1101 Sixteenth Street, N.W.
2nd Floor
Washington, DC 20036

In the Matter of: PENSON FINANCIAL SERVICES, INC
Witness: Brian Stuart Gover
File No.: D-03163-A
Date: Wednesday, August 17, 2011
Location: Ft. Worth, Texas

This is a letter to inform you that we do not release our tapes and notes. I do maintain them for a period of one (1) year.

Sincerely,

_____

Rhonda Mears

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. D-03163-A
PENSON FINANCIAL SERVICES, INC.)

WITNESS: Brian David Hall
PAGES: 1 through 207
PLACE: Securities and Exchange Commission
1801 California Street
Denver, Colorado

DATE: Thursday, July 7, 2011

The above-entitled matter came on for hearing, pursuant to notice, at 9:07 a.m.

APPEARANCES:

On behalf of the Securities and Exchange Commission:
JONATHAN WARNER, ESQ.
JAY SCOGGINS, ESQ.
LAURA MAGYAR, ESQ. (Via speakerphone)
Securities and Exchange Commission
1801 California Street
Denver, Colorado 80202-2648

On behalf of the Witness:
MICHAEL MacPHAIL, ESQ.
HOLME ROBERTS OWEN, LLP
1700 Lincoln Street
Denver, Colorado 80203

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PROCEEDINGS

9:07 a.m.

MR. WARNER: Let's go on the record at 9:07 a.m.

Mr. Hall, would you please raise your right hand?

Whereupon,

BRIAN DAVID HALL

was called as a witness and, having been first duly sworn, was examined and testified as follows:

EXAMINATION

BY MR. WARNER:

Q Mr. Hall, please state your full name and spell your name for the record.

A It's Brian David Hall. It's B-r-i-a-n, D-a-v-i-d, H-a-l-l.

Q I'm Jonathan Warner. And with me here is Jay Scoggins. We are officers of the Commission for purposes of this proceeding. For your information, also listening by phone is Laura Magyar, from our Office of Compliance, Inspections, and Examinations.

A Okay.

Q This is an investigation by the United States Securities and Exchange Commission in the matter of Penson Financial Services, Inc., to determine whether there have been violations of certain provisions of the federal securities laws. However, the facts developed in this

investigation might constitute violations of other federal or state civil or criminal laws.

Prior to the opening of the record, I gave you a couple of documents. I gave you a copy of the formal order of investigation in this matter. And it will be available for you -- for your examination during the course of this proceeding.

Mr. Hall, have you had a chance to review the formal order?

A Yes, I have.

Q Now, if you could hand me back the other document there.

(SEC Exhibit No. 1 was marked for identification.)

BY MR. WARNER:

Q Prior to going on the record, I gave you a copy of what I've now marked as Exhibit 1, which is the Commission's supplemental information form.

Mr. Hall, have you had a chance to read Exhibit No. 1?

A Yes.

Q Do you have any questions about this notice?

A No questions.

Q Mr. Hall, are you represented by counsel?

A Yes, I am.

MR. WARNER: Counsel, would you please identify yourself, along with your firm name, address, and telephone number.

MR. MacPHAIL: Mike MacPhail, Holme Roberts Owen, LLP, 1700 Lincoln Street, Suite 4100, Denver, 80201, (303) 866-0413.

MR. WARNER: Mr. MacPhail, are you representing Mr. Hall as his counsel today?

MR. MacPHAIL: Yes.

(SEC Exhibit No. 2 was marked for identification.)

BY MR. WARNER:

Q Mr. Hall, I'm handing you what we've marked as Exhibit No. 2, which is a subpoena dated June 29th, 2011. Is this a copy of the subpoena which you are appearing to pursuant here -- is this a copy of the subpoena you are appearing pursuant to here today?

A Yes, it is.

Q Let me take a moment to kind of talk through the process of our discussion today. The oath you've taken this morning is a solemn oath, just like the oath you take when you're in court. And any -- and any answer in violation of that oath carries the same consequences as it would in court. Do you understand this?

A I do.

Q Everything we say today is being taken down by the court reporter and will be returned in the form of a written transcript. To make things clear for the record, we need to follow a few guidelines. First of all, you need to respond to all of my questions verbally.

A Okay.

Q Yes. Nods or head shakes, while I'll understand them, the court reporter won't. And each of us needs to take care to do our best not to speak over each other. So, if you do your best to listen to the end of my question before you answer, I'll do my best to listen to the end of your answer before asking the next question; okay?

A Sounds good.

Q Now, when people in the future read this transcript, they're going to assume that you understood my questions when you answered them. So, I'm inviting you and asking you, please, if you don't understand any of my questions, please let me know.

A Okay.

Q Now, we, Jay and I, control the record today. And, so, we're the ones that get to say when we go on the record or off the record. Having said that, we're happy to accommodate you for breaks as needed. So, please let me know if you need to take a break at any point in the questioning.

A Very good.

Q And my one, I guess, request there is that we not take breaks while a question is pending. So, if I've asked a question and there's not an answer yet, I appreciate receiving the answer before we take a break.

A Understood.

Q Is there any reason, Mr. Hall, why you won't be able to answer my questions fully and accurately today?

A Well, specifically, I'm here to testify regarding the questions that directly involve stock loan. Now, I am willing and able to answer the questions regarding other areas of the firm and responsibilities if I have personal knowledge of those issues.

Q Okay. Well, I don't want you to speculate --

A Okay.

Q -- or guess. I want you to testify from your knowledge. And I want you to tell me if you don't have a basis for answering my questions.

A Very good. And, just to be clear, Penson has, you know, clarified for me and I would like to make sure that you understand that, you know, any questions that I'm not able to answer, the firm is more than willing to send additional witnesses as necessary until all the questions have been responded to.

Q I do appreciate that.

BY MR. SCOGGINS:

And, in our line of work, there's a lot of natural checks and balances in terms of whether or not certain functions are being performed properly. In terms of, like, borrows, for example. You got to attempt to borrow the securities. Now, what I would do is they have a list of borrows, for example, that they would go out and attempt to borrow, you know. They would take these lists and they would throw them into an automated system called LCOR. It's a Loanet order routing system for borrows.

And, so, the way that system works is you input borrows into the system and it automatically distributes them to various lenders, who will attempt to fill those orders. And, so, this list would be -- would be processed through LCOR. And, anything that LCOR is unable to fill, they will actually send back a report that we would review and store daily to ensure that all these -- these borrows were attempted.

In terms of recalls, there's overlap between our borrow processes and our recall processes. We basically divide up borrows into -- by dollar amount. So, I don't know how much detail, you know, you want me to get into at this point. But we divide our borrows by dollar amounts. Anything above $100,000 for a borrow need, a manager will actually go through, review those borrows to make sure that their recommended amount is correct. And we will actively

e-mail those out to lenders in an attempt to borrow those -- borrow those shares.

If it's less than $100,000, what we're going to do is we're going to take those and throw them into the LCOR application. So, there's overlap there between those borrows and our recall processes. So, we have borrows and recalls. So, if we need securities back, if it's under $100,000 in value, we're going to attempt to borrow it regardless of whether or not we also do a recall. So there may be some overlap there.

So, as far as the recalls go, our system would tell us, our Sendero application would tell us -- S-e-n-d-e-r-o -- would provide a list of recommended recalls. And it's very simple for our stock loan staff to -- to go into Sendero and simply press a button to submit a locate to a borrowing counterparty. And, so, they will go in daily to perform that function.

And, so, through the borrowing process, what will happen is they go in; they attempt the recall. And there's no formal process of review of the recalls; that every single recall is being done. However, this goes back to the system of checks and balances that I was talking about, where we're actually attempting to borrow, in addition to also attempting to recall the securities.

So, one way or another, we're going to cover the

requirement there, because we can elect to attempt to borrow or recall the securities as needed.

So, that's -- you know, that's essentially how we would monitor whether or not recalls and borrows are being performed on a daily basis. We also keep e-mail records. Whenever we submit a borrow request to a counterparty, we keep a recall record -- I'm sorry -- an e-mail record, that an attempt was made.

Q Okay. Now, are there these types of, I guess, structural or institutional checks and balances, effects, in place for making sure the closeouts are performed properly?

A In terms of the closeouts, you're -- strictly speaking as far as stock loan and closeouts, as far as, like, the customer short sale, that's not something that I'll be able to address. There are --

Q Explain to me the distinction that you just drew there.

A Sure. Okay. There's -- there's -- as far as Rule 204, there are short sales and there's long sales. For the short sales, the requirement for closing that out is on the morning of T+4 at the market open. Now, for long sales, which is what stock loan deals in, it's the morning of T+6.

So, when this comes to stock loan closeouts on T+6 -- and this is something I'd like to discuss -- in terms of closing out on T+6, the morning of, we -- it is rare that we

will actually do that. We are fully aware of the rule.

Whenever the rule was -- even in its temporary form when it was first adopted, we attempted to close out for CNS fails on the morning of T+6 and met significant resistance from that.

Q From whom?

A From our borrowing counterparties. Not only did we receive significant resistance to it, but we did not -- we did not see that our -- that, conversely, that our lending counterparties were buying us in on that same timeframe. So, we went away from that pretty quickly.

The response to it was so -- was severe in some cases, where you would actually have counterparties who would threaten to discontinue doing business if we closed out in that timeframe.

Q These are the borrowing counterparties?

A Yes.

Q So, what is Penson's actual practice with respect to closing out long sales?

A Long sales. There is -- it's left up to the discretion of both the stock loan associates who are performing the recalls, and also management. Our policy is to try to get these things closed out as quickly as possible.

And, also, to note one more thing. I actually spoke to the two individuals who perform our stock loan

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. D-03163-A
PENSON FINANCIAL SERVICES, INC.)

WITNESS: Lindsey Wetzig
PAGES: 1 through 174
PLACE: Securities and Exchange Commission
Ft. Worth Regional Office
Burnett Plaza
801 Cherry Street, 19th Floor
Fort Worth, Texas 76102

DATE: Thursday, August 18, 2011

The above-entitled matter came on for hearing, pursuant to notice, at 11:01 a.m.

Diversified Reporting Services, Inc.
(202) 467-9200

APPEARANCES:

On behalf of the Securities and Exchange Commission:
JONATHAN WARNER, ESQ.
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1801 California Street, Suite 1500
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(303) 844-1000

On behalf of the Witness:
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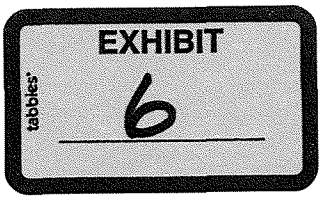

PROCEEDINGS

MR. WARNER: Let's go on the record the 11:01 a.m. Mr. Wetzig, please raise your right hand.

Whereupon,

LINDSEY WETZIG

was called as a witness and, having been duly sworn, was examined and testified as follows:

EXAMINATION

BY MR. WARNER:

Q. You can lower your hand. Thanks. Please state your full name and spell your name for the record.

A. Lindsey Alan Wetzig it's L-i-n-d-s-e-y, A-l-a-n, Wetzig, W-e-t-z-i-g.

Q. My name is John Warner. I'm an officer of the Commission for purposes of this proceeding. This is an investigation by the United States Securities and Exchange Commission in the matter of the Penson Financial Services, Inc., to determine whether there have been violations of certain provisions of the federal securities laws. However, the facts developed a this investigation might constitute violations of other federal or state civil or criminal laws.

Prior to the opening of the record, I gave you two -- two documents, Mr. Wetzig, the first is the Formal Order of Investigation in this matter. It

will be available to you for your examination during the course of this proceeding. Mr. Wetzig, have you had an opportunity to review the formal order?

A. Yes, sir.

BY MR. WARNER:

Q. I have also put in front of you what we have previously marked as Exhibit Number 1. Exhibit 1 is the Commission's Supplemental Information Form. Have you had opportunity to review Exhibit Number 1?

A. Yes, sir.

Q. Do you have any questions about this notice?

A. I do not.

Q. Mr. Wetzig, are you represented by counsel?

A. Yes.

MR. WARNER: Mr. MacPhail, would you please identify yourself along with your firm name, address and telephone number?

MR. MacPHAIL: Mike MacPhail, Holme, Roberts & Owen, LLP, 4100 Lincoln Street -- 1700 Lincoln Street, Suite 4100, Denver, Colorado 80203, (303) 866-0413.

MR. WARNER: Mr. MacPhail, are you representing Mr. Wetzig as his counsel today?

MR. MacPHAIL: Yes.

MR. WARNER: Thank you.

(SEC Exhibit Number 58 was marked for identification.)

BY MR. WARNER:

Q. Mr. Wetzig, I'm placing in front of you Exhibit 58. Do you recognize Exhibit 58?

A. Yes, sir.

Q. Is Exhibit 58 a copy of the subpoena you are appearing pursuant to here today?

A. Yes, sir.

Q. All right. I would like to take a few minutes to talk about the process we're involved with today. Would you like some water? You have some.

A. Yes, sir. Thank you.

Q. I want to note at the outset that the oath you took this morning is a solemn oath just like the oath you take if you were in court. And any answer in violation of that oath carries the same consequences as if you were in court. Do you understand that?

A. Yes, sir.

Q. Everything we say today will be taken down by the court reporter and will be returned in the form of a written transcript. To make sure that that record is clear, we need to follow a few guidelines during our conversation.

First off, I will need you to answer all

my questions verbally. The court reporter won't be able to pick up nods and shakes of the head. Do you understand that?

A. Yes, sir.

Q. And also where appropriate I appreciate it if you could do your best to answer with a yes or a no as opposed to uh-huh or, huh-uh just so it's clear for the record. Okay?

A. Yes, sir.

Q. We also need to do our best not to talk over each other. It's normal as we talk back and forth to jump in on each other's conversation, it makes it hard for the court reporter to have a clean transcript, so I will do my best to wait until the end of your answer before I come in with my question, and I ask that you do your best to wait until the end of my question before you give your answer even if it's painfully obvious where I'm going. Okay?

A. Yes, sir.

Q. Okay. When people review the transcript in the future, they are going to assume that you understood my questions, so I invite and encourage you if at any point I am -- you are unclear about what I mean to please ask for clarification and I will do my best to clarify. Okay?

A. Yes, sir.

Q. I control the record today, which means that I say when we take breaks or don't take breaks. Having said that, I'm happy to take a break as you need them. I will try to take a break every hour or so. My current thinking is to -- to go until about 11:00 -- about 12:30 and take a half hour or so for lunch and then come back and see if we can wrap things up as early in the afternoon as possible. Does that sound good?

MR. MacPHAIL: That's sounds good.

THE WITNESS: Yes, sir.

MR. WARNER: Okay with you, Mike?

BY MR. WARNER:

Q. As we go through this, if you need to take a break at any point, let me know, I'm happy to do it. I may have a few follow-up questions to get a good breaking point. My one request that is that we not leave questions pending while we're -- while we're on our break. If there is a question open, I would appreciate it if you answer the question before we go on the break. Do you understand that?

A. Yes, sir.

Q. Is there any reason why you won't be able to answer my questions fully and accurately today?

A. No, sir.

Q. Do you think on an average week in 2010 how many times per week would Marc McCain and Logan Satterwhite come to you to approve an extension request in the context of a recall for a rule 204 close out on long sales?
A. How many times per week?
Q. An average week.
A. I would say three, four times.
Q. What's the most you recall ever getting in a week? Or what would be a large but still occurring week?
A. Maybe ten.
Q. Ten is the outer limit?
A. I would say ten would be quite a few, yes, sir.
Q. Do they take these requests just to you or does Rudy De La Sierra deal with them as well?
A. If I have a -- for whatever reason I had a question about one, I would go to Rudy or Brian.
Q. You're the first line contact for --
A. Correct.
Q. -- Marc McCain and Logan Satterwhite?
A. Correct. I try to filter out as much noise for those other guys as I can.
Q. An average week of those three to four

extension requests that are brought to you, how many of those do you approve?
A. I would say one.
Q. So you only approve 25 to 30 percent -- 33 percent of the extension requests?
A. I would say that's accurate. You know, again, this is a -- we talked about. This is a relationship, you're in business. If I buy Citi in who is uncovered because their client covered their short, they're not going to be very happy with me. If I do that -- you know, happen to do that a few times, they would probably shut me off. So, you know, as much as we try to -- and our reputation on the street is, A, we recall a lot because we're cleared for day traders, and we buy in a lot. That's our reputation. We're known as, you know, we will drop the hammer, as everybody likes to say.
Q. How do you know that that's your reputation?
A. Just, you know, talking to people. You guys buy in a lot. You guys recall a lot. It's -- you know, affecting our business. Can you look at that? Is there anything you can do about it? Sorry. That's us. We recall and buy in. Our stock records swings back and forth because of all the day traders we cover for. One day we have 100,000, the next day we don't. We have to recall it.

So there is a management process that we have to go through. We have to manage that relationship. If I -- If I buy in T six at the open every day, we will be out of business. There is no question about it. We have tried to do it twice and if hasn't worked.
Q. You give me a list of reasons why you would approve an extension request, one, is the borrowing counterparties has made a credible representation that their client has already covered it?
A. Correct.
Q. Two, you see the stock records clearing up?
A. Correct.
Q. Three, you can see that they have returned some shares of the recall period and it looks like they're making a good faith effort to get it to you?
A. Correct.
Q. Any other reasons why you would approve an extension request?
A. Yes. If CNS is coming after me. Obviously, the reason I'm recalling is because I owe CNS, so somebody through CNS another broker is telling me they're going to buy me in, so if I close out on T six, and CNS is coming after me on T seven and I'm closing out these guys for 50,000 shares, CNS doesn't care. I

still haven't satisfied my delivery because that buy-in hasn't settled even if I buy in whoever it is. I can't deliver that trade if it doesn't settle for three days.
I may -- you know, there is a very good chance CNS hits me the next day. I have any coverage now because I bought in the loan, I have to take it market and risk losing, you know, a sizeable amount of money.
Q. So my --
A. Same thing for other --
Q. So you might actually get the shares back faster by allowing extensions than doing the buy in?
A. Correct.
Q. Any other reasons why you would grant the extension on the recalls in the rule 204 context?
A. People will guarantee delivery.
Q. What does that mean?
A. I will -- I will get you shares back tomorrow.
Q. And they have some credibility behind that?
A. You take them -- You take them at their word. And again, that also satisfies your delivery obligation to the them buying it in.
Q. Some people you will believe when they say that and some people you won't?
A. If they say they're, you know -- if they say

A. Very rarely.
Q. And let's just kind of quantify that in terms of the number of times per week or per month you see this happen.
A. I would say once -- you know, once a month they come back on something really close to open to try to get to us borrow it.
Q. Last exhibit.
A. Sure.
(SEC Exhibit Number 62 was marked for identification.)
BY MR. WARNER:
Q. Looking at Exhibit 62 which is Bates labeled Penson zero --
MR. WARNER: Sorry, Mike. I have one for you.
BY MR. WARNER:
Q. 00176953 through 00017696. Do you recognize Exhibit 62?
A. Yes, sir.
Q. Can you tell me the story behind Exhibit 62, what's going on here?
A. This is -- I will assume there is another e-mail here that -- initially to Heather Wright I inquired with Heather why is this -- why is this still

failing. Why are these shorts not closed out. Heather then e-mails Summer asks her about it. Summer says we have a buy in due tomorrow. And then I make a sarcastic comment at the end of the e-mail.
Q. We're as Ridge?
A. We're as bad as Ridge.
Q. What does that mean?
A. That means we need to do better a job covering fails and shorts.
Q. Was Ridge bad at that?
A. They could be more aggressive on the DVP receipts as far as hassling those guys to get their shares in.
Q. So Ridge is not as aggressive as you would like them to be in buying in DVP context?
A. Correct.
Q. Have you noticed any problems with Ridge in the 204 context?
A. I don't handle that area.
Q. Who does the Penson -- Who does the Ridge 204 list for short sales come up to for borrowing purposes?
A. Rudy borrows for the 158, 204 items.
Q. Do you ever fulfill that function for Rudy?
A. Very, very rarely. I'm -- I'm mainly 234 guy.
Q. In filling in for Rudy De La Sierra on doing

borrows for rule 204 for the penalty box, have you ever encountered scenarios like the ones that we discussed earlier -- a few minutes ago where last minute push from buy ins trying to borrow items that potentially results in missing market open buy in?
A. I haven't seen it from Ridge.
MR. WARNER: Go off the record at 4:08 p.m.
BY MR. WARNER:
Q. Back on the record at 4:13 p.m.
Mr. Wetzig, did I have any discussions with you about this inquiry while we were off the record?
A. No, sir.
Q. Mr. Wetzig, I have no further questions for you at this time. I may, however, call you again to testify in this investigation and, should this be necessary, I will contact Mr. MacPhail. Okay?
A. Yes, sir.
Q. Mr. Wetzig, do you wish to clarify anything or add anything to the statements you've made today?
A. No, sir.
MR. WARNER: Mr. MacPhail, do you wish to ask any clarifying questions?
MR. MacPHAIL: No.

MR. WARNER: We are off the record at 4:13 p.m.
(Whereupon, at 4:13 p.m., the examination was concluded.)
* * * * *

PROOFREADER'S CERTIFICATE

In the Matter of: PENSON FINANCIAL SERVICES, INC
Witness: Lindsey Wetzig
File No.: D-03163-A
Date: Thursday, August 18, 2011
Location: Ft. Worth, Texas

This is to certify that I, Susan Davis, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

_____ _____
Susan Davis Date

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
REPORTER'S CERTIFICATE

I, Carolyn H. Gayaldo, reporter, hereby certify that the foregoing transcript consisting of 173 is a complete, true, and accurate transcript of the testimony indicated, held on August 18, 2011, at the SEC, 801 Cherry Street, Floor 19, Fort Worth, Texas, in the matter of Penson Financial Services, Inc.,

I further certify that this proceeding was recorded by me, and that the foregoing transcript has been prepared under my direction.

Date: _____

_____
Official Reporter
Diversified Reporting Services

Diversified Reporting Services, Inc.
1101 Sixteenth Street, N.W.
2nd Floor
Washington, DC 20036

In the Matter of: PENSON FINANCIAL SERVICES, INC
Witness: Lindsey Wetzig
File No.: D-03163-A
Date: Thursday, August 18, 2011
Location: Ft. Worth, Texas

This is a letter to inform you that we do not release our tapes and notes. I do maintain them for a period of one (1) year.

Sincerely,

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Carolyn H. Gayaldo