BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of THE CALIFORNIA CORPORATIONS COMMISSIONER, Complainant, v. WILLIAM JOHNS & ASSOCIATES, dba WILLIAM PATRICK JOHNS, Respondent.	)	Case No. 923-2732 OAH No. L2003100190

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated November 6, 2003, is hereby adopted by the Department of Corporations ("Department") as its Decision in the above-entitled matter with the following technical and minor changes pursuant to Government Code Section 11517(c)(2)(C).

(1) In the third sentence of paragraph 2 of the Factual Findings, on page 2 of the Proposed Decision, the punctuation and word ", California" are inserted after "Tarzana" and before the period concluding the sentence.

(2) In the middle of the fifth sentence of the subparagraph numbered 11 contained within paragraph 3 of the Factual Findings, on page 6 of the Proposed Decision, the word "failed" is substituted for the word "filed."

This Decision shall become effective on February 20, 2004.

IT IS SO ORDERED February 20, 2004.

WILLIAM P. WOOD
California Corporations Commissioner

BEFORE THE DEPARTMENT OF CORPORATIONS

OF THE STATE OF CALIFORNIA

In the Matter of **THE CALIFORNIA CORPORATIONS COMMISSIONER,** **Complainant,** **v.** **WILLIAM JOHNS & ASSOCIATES, dba WILLIAM PATRICK JOHNS,** **Respondent.**	**Case No. 923-2732** **OAH No. L2003100190**

PROPOSED DECISION

This matter came on regularly for hearing on October 22, 2003, in Los Angeles, California, before H. Stuart Waxman, Administrative Law Judge, Office of Administrative Hearings, State of California.

Complainant, Demetrios A. Boutris, the Commissioner of the Department of Corporations of the State of California ("Complainant" or "Commissioner"), was represented by Michelle Lipton, Corporations Counsel.

Respondent, William Patrick Johns ("Respondent"), was present and represented himself.

Oral and documentary evidence was received. The record was closed and the matter was submitted for decision.

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FACTUAL FINDINGS

The Administrative Law Judge makes the following factual findings:

1. On October 19, 1993, the Commissioner issued to William Johns & Associates, dba William Patrick Johns ("WJA" or "Respondent") an investment adviser certificate pursuant to Corporations Code section 25230. At all relevant times, the certificate was valid and unrevoked, and it remains so today.

2. WJA is a small financial services firm that provides financial planning, tax preparation and investment advice. William Patrick Johns is the firm's owner and only employee. Mr. Johns operates the firm from his home in Tarzana.

3. At the hearing, Complainant proved the allegations contained in paragraphs 2 through 15, inclusive, of the Department's September 24, 2003 "Statement in Support of Order to Discontinue Violations Pursuant to Corporations Code Section 25249 and Commissioner's Intention to Make Order Final." Those allegations are repeated verbatim below and are incorporated herein as factual findings.

> "2. In or about January 2003, the Commissioner commenced a regulatory examination of WJA's investment adviser business. The examination revealed violations of the books and records provisions of the Corporate Securities Law of 1968 ('CSL')(Corp. Code § 25000 et seq.) and the regulations thereunder found at California Code of Regulations, title 10 (§ 260.000 et seq.).
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> "3. These violations consisted of WJA's failure to keep true, accurate and current books and records. WJA did not prepare proper monthly computations of net capital, and failed to file annual financial reports. The books and records requirements provide the Department with a regulatory mechanism to validate a firm's liquidity and financial integrity on a monthly basis to ensure that licensees maintain the necessary net capital for the protection of the public. WJA's failure to keep true, accurate and current books and records prevented the Department from determining as part of its regulatory exam, if WJA met the capital requirements imposed by the CSL and the regulations enacted thereunder.

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"4. California Corporations Code ('Corp. Code') section 25241 provides that investment advisers are required to maintain books and records that are subject to examinations by the Commissioner. Corp. Code section 25241 provides, in relevant part, as follows:

> [E]very investment adviser licensed under Section 25230 shall make and keep such accounts, correspondence, memoranda, papers, books, and other records and shall file such financial and other reports as the commissioner by rule requires, subject to the limitations of . . . Section 222 of the Investment Advisers Act of 1940 with respect to investment advisers. All records so required shall be preserved for the time specified in the rule. All records referred to in this section are subject at any time and from time to time to such reasonable periodic, special, or other examinations by the commissioner, within or without this state, as the commissioner deems necessary or appropriate in the public interest or for the protection of investors.

"5. California Code of Regulations, title 10 ('CCR'), section 260.241.3 sets forth the specific books and records required to be maintained by investment advisers. Various provisions of the CSL and the CCR were amended and became effective April 3, 2003. This action relates to acts that occurred under statutes and rules prior to the effective date of the amendments. Thus, prior to April 3, 2003, CCR section 260.241.3 (j) provided as follows:

> (j) Any investment adviser who is subject to the minimum capital requirements of Section 260.237.1 shall, in addition to the records otherwise required under this section, maintain a record of the proof of money balances of all ledger accounts in the form of trial balances and a record of the computations of net capitals and aggregate indebtedness pursuant to Section 260.237.1 of these rules (as of the trial balance date). The trial balances and computations shall be prepared currently at least once a month.

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"6. Prior to April 3, 2003, CCR section 260.237.1 set forth the capital requirements for investment advisers. Subdivision (a)(2) of CCR section 260.237.1 provided, in relevant part, as follows:

> (a) No investment adviser who has any power of attorney from any investment advisory client to execute transactions or has regular or periodic custody of any of its investment advisory clients' securities or funds, including fees for periodic publications or other investment advisory services paid six months or more in advance of the services, shall permit its total aggregate indebtedness to exceed 500% of its tangible net capital or permit its current aggregate indebtedness to exceed its current net capital; and,
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> > (2) If the investment adviser has any power of attorney from any investment advisory client to execute transactions and does not have regular or periodic custody or possession of any of its investment advisory clients' securities or funds, except the receipt of prepaid subscriptions for periodic publications, or other investment advisory services, it shall at all times have and maintain tangible net capital of not less than $5,000.00.

"Subdivision (c) of CCR section 260.237.1 provided that for purposes of CCR section 260.237.1(a), all financial information shall be determined in accordance with generally accepted accounting principles ('GAAP').

"7. WJA was subject to the capital requirements of CCR section 260.237.1. During the Department's regulatory examinations, the examiner found that WJA had power of attorney to execute transactions for clients and therefore WJA was required to maintain a tangible net capital of not less than $5,000.

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"8. Prior to April 3, 2003, CCR section 260.241.2 set forth the specific annual report required by investment advisers and when said reports needed to be audited. CCR section 260.241.2(a)(2) provided, in relevant part, as follows:

> (a) **General Rule**. Subject to the provisions of Subsection (c) of this section, . . . every licensed investment adviser subject to the provisions of section 260.237.1 of these rules, shall file an annual financial report containing the information required by a form or forms to be supplied or approved by the Commissioner, as follows:
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> > (2) The annual report for investment advisers shall contain a Statement of Financial Condition. Supporting schedules shall contain computations of net capitals, aggregate indebtedness and ratios required under section 250.237.1 (sic) and the certificate of the accountant required under subsection (e) of section 260.237 of these rules.

"9. The Department's examiner found during its (sic) regulatory exam beginning in or around January 2003, that WJA did not maintain proper books and records for its investment advisory business. WJA did not prepare a calculation of net capital and aggregate indebtedness on a monthly basis in violation of CCR section 260.241.3(j).

"10. It was also noted during the examination that WJA had power of attorney over some client accounts. Therefore prior to April 3, 2003, WJA was required to meet the capital requirements provided for under CCR section 260.237.1(a)(2) and to show proof of compliance with this regulation. As a result of WJA's violation of CCR section 260.241.3(j), the Department was unable to determine at the time of the examination, if the firm was in compliance with the net capital requirements under CCR section 260.237.1.

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"11. Finally, during this exam it was also discovered that WJA had failed to file annual financial reports in violation of CCR section 260.241.2(a)(2). Prior to April 3, 2003, pursuant to CCR section 260.241.2(a)(5), WJA was required to file this report within 60 days after the firm's year-end. WJA's year-end was December 31. The last annual report filed was as of June 26, 1995. WJA has failed to file annual financial reports for 1996, 1998, 1999 and 2000 and filed to timely file annual financial reports for 1997 and 2001. WJA did submit the annual reports for December 31, 1997 and December 31, 2001 but only in response to the Department's requests made in its 1998 and 2003 regulatory letters.

"12. On February 6, 2003, the Department sent WJA a regulatory letter notifying it of the various violations discovered during the January 22, 2003 examination conducted pursuant to CC [Corporations Code] section 25241, including violations of CCR sections 260.241.3(j) and 260.241.2(a)(2). The Department's letter also requested that WJA confirm that proper books, records and reports would be maintained in the future, and requested that WJA submit specific financial records. The Department requested that WJA provide the following: 1) Confirmation that WJA will reconcile the bank accounts, prepare monthly net capital computations and establish a liability account for unearned income; and 2) A copy of the December 31, 2001 annual financial report and confirm in the future annual financial reports will be filed timely.

"13. WJA responded to the Department's regulatory letter in a letter dated March 5, 2003. In the letter, WJA promised to prepare the required monthly net capital computations in the future and explained its reason for failing to do so. WJA falsely believed that it was not a requirement of the firm.

"14. A prior regulatory examination of WJA conducted by the Department in 1998 revealed similar books and records violations to those that were found in the 2003 exam.

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"15. As a result of the Department's 1998 examination, a regulatory letter was sent on November 10, 1998 notifying WJA of its failure to maintain true, accurate and current books and records in violation of CCR sections 260.241.3(j) and 260.241.2(a)(2). During this exam, it was revealed that WJA failed to prepare monthly net capital computations as required and failed to file its annual reports since June 26, 1995. In this 1998 letter, the Department requested that WJA confirm that its future computations of net capital and aggregate indebtedness would be prepared on a monthly basis. Also the Department requested that WJA submit a copy of its December 31, 1997, annual financial report and confirm that in the future annual financial reports would be filed timely. On November 25, 1998, in response to the Department's request in its regulatory letter, WJA submitted its financial report as of December 31, 1997 and stated that in the future WJA would compute monthly net capital computations."

4. Respondent is not, and has not been in violation of the Department's net capital requirements. The violations stem from Respondent's failure to maintain and file the required documentation. Respondent claimed that all of the necessary information was contained on his computer's hard drive or ZIP drive. Therefore, given the advances in data-based technology, it was unnecessary for him to generate the monthly net capital computations and the annual financial reports because he kept the data and was capable of generating a report at any time, essentially with the click of a mouse. The generation of net capital computations would be only slightly more complex than the generation of annual financial reports. In addition, Respondent claimed he was able to ascertain his net capital and ensure that it met the Department's minimum standards by simply looking at the balance on his bank statements.

LEGAL CONCLUSIONS

Pursuant to the foregoing Factual Findings, the Administrative Law Judge makes the following legal conclusions:

1. Cause exists to make final the Department's September 24, 2003 Order to Discontinue Violations Pursuant to Corporations Code Section 25249, for repeated failures to prepare and maintain monthly net capital computations and repeated failures to file required annual financial reports, pursuant to Corporations Code sections 25241, 25249 and 25251, and Title 10, California Code of Regulations sections 260.241.2 and 260.241.3, as such statutes and regulations applied prior to April 3, 2003, as set forth in Findings 3 (subparagraphs 2 through 15, inclusive) and 4.

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2. Cause exists to levy administrative penalties against Respondent for repeated failures to prepare and maintain monthly net capital computations and repeated failures to file required annual financial reports, pursuant to Corporations Code section 25241 and 25252, and Title 10, California Code of Regulations section 260.241.2 and 260.2412.3, as such statutes and regulations applied prior to April 3, 2003, as set forth in Findings 3 (subparagraphs 2 through 15, inclusive) and 4.

The storage of data on a computer's hard drive or ZIP drive is insufficient to satisfy the statutory and regulatory requisites for net capital computation and filing of annual reports. Respondent recognizes he is subject to those requisites but has deliberately failed to comply with them, except when specifically ordered to do so in regulatory letters issued by the Department, because he considers the Department's auditing standards "antiquated," and the Department "mired in a paper world of 20 years ago" (his terms).

A licensee is not at liberty to disregard the Department's statutory and regulatory requirements simply because he/she disagrees with them or believes he/she has a more efficient manner of maintaining the necessary data. Respondent, in disregarding those requirements, catered to the efficiency of his own business. The Department's obligations, however, go beyond the conveniences of its individual licensees. The Department is charged with the protection of the public. It accomplishes that task, in part, by requiring licensees which meet certain requisites, to perform monthly net capital computations and to file annual financial reports. Those documents may serve to ensure compliance with minimum financial requirements mandated by the Legislature as a means of public protection through licensees' liquidity and financial integrity.

Complainant is claiming three violations: Respondent's failure to prepare monthly net capital computations, Respondent's failure to file annual financial reports for 1996, 1998, 1999 and 2000, and Respondent's failure to timely file annual financial reports for 1997 and 2001. Pursuant to Corporations Code section 25252(b), Respondent is subject to penalties of not more than $5000.00 for the first violation, not more than $10,000.00 for the second violation, and not more than $15,000.00 for the third violation. Complainant does not seek the maximum penalties, but rather seeks an administrative penalty of $750.00 for each of the three violations, or a total of $2,250.00.

Respondent argues that he is not subject to penalties under Corporations Code section 25252 because he did not "willfully" violate any statute, rule or order. Respondent is incorrect on two grounds. First, despite notices from the Department in 1998 and in 2003, Respondent knowingly failed to perform monthly net capital computations, and either failed to file or failed to timely file annual financial reports.

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Alternatively, the term "willfully" has been defined as follows:

> "The word "willfully," when applied to the intent with which an act is done or omitted, implies simply a purpose or willingness to commit the act, or make the omission referred to. It does not require any intent to violate law, or to injure another, or to acquire any advantage."
> Penal Code section 7(1).[1]

Respondent's conduct with respect to his failure to perform monthly net capital computations, and his failure to file or to timely file annual financial reports, meets the definition of "willfully" as referenced in Penal Code §7.

In light of the circumstances of this case, Complainant's request for administrative penalties totaling $2,250.00 is deemed just and reasonable.

ORDER

WHEREFORE THE FOLLOWING ORDER is hereby made:

1. The Department's September 24, 2003 Order to Discontinue Violations Pursuant to Corporations Code Section 25249 is final.

2. Within 90 days from the effective date of this decision, Respondent shall pay to the Department administrative penalties totaling $2,250.00.

DATED: November 6, 2003

H. STUART WAXMAN
Administrative Law Judge
Office of Administrative Hearings

[1] Brown v. State Department of Health (1978) 86 Cal.App.3d 548, 554 permits the use of Penal Code section 7 to define terms in other codes.