

REPORT TO THE  
UTAH LEGISLATURE

Number 2008-07

**A Performance Audit  
of the  
Division of Securities**

July 2008

Audit Performed By:

|                  |                 |
|------------------|-----------------|
| Audit Manager    | Tim Osterstock  |
| Audit Supervisor | Susan Verhoef   |
| Audit Staff      | David Pulsipher |

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# Digest of A Performance Audit of The Division of Securities

The credibility of the Division of Securities has been challenged by those investigated by the division. Their concerns are with procedural errors, an alleged overzealous pursuit of securities violations, and the perception that those investigated do not receive fair treatment. These concerns have recently been heightened by personnel conflicts within the organization.

These concerns appear to be a result of the division not following established policies and procedures. Case management is inconsistent and, at times, appears inappropriate. While the division protects securities investors, it is alleged the division has abused its power and damaged reputations. The division has significant authority but its credibility depends on using that authority judiciously.

## Chapter I: Introduction

### **Division Mission Is to Protect Investors and Promote Business.**

The division's mission is to "enhance Utah's business climate by protecting Utah's investors through education, enforcement, and fair regulation of Utah's investment industry while creating opportunities for capital formation." To accomplish its mission, the division is divided into three sections—corporate finance, licensing, and enforcement.

### **Cases Presented to Legislators Cited Concerns With Division Actions.**

We reviewed the division's administrative process followed for three specific cases and a number of others brought to our attention. Two of the three cases involved administrative licensing actions and one involved a business owner who allegedly conducted securities transactions without being licensed. Each believes the division acted inappropriately.

## Chapter II: Poor Management Decisions Have Harmed the Division's Credibility

**Division Lacks Guiding Policies and Procedures.** Frequent management changes have brought changes in management philosophy and an increased likelihood for inconsistent decisions. The division needs clear policies defining the role of the various participants involved in enforcing securities laws. The roles of the division director and presiding officer need a clear separation between investigative and adjudicative functions. Policies and procedures must either require the director to not be involved in cases or the presiding officer's responsibilities should be placed outside

of the division. Policies are also needed to address the role of the attorney general and the role of the advisory board.

Additionally, the division needs to establish enforcement procedures that give clear guidance on how cases should be managed. The division was criticized after inappropriately publicizing administrative actions, not informing a business they were being investigated, and continuing to pursue actions for cases handled in district court. Individuals associated with cases the division investigated complained the division used intimidation to coerce cooperation and violated settlement agreements. Policies and procedures should address these concerns, as well as provide guidance for when it is appropriate to use an administrative subpoena, or to file an administrative action for a case referred for criminal action.

1. We recommend that the Department of Commerce clarify policies to clearly define the roles of the division director and presiding officer.
2. We recommend that the Department of Commerce develop baseline policies and procedures outlining its interaction with the Attorney General's office.
3. We recommend that the Department of Commerce continue working with the Legislature on changing the board to a commission with additional responsibilities.
4. We recommend that the Legislature consider changing the advisory board to a commission to provide division oversight.
5. We recommend that the Division of Securities establish written policies and procedures to guide case management.

**Chapter III:  
Inadequate  
Guidance Has  
Created Internal  
Conflicts**

**Personnel Conflicts Have Been an Ongoing Problem.** Conflicts within the division have resulted in reprimands, organizational restructuring, the resignation of the former division director, and the threat of legal action by several employees. If not resolved, conflicts resulting from the lack of policies and procedures, frequent management changes, poor communication, and conflicting personalities may limit the division's ability to accomplish its mission of protecting the public.

1. We recommend that the Division of Securities examine methods for improving communication with the division and with the department.
2. We recommend that the Department of Commerce evaluate its open door policy offering conflict resolution and assuring confidentiality.

# Chapter I

## Introduction

The credibility of the Division of Securities (division) within the Department of Commerce has been challenged by those investigated by the division. Their primary concerns are with procedural errors, an alleged overzealous pursuit of securities violations, and the perception that those investigated do not receive fair treatment. These concerns have recently been heightened by personnel conflicts within the organization.

These concerns appear to be a result of the division not following established policies and procedures. Case management is inconsistent and, at times, appears inappropriate. While the division protects securities investors, it is alleged the division has abused its power and damaged reputations. The division has significant authority, but its credibility depends on using that authority judiciously.

### Division Mission Is to Protect Investors And Promote Business

The Division of Securities' mission is to "enhance Utah's business climate by protecting Utah's investors through education, enforcement, and fair regulation of Utah's investment industry while creating opportunities for capital formation." Specifically, the division is responsible to:

- license broker-dealers, broker-dealer agents, investment advisors, federal covered advisors, investment adviser representatives, certified dealers, certified dealer agents, and issuer agents.
- register securities offerings qualified to be sold in Utah and review the adequacy of disclosures to potential investors.
- investigate securities violations and initiate administrative actions to deny, revoke, or suspend licenses or registration to stop unlawful activities.

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**The division's mission is to protect investors through education, enforcement, and fair regulation of the industry.**

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**The division is divided into three sections – corporate finance, licensing, and enforcement.**

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- bring civil injunctive actions and refer investigations to state or local prosecutors for criminal prosecution.
- educate securities firms and Utah lawyers about new developments in securities regulation, promote financial literacy and investment knowledge among secondary school students, and educate the public about the types of investment frauds being promoted in Utah.

The division director is appointed by the executive director of the Department of Commerce with the Governor’s approval. The division has 22 full-time positions that include: attorneys, certified law enforcement officers, business professionals, and accountants—most with securities industry experience. It is divided into three sections—corporate finance, licensing, and enforcement.

The corporate finance section promotes legitimate capital markets by registering securities offerings that are qualified to be sold in this state and by reviewing the adequacy of disclosures to potential investors. Division staff also meet with companies seeking to raise capital to explain their options and improve the quality of disclosure to potential investors.

The licensing section licenses and regulates those in the securities industry that sell securities, offer advice about securities, or manage the investments of others. This section conducts compliance examinations and investigates complaints of possible misconduct of licensed securities professionals. The licensing section conducts disciplinary proceedings when misconduct is found.

The enforcement section primarily investigates complaints about investment offerings from unlicensed individuals or businesses. The division becomes aware of possible fraud as a result of investor complaints, referrals from other government and consumer agencies, and the division’s own investigations. For allegations that prove valid, the division is statutorily authorized to investigate possible securities violations and, when deemed necessary, to bring enforcement action(s) against those suspected of securities violations.

Actions can be brought administratively by the division, which may include cease-and-desist orders or disciplinary licensing actions. The division can also seek civil court-imposed injunctions and restitution.

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**The division can bring civil or administrative actions against those suspected of securities violation.**

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Criminal cases are referred for prosecution to either the Utah Attorney General Financial Crimes Section (AG) or to the district or county attorney where the alleged crime occurred. Criminal cases also generally include an administrative action. The division determines at what point a criminal case is referred and the AG or local attorney decides what charges to file.

Figure 1.1 summarizes the activities of the division over the past five years according to the division's information system.

**Figure 1.1 Enforcement, Licensing & Securities Filings.** Division reports show over the past five years, the number of complaints and cases investigated steadily dropped until fiscal year 2007. The number of licenses processed and securities filings have steadily increased.

|                        | FY03   | FY04   | FY05   | FY06   | FY07    |
|------------------------|--------|--------|--------|--------|---------|
| Enforcement Complaints | 175    | 171    | 98     | 85     | 115     |
| - Cases Opened         | 104    | 87     | 70     | 61     | 77      |
| - Cases Closed         | 123    | 86     | 66     | 47     | 75      |
| Administrative Actions | 118    | 70     | 55     | 87     | 108     |
| Civil Actions          | 0      | 0      | 1      | 7      | 2       |
| Criminal Actions       | 46     | 54     | 35     | 19     | 24      |
| Audits                 | 41     | 50     | 36     | 54     | 23      |
| Licenses Processed     | 81,297 | 82,703 | 89,659 | 96,478 | 104,319 |
| Securities Filings     | 4,812  | 4,732  | 5,102  | 5,496  | 6,111   |

**Division reports show an increase in the number of licenses processed each year.**

The information in Figure 1.1 is from division reports. There does not appear to be a consistent relationship between the number of complaints, number of cases opened, and the number of actions filed. This is because cases can be opened without a resulting action, there can be multiple actions on one case, or the action may not be filed until the following year. In addition, our evaluation leads us to believe the information is not reliable. Concerns that the division does not have any guiding policy to ensure consistency of records is discussed in Chapter II.

One reason there may not be a relationship between the number of complaints and cases is because any given complaint can be complex and

result in more than one disciplinary action. For example, a recent investigation with the U.S. Securities and Exchange Commission (SEC) and several other states resulted in charges against an individual that involved 150 companies and 800 investors with estimated losses of \$180 million.

The division can impose fines and gain restitution for the victims of securities fraud. According to division reports, Figure 1.2 identifies the fines paid and restitution ordered for division cases over the last five years.

**Figure 1.2 Fines & Restitution.** According to division reports, over the past five years, fines paid and restitution ordered fluctuated from one year to the next.

|                     | FY03       | FY04         | FY05       | FY06       | FY07       |
|---------------------|------------|--------------|------------|------------|------------|
| Fines Paid*         | \$ 782,341 | \$ 3,535,142 | \$ 880,333 | \$ 450,393 | \$ 690,066 |
| Restitution Ordered | 5,191,923  | 28,167,307   | 63,649,804 | 2,480,666  | 25,026,659 |

\* Fines paid in fiscal year 2004 were high because defendants in a large national case were ordered to pay a fine to all involved states. Restitution ordered in fiscal year 2005 was high because of the division's involvement in a regulatory action where a large company agreed to pay back Utah citizens for their losses.

The values in Figure 1.2 vary from year to year based on the amount of fines collected and the degree of the infraction for a specific case. There is no relationship between fines paid and restitution ordered. The amount of restitution actually paid is not tracked by the division. Concerns about following up on settlement agreements is discussed in Chapter II.

### **Cases Presented to Legislators Cited Concerns with Division Actions**

Legislators requested this audit based on concerns about how the division managed three cases. We reviewed the division's administrative process followed in these cases and a number of others brought to our attention. We did not address the legal issues of any of the cases. Our work has been complicated by the desire of many interviewees to keep their names confidential. They fear reprisal for criticizing the division's actions.



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**The division potentially damaged the reputation of a business by publicizing an action before the business had an opportunity to respond.**

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As for the initial three cases, two involve administrative licensing actions. The third case involves a business owner who allegedly conducted securities transactions without being licensed as a broker-dealer or agent. In each case, the complainants believed that the division acted inappropriately. The following is an overview of these three cases.

### **Case One**

The division accused a business and four current or former brokers of generating excessive commissions by making inappropriate investments for nine of their clients. The case originated after an investigation was completed by the SEC. The SEC did not have a negative finding, but referred the case to the division and provided them with information collected in the investigation.

The division completed its own investigation without notifying the business until after an enforcement action had been initiated. A media alert released by the division stated that four broker-dealers were charged with securities fraud because clients' money was put into funds with higher commissions and fees, without disclosing the relative costs to investors. The division publicized its petition, proposing to revoke the broker-dealers' securities licenses and bar them from the securities industry, before the allegations had been substantiated. Two weeks after announcing its charges, the division dropped its fraud allegations and issued a press release expressing regret for any potential harm to the broker-dealers' reputations caused by publicizing the information.

Individual defendants settled the case by agreeing to refund client fees in lieu of paying a fine. However, an administrative sanction against the business for failure to maintain accurate books and records, and for failure to supervise the activities of the four broker-dealers was not settled at that time. During the course of our audit, the charges were dismissed by the Administrative Law Judge (ALJ) and accepted by the division. The ALJ ruled the division could not seek to suspend or revoke the firm's license because the division did not bring the action within 120 days of renewing the firm's license. The ruling addressed when the 120 days should commence, but did not consider the merits of the case or if sanctions were actually warranted.

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**The division continued to pursue allegations that a supervisor did not provide adequate supervision after an adverse district court ruling.**

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## **Case Two**

Fraud charges were filed against a broker-dealer agent. A district court upheld the charges against the agent, but dismissed charges against the supervisor. Two investors then filed a civil lawsuit which was settled and which also excluded the supervisor. The division then audited the supervisor and filed a civil action which included allegations that the supervisor had violated anti-fraud provisions for failing to detect a number of red flags concerning the agents behavior. The district court also dismissed these charges against the supervisor ruling that inadequate supervision did not constitute fraud. The division then pursued an administrative action proposing to revoke the securities licenses of the firm and supervisor and to impose a fine because of the alleged inadequate supervision. The supervisor responded by filing a lawsuit against the division challenging that the division should be barred from litigation arising from the same transactions. His challenge succeeded and the court issued an injunction prohibiting the division's administrative action from proceeding. The court ruled the allegations were the subject of a former finalized proceeding that was dismissed and therefore, barred from re-litigation. The division is currently appealing that decision to avoid establishing a precedent that district courts may rule on administrative cases before administrative remedies have been exhausted.

The division acknowledged problems with this case are largely its fault because it should not have filed a lawsuit saying that "failing to supervise" is a criminal violation of the law. According to the former director, failing to supervise, and other conduct listed in *Utah Code* 61-1-6, provides grounds to discipline a licensee, but that does not mean that the conduct is illegal.

## **Case Three**

The third case involves an on-going enforcement investigation of a number of affiliated businesses. The division is currently investigating if these businesses have violated securities law by selling unsecured promissory notes to investors. None of those being investigated have a securities license. It is alleged that investors were falsely told the funds would be invested in real estate. The division also alleges the investments represent a Ponzi scheme because new investor money is used to pay earlier investors and is a pyramid scheme because earlier investors were given financial bonuses to recruit other investors.

We limited our review of this case because of the division's active investigation. During the course of this audit, one of those being investigated entered a no contest plea to two second degree felony charges for securities fraud involving \$11 million and 140 investors. The unlicensed individual solicited investor money from 2005 to 2007. Investors were told that their money would be used to fund real estate loans, but the businessman acknowledged he did not purchase any real estate with the investments.

## **Audit Scope and Objectives**

This audit was requested by two State Representatives prior to the 2008 Legislative Session. Originally approved by the chairs of the Legislative Audit Subcommittee as a special project, staff was directed to review concerns about the Division of Securities and return with a short report or a determination of a need for further work based on three cases presented to the legislators. The original request called for evaluations of:

- the impartiality of the director serving as the presiding officer,
- the fairness of the decision process used to pursue cases, and
- whether conflicts within the division have impaired investigations involving security violations.

As a result of our preliminary review, it was determined that greater depth was needed. The Legislative Audit Subcommittee agreed and approved a full audit of the division. As a result, the audit goes beyond the original request and evaluates the administrative processes of the division. In total, the audit reviewed over 20 division cases in varying depth. These cases were referred by those the division investigated, division staff, and state attorneys. The audit does not attempt to address specific legal issues.

Chapter II of this report discusses concerns with the division's process based on the three cases and others brought to our attention during the course of the audit. Chapter III examines division management and staff conflicts resulting from inadequate guidance.

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## **Chapter II**

### **Poor Management Decisions Have Harmed the Division’s Credibility**

The Department of Commerce’s Division of Securities (division) has been criticized for its handling of a number of licensing and enforcement cases, as well as its treatment of select employees. A large part of the problems faced by the division appear to be caused by management and staff disagreeing about procedures. Unfortunately, these disagreements could not be effectively resolved because the division does not have clear and consistent written policies and procedures.

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**The administrative action steps the division believes should be taken and those actually taken do not always match.**

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To address what steps are appropriate in the division’s administrative action process, we interviewed the division’s former director and other staff to outline its procedures. The results provided in Appendix A are the procedures the staff agrees should be followed. Unfortunately, the steps the division believes should be taken and those actually taken do not always match. Rather, division procedures may vary from case to case and are not consistently applied.

#### **Division Lacks Guiding Policies and Procedures**

The division has not been operating under set, written policies and procedures. As a result, division decisions for actions against the regulated industry and the treatment of its employees rest solely with department and division management. Frequent management changes have brought changes in management philosophy and an increased likelihood for inconsistent decisions.

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**The division has not followed written operational policies and procedures for at least four years.**

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The department director pointed out the division is governed by department and state policies, procedures and administrative rules, the Administrative Procedures Act, as well as securities-specific statutes and rules. However, we feel more detailed guidance is needed. During the course of this audit, we were told that the division did have policies and procedures a number of years ago. However, there have been no written policies and procedures in place, or operational procedures followed, for at least the last four years under the direction of three division directors.

Shortly before this audit's completion, division staff found a discarded copy of a 1993 policies and procedures manual. It is disconcerting that the division has faced procedural control difficulties for a number of years, yet no one in either departmental or divisional leadership noted the lack of policies and procedures. In our opinion, had this discarded manual been updated and followed, many of the division's problems could have been avoided.

### **Division Policies Should Clearly Define Roles**

The division has not identified the role of the various participants involved in enforcing securities laws. There has been little, if any, documentation defining the roles of the division director, the presiding officer, the attorney general's staff, sectional staff leadership, and sectional staff. Direction is also needed for advisory board members duties, responsibilities, and limitations. In our opinion, conflicts have surfaced because division roles are not clearly defined.

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**The role of the division director and presiding officer needs to be clearly defined.**

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**A Primary Concern Is the Clarification of the Roles of the Division Director and Presiding Officer.** There has been significant concerns about the former director's involvement in case administration and determination. Complaints surfaced that those charged with securities violations could not get a fair hearing. These claims are the result of the former director taking an active role in case management, while at the same time serving as the case's presiding officer.

A presiding officer is empowered to make decisions and conduct adjudicative proceedings on a given case. There are concerns the former director could not be impartial as the presiding officer because he took an active role in developing the division's cases. In several cases, it was questionable if the former director had maintained an independent and unbiased perspective. For example, the former director did not recuse himself from serving as the presiding officer after helping to draft the pleadings for the case. It was apparent he was no longer impartial. Even the perception that the presiding officer is biased is concerning as it can give the appearance of unfair treatment. The responsibilities and limitations of the presiding officer need to be clearly defined.

Those accused of securities violations told us they felt intimidated into settling, given that the division's former director would likely serve as the

presiding officer. One business owner perceived the system as “a stacked deck” because the investigator, jury, and judge are all in the same office. He informed us that during an investigation, a division employee boasted that the division always wins. Concerns about a conflict regarding the former director serving as the presiding officer have been specific to the most recent former director. Prior directors emphasized the importance of remaining objective by carefully avoiding involvement in cases.

The former director contends there are different responsibilities for a presiding officer and a hearing officer. The director can serve as the presiding officer to handle several administrative functions without concerns about bias and then a different person can be assigned as the hearing officer. He stated that as a practical matter, the objectivity of the presiding officer has not been a concern because there has only been one hearing in the past seven years. That hearing was held in 2001 before an ALJ, not the director serving as the presiding officer.

However, we feel there is still a concern because the former director served as the hearing officer for several cases. They were not hearings held to rule on the merits of the case, but there was an impact. For example, we listened to a taped hearing requesting a stay where the former director, as the hearing officer, denied the motion. In our opinion, the former director did not appear to be impartial for this particular case. The former director clearly knew everything about the case and never asked the attorney representing the division for any information.

After the concerns surfaced, the department director began clarifying the role of the division director as the presiding officer. She instructed the former director to “separate yourself from investigative and examination functions” and to maintain a proper role within the adjudicative process. She ordered that “you may not involve yourself in the planning and decision-making on examinations and investigations: prior to the conclusion of a division administrative proceeding; prior to a decision not to pursue an adverse licensing or enforcement action, or unless you have recused yourself completely from any adjudicative role in the matter.”

After receiving these instructions, staff from the enforcement section said the former director complied and became less involved in cases. The former director also assigned a subordinate, the Corporate Finance Supervisor, to serve as presiding officer for the licensing section’s

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**The director must remain separate from investigations to maintain a proper role in the adjudicative process.**

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administrative cases. However, concerns remain about the impartiality of the supervisor because the position is subordinate to the director.

Assigning a subordinate or someone else to serve as the presiding officer does not address the impartiality problem because the director can reject the decision. Regardless of the hearing officer's decision, the division director is required to accept or reject the orders of the hearing officer. The director is empowered to determine the outcome of cases, even if the presiding/hearing officer's responsibilities are assigned to someone else.

The perception that those investigated will not receive fair treatment is a serious concern that we feel should be addressed. After the former director's resignation, the acting director designated a lead examiner so that he would not be involved in cases. The division needs to take steps to assure the separation between its investigative and adjudicative function is not compromised. Written policies and procedures should require the director either to not be involved in cases or the presiding officer's responsibilities should be placed outside of the division.

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**There have been conflicts involving the Attorney General's role in division actions.**

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**There Is Some Confusion as to the Attorney General's Role in Division Actions.** It is also important to establish a policy identifying the role of the attorney general in relation to the division. The Attorney General (AG) is involved in securities cases in two ways. First, criminal cases must be referred to either the AG or district or county attorney for prosecution. At that point, all decisions about a case becomes that of the attorney. Second, staff from the AG's office are assigned to represent the division. Securities law states "The attorney general shall advise and represent the division and its staff in all matters, administrative or judicial, requiring legal counsel or services in the exercise or defense of the division's power or the performance of its duties" (*Utah Code* 61-1-21.5).

There have been conflicts with both how the former director utilized the attorneys representing the division and the level of authority the attorneys should have in defining division activities. In some cases, it appears the former director assumed the role of the attorney.

As an example, poor communication between the former director and an attorney resulted in the exclusion of the attorney from a decision on how a case would be handled, even though the attorney had been involved in the case for a number of months. The attorney was frustrated and



raised concerns when the former director drafted and sent out documents over the attorney's name, thus implying the AG gave his approval, even though the attorney was not aware a decision had been made and had not reviewed the final document. He learned about the legal action when defendants contacted him because they assumed he represented the division. The former director contends that the attorney was familiar with the document.

Conversely, the department and division believe that some attorney actions step beyond their role and into that of division management. Blurring the division and Attorney General's responsibilities may be attributed, in part, to the former director's previous employment with the Attorney General's office. While in that office, the former director was legal counsel for the division.

In our opinion, establishing policies clarifying the role of the attorney general in relation to the division and written procedures identifying what is expected of each other will promote consistency and improve relationships.

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**Potential conflicts exist by having a board member who represents clients involved in litigation with the division.**

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**Clarification Is Needed in the Definition of the Advisory Board's Role.** A five-member advisory board appointed by the Governor with the consent of the Senate "acts in an advisory capacity to the director with respect to the exercise of his duties, powers, and responsibilities" (*Utah Code* 61-1-18.5(1)(iv)). Some disciplinary actions and fines must be approved by a majority of the board.

Securities laws require that the board be comprised of two members from the securities brokerage community, one member from the securities section of the Utah Bar Association, one member who is an officer or director of a corporation not subject to the reporting requirements of the SEC, and one member from the public at large who has no active participation in the securities business.

A potential role conflict exists because a board member, who is an attorney, represents clients involved in litigation with the division. This board member brings valuable knowledge and expertise to the board. He also recuses whenever there is a conflict of interest which he acknowledges can be as much as a third of the cases. Nevertheless, allegations that cases have received either preferential or discriminatory treatment have surfaced because of the attorney's relationship with division employees.

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**Changing the advisory board to a more responsible commission may improve oversight and reduce perceived biases.**

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For example, we were told the former director instructed staff that the board member's clients should be treated differently. We did not find any evidence that his clients were treated differently, but even the perception of unfair treatment challenges the credibility of the division. In our opinion, a board member should not be involved in litigating cases involving the division. Appointing an attorney board member only involved in corporate securities instead of litigation could resolve the potential conflicts.

The Legislature may also want to consider changing the advisory board to a commission that has more responsibilities for division oversight. This could resolve some of the concerns involving the director serving as the presiding officer. Although the department director believes a commission similar to that of the Division of Real Estate within the Department of Commerce may be suitable, the division's former director stated it would not be appropriate because of the more adversarial relationships involving securities regulation.

The commission for the Division of Real Estate consists of five commissioners who are appointed by the Governor and approved by the Senate. The commissioners meet monthly and their duties are to:

1. Create administrative rules for the division.
2. Coordinate with the division to establish fees.
3. Conduct administrative hearings.
4. Coordinate with the division director to impose sanctions.
5. Advise the director regarding the division budget.

The Department of Commerce is currently working with the Legislature to change the advisory board to a similar type of commission. The department must evaluate what changes are appropriate to improve oversight for the division and reduce the perceived bias of the director serving as the presiding officer.

## **Division Needs Clear Enforcement Procedures**

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**Clear enforcement policies and procedures are needed to guide the process and promote consistency.**

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The division needs to establish enforcement procedures that give clear guidance on how cases should be managed. The division has been criticized for how they have handled several cases and the division's former director has acknowledged that there have been procedural problems. He attributed the problems to one overzealous employee who showed bad judgement on how the cases were prosecuted and settled. However, our review shows procedural problems are more widespread.

During the audit, many individuals associated with various cases contacted us with complaints about the division. Our review of case files resulted in a number of questionable actions including: inappropriate publicity, emphasis on punishment rather than compliance, the use of intimidation tactics, violating terms of settlement agreements, failure to notify those being investigated, and inconsistent case management.

To evaluate these complaints, we reviewed case files, listened to tapes of hearings, and interviewed staff and attorneys involved with the cases. Many of those who talked with us requested confidentiality because they feared retaliatory action by the division if they were identified.

Some concerns with the division's enforcement process appear valid. These questionable actions often can be attributed to the division's lack of clearly defined procedures. A discarded policy manual states that "the manual will be reviewed and updated on a yearly basis to reflect current or additional practices." Not complying with this requirement has resulted in division policies and procedures that are inconsistently applied. Before resigning, the former director agreed that establishing policies and procedures would promote consistency of enforcement actions. Prior to his resignation, he began drafting those policies and procedures he felt were most important.

### **Division Actions Were Publicized Inappropriately**

The division has publicized administrative actions without giving the individuals being investigated an opportunity to defend themselves. The former director began issuing multiple press releases for developing cases and publishing a quarterly newsletter shortly after he was hired.

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**Administrative actions were publicized before those being investigated had an opportunity to defend themselves.**

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However, he did not establish procedures to guide the process. While the division is statutorily authorized to publish information concerning any securities violations (*Utah Code* 61-1-19(1)(c)), those investigated objected to publicizing cases before they had an opportunity to defend themselves against the allegations. An untarnished reputation is essential for securities businesses to be trusted by investors. Some believe the publicity is helpful to investors and others believe it is intended to “shame” those being investigated.

In Case One, from Chapter I of this report, the division’s failure to comply with an agreement to not publicize the actions may damage the reputation of the business. The division expressed regret for any harm caused by the initial press release, but an internet search shows the Department of Commerce continues to display the accusatory press release on its web-page. The press release recanting the information is listed only on the division’s press release page. The department’s web-page excludes the second press release, which gives the impression that the business committed fraud. We question why the department has not corrected its web page.

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**The division should establish policies and procedures for publicizing administrative actions.**

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**The Division Needs to Establish Procedures For Publicizing Disciplinary Actions.** We feel conflicts about publicizing developing cases resulted because there were no procedures guiding the process. The former director decided to increase public awareness by publicizing division actions more extensively, without establishing any controlling guidelines or procedures.

Some staff disagreed with the former director’s decision to publicize all actions in press releases and a newly established quarterly newsletter. The former director said that the publicity was intended to both inform the public about concerns and to serve as a deterrent for inappropriate actions by brokers-dealers and agents. Investors and those in the securities industry appreciate the published information because it may be the only record available to identify the subjects of the division’s administrative actions. Nevertheless, we feel the unintended consequences of the publicity was not carefully considered before the new procedures were implemented. Publicizing licensing actions pending final disposition can unfairly damage the reputation of individuals and businesses before they have had an opportunity to defend themselves against the allegations.

After the division was criticized that by publicizing administrative

actions, the division damaged the reputation of the business in Case One, the former director established the following policy:

When disciplinary actions are brought against licensees, no news releases will be issued by the division (on the web site or distributed to media) until there is a settlement or a final result after a hearing.

The former director indicated it is still appropriate to publicize administrative actions against unlicensed individuals and that it is a public record that an action has been taken. Therefore, the division will continue listing pleadings on the division web site. However, the division will not issue a press release about the filing of the action until its conclusion. We do not feel it protects the public to list all actions before they are finalized unless there is a clear risk to the public. The division should evaluate what is appropriate and then issue clear procedures for publicizing administrative actions.

### **Division Sometimes Emphasizes Punishment Rather Than Compliance**

The division appears to emphasize punishment of offenders rather than compliance with securities laws. A number of those involved in the division's actions believe the division has overzealously pursued securities violations. They criticize that charges are brought one after another, cases are drawn out over long periods of time, and decisions on who to investigate can be arbitrary.

Continuing to pursue administrative actions for cases referred to district courts can appear punitive. Division procedures have evolved in that it currently files administrative actions for most every case, including those that are referred for criminal violations. Additionally, in at least three of the twenty cases we reviewed, the division issued the same charges in an administrative action that had been dismissed or resolved in a civil and/or criminal hearing in district court. For example, for Case Two cited in Chapter I, the division pursued administrative actions for charges a district court had dismissed. The district court at various times dismissed the criminal, civil, and administrative actions against the supervisor. The division is now appealing the decision involving the administrative action.

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**Pursuing administrative action for cases dismissed in district court appears to emphasize punishment rather than compliance with securities laws.**

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In another case that began before the current department executive director's appointment, the process was drawn out when the Administrative Law Judge (ALJ) did not return a decision for over three years. Such a delay was a problem because the defendant's legal fees continued but he had difficulty working in the securities industry until the case was resolved. In this particular case, the defendant filed a petition in district court requesting the court dismiss the matter because no decision had been rendered in the administrative proceeding. After the court dismissed the case, the division appealed and the order for the dismissal was vacated. The ALJ was required to issue a ruling within a week, that ruling found in favor of the division. Almost five years after the hearing, the respondent claims he no longer had the funds to defend himself and could no longer continue to contest the case. Proposed administrative rules are addressing concerns involving the prompt resolution of adjudicative proceedings.

In these cases, the defendants believe that the division was relentless in continuing to pursue their cases. Successful defense in one venue can result in having to face charges in a second or third venue. We feel policies are needed to guide decisions on when an administrative action should be filed for a case that has been referred for criminal action and to prevent delays.

The division should also outline the decision process it uses to initiate investigations. Some of those investigated by the division have expressed concerns that the division's decisions on who to investigate is arbitrary and could be punitive. For example, business owners in Case One, felt they were investigated for violating disclosure requirements for certain types of products when others were not. Procedures for handling complaints and initiating investigations could protect the division from concerns that they are unfairly targeting individuals.

### **Some Division Tactics May Be Considered Intimidating**

The division's use of intimidation to obtain information has been cited by both those being investigated and others involved with the division. In one case, the accused stated that an investigator attempted to coerce cooperation by intimidating and threatening that the person would be arrested. In another case, investigators seized personal information by copying all information from the business owner's computer without

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**The division should outline the decision process used to initiate investigations.**

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distinguishing business and personal information. The owner said that he complied with the investigator's demands only because they threatened to immediately close him down if he refused.

The division is not required to have a subpoena to obtain information from licensed businesses but is expected to only take information related to the audit or complaint against the business. We believe that a policy limiting the information allowed to be taken by the division is appropriate and that, when possible, businesses should be given the opportunity to provide requested information. Unless it is reasonably expected that information will be concealed, investigators and auditors should not seize information that does not directly relate to their case.

In addition, the division should establish procedures for issuing administrative subpoenas. Administrative subpoenas are investigative tools used to obtain documents in the course of an investigation. There has been some disagreement about the use of administrative subpoenas when a case involves possible criminal charges because only a court can issue a subpoena in a criminal case. In these cases, the authority to use administrative subpoenas could be abused.

According to the former director, administrative subpoenas should not be issued if (a) a case has been referred to a prosecutor for criminal prosecution, or (b) a decision has been made to refer a case for criminal prosecution. Earlier instructions on the use of administrative subpoenas stated they should only be used "when there is almost no chance the case will be referred for criminal prosecution or when the decision has been made to bring an administrative case (and finish it) before making a criminal referral." Because of the legal issues involved, we feel the division should have written policies identifying at what point the division may no longer use administrative subpoena's to obtain information. Further, if staff question the appropriateness on a specific case, they should be encouraged to consult with the Attorney General's Office and follow their recommendation.

### **Division Has Not Always Honored the Terms of Its Settlement Agreements**

The division has, at times, violated the terms of its settlement agreements. In one case, the division agreed to not publicize the action or commence further administrative actions and then violated both terms of

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**The division should establish procedures for issuing administrative subpoenas.**

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**The division violated the terms of a settlement agreement.**

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the agreement. The person accused told us he felt compelled to plead guilty to a lesser criminal charge rather than place his business in jeopardy defending a greater charge. The division agreed to not seek additional charges but nevertheless pursued an administrative action. The respondent then signed the settlement agreement after the division agreed to not publicize it. However, the day the settlement was signed, the division publicized the information on its web page and also published the information in its newsletter the following month.

In another case, a settlement agreement was not finalized when the plaintiff learned the division planned to renege on its agreement to not publicize any more information about the case. In negotiations, the division agreed to not publicize the information, but did not specify in the agreement that it did not apply to the division's newsletter. We feel this action was disingenuous. To maintain its credibility, the division's settlement negotiations should be made in good faith and it should abide by its settlement agreements.

The division should establish procedures for negotiating and for follow-up on settlement agreements. There are often settlement agreements that require some action, such as requiring a person to pay restitution within a certain amount of time, which could be in lieu of a fine. However, the division does not follow-up to determine if a settlement agreement has been followed. For example, one individual was fined, barred from the securities industry, and ordered to not associate with a broker/dealer or investment advisor. His fine was suspended based on the premise he would comply with the order for 10 years. The division does not routinely check compliance with the agreement.

We feel the division should track if a person has complied with the terms of an agreement. Similarly, the division should also abide with agreements it makes, which is not always done. As noted earlier in this chapter, in at least one case, the division violated its agreement to not pursue additional administrative actions nor publicize the case.

### **A Business Was Not Informed of Investigation**

A business was not informed they were being investigated until after an enforcement action was initiated. Although this does not violate the law, the former director acknowledged this was an error in the process



and blamed the staff involved with the case. The staff defended their actions by stating that administrative licensing action pleadings provide the notice and that the former director had not implemented any change in policy that required them to notify subjects of pending actions.

Rather than inform the business and initiate its own investigation, the division relied mostly on information from an investigation completed by the U.S. Securities and Exchange Commission (SEC) investigation. The SEC did not have a negative finding and gave its information to the division. Division investigators did not interview the business owner, staff, or any of the alleged victims during its investigation.

The division should generally provide notification about an investigation before initiating proceedings. Unless the integrity of an investigation could be compromised, individuals should be notified that they are being investigated. The respondents in Case One were not aware the division was investigating them and were not provided an opportunity to defend themselves until after enforcement actions were initiated. In effect, the division attempted to prove inappropriate behavior without contacting the business to fully develop its case.

According to the business owner, he learned about the investigation only after it was completed and charges were filed. Before he had an opportunity to respond, the media called to ask about the division revoking his license and issuing fraud charges. The media release was damaging to the business and the resulting retraction and apology was damaging to the division.

Conflicts surrounding this case resulted in the division establishing a new policy. This new policy states that absent exceptional circumstances approved by the department director, licensees must be notified that the division is conducting an investigation before disciplinary proceedings are initiated. Specific instructions in the drafted procedures direct that:

Targets of an investigation should be aware of the existence of the investigation before an enforcement action is initiated. If the target is not aware of the investigation . . . a letter should be sent to the target notifying him/her that the division intends to initiate enforcement proceedings.

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**The division should establish procedures for notifying individuals they are being investigated.**

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## Other Policies and Procedures That Need To Be Addressed

Other issues came to our attention that should be addressed in division policies and procedures including how the division sets fines and the accuracy of statistical information compiled by the division. We also learned that there is not a consistent process for handling case files.

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**The division should establish guidelines for setting fines.**

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**Establish Guidelines for Setting Fines.** The division has been criticized for not identifying how fines are set. Board minutes disclosed the former director explained that fines are set to “make it hurt,” which is troublesome to those in the securities industry. The former director explained to us that fines are set based on an evaluation of the seriousness, nature, circumstances, and persistence of the conduct which is consistent with the *Financial Industry Regulatory Authority* (FINRA) guidelines. However, because the division does not have written guidelines or procedures identifying the process used to set fines, they appear to be set arbitrarily, based solely at the discretion of the division.

It remains unclear to us how the division determines the amount of a fine, if restitution should offset fines, or if there should be other sanctions, such as barring a person from the industry. Fines imposed by district courts are limited to \$500 for each violation (see *Utah Code* 61-1-20(2)(b)(vii)), but there are no such limits for administrative fines. While we understand that set fines may not be effective, to ensure decisions are consistent and fair it is important for the division to communicate the criteria it uses. For example, Texas also bases its fines on the FINRA guidelines. Texas’ administrative rules provide the following guidelines for assessing the amount of an administrative fine:

1. the seriousness, nature, circumstances, extent, and persistence of the conduct constituting the violation,
2. the harm to other persons resulting either directly or indirectly from the violation,
3. cooperation by the person or company in an inquiry conducted by the State Securities Board concerning the violation, efforts to prevent future occurrences of the violation, and efforts to mitigate the harm caused by the violation, including any restitution made to other persons injured by the acts of the person or company,

4. the history of previous violations by the person or company,
5. the need to deter the person, company or others from committing such violations in the future, and
6. such other matters as justice may require.

The procedures the former director began drafting state similar guidelines. We feel procedures should also require that the division document how a fine was determined for a particular case.

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**The division should standardize the way in which data is entered into its information system and for managing case files.**

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**Establish Procedures For Compiling Information and Managing Case Files.** We encountered other procedures that were not clearly defined. First, the procedures for entering information into their information system should be standardized. We questioned if statistical information was reliable because we could not reconcile information in complaint logs with information entered into the division's information system. Procedures for compiling information appear to have evolved over time. For example, procedures from the old procedures manual state that complaints referred to another agency are entered into the system but this is no longer the practice. Accurate information is needed both to track cases and measure performance.

The division also needs to have procedures for managing case files. We could not locate files without divulging a person's identity because each investigator handles files differently. Further, there is no system to track files turned over to attorneys when a criminal case is referred.

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**Clearly defined procedures will promote consistent and appropriate practices.**

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We believe that it is important for the division to establish written policies and procedures to ensure that cases are handled appropriately and consistently. Rather than enacting policies in response to conflict, the division should be proactive in evaluating and issuing policies and procedures to guide the enforcement process. We feel clearly defined procedures will promote consistent and appropriate practices, help to avoid future criticism, and guide future administrators. In addition, important policies should be incorporated into administrative rules to safeguard the rights of the public.

## Recommendations

1. We recommend that the Department of Commerce clarify policies to clearly define the roles of the division director and presiding officer.
2. We recommend that the Department of Commerce develop baseline policies and procedures outlining its interaction with the Attorney General's office.
3. We recommend that the Department of Commerce continue working with the Legislature on changing the board to a commission with additional responsibilities.
4. We recommend that the Legislature consider changing the advisory board to a commission to provide division oversight.
5. We recommend that the Division of Securities establish written policies and procedures to guide case management.

## **Chapter III**

### **Inadequate Guidance Created Internal Conflicts**

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**Conflicts have resulted in reprimands, organizational restructuring, and the resignation of the director.**

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Personnel conflicts within the Division of Securities (division) have resulted in management turnover and a demoralized staff. Both the department executive director and the division's former director have been open about their beliefs that specific employees have seemed reluctant to accept change and may be subverting management authority. A number of division staff feel their jobs are threatened or other forms of management reprisal may occur should they offend management in some way. The escalating conflicts have resulted in reprimands, restructuring, and ultimately, the resignation of the director, and the threat of legal action by several employees.

In spite of the conflicts, it appears the division is accomplishing its mission. We are concerned, however, that the negative culture caused by the lack of policies and procedures, poor internal and external communications, and conflicting personalities may limit the division's ability to effectively accomplish its mission of protecting the public. We feel establishing policies and procedures to guide the division's actions can be effective only if the division's personnel problems are appropriately addressed.

#### **Personnel Conflicts Have Been an Ongoing Problem**

Personnel conflicts, as with the policy and procedure problems faced by the division, are an ongoing problem that can be attributed, in part, to the division's frequent management changes. The division has had four directors in the past five years. Each new director has had a different management style that has taxed staffs ability to adapt and, apparently, has resulted in some rigidity of staff thinking.

Existing personnel problems escalated when the former director was hired in 2005, partly because his more involved management style differed from that of prior directors and limited staff decision making. The former director had extensive experience in securities regulation, having served as

an assistant attorney general representing the division and the chief of the Idaho Securities Bureau.

Several staff disagreed with some of the changes the former director made. They were especially concerned with his high level of direct involvement in cases. The process they were accustomed to was to avoid involving the director in cases to keep from jeopardizing his impartiality as the presiding officer. Accustomed to a different process that was not supported by written procedures, staff resisted the former director's changes.

### **Former Director Criticized Staff for Survey Results**

The former director conducted an employee survey in August 2006 which stated it was intended to address concerns about job clarity and division organization. However, the former director used his interpretation of the results of the survey to criticize the division's licensing section by reprimanding the supervisor and reorganizing the section.

Seventeen of twenty staff responded to the survey. The survey identified staff's level of satisfaction in a number of areas. Staff's greatest concern was with section leadership issues, followed by general division issues, and last, the former director's leadership. The lowest satisfaction level came from staff in the enforcement section.

Conducting a broad personnel survey can be helpful in identifying concerns but the results must be interpreted correctly and used judiciously. In this case, it was unfortunate that the former director chose to use the survey's information to criticize certain staff, rather than seek ways to address conflicts and improve relationships. We feel that both his use and interpretation of the results were inappropriate. Some of the results of the survey's questions that raised concerns are in Appendix B. Figure 3.1 shows some of the more concerning survey results on overall division staff satisfaction and with management.

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**The 2006 survey shows most conflict and the lowest staff satisfaction level involved the enforcement section.**

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**Figure 3.1 Selected Survey Results on Division Personnel Satisfaction with Division Management.**

| Question   | Percentage of Staff Who Agreed |
|--|--------------------------------|
| I'm encouraged to participate in decisions that affect the goals and objectives of the division. | 47%                            |
| The division works as a team.  | 59                             |
| There is an identity and sense of community in the division.                                     | 59                             |
| Morale is good in the division.  | 59                             |
| There is a climate of trust in the division.   | 59                             |
| The director accepts constructive criticism.   | 53                             |

The survey revealed that many division staff were dissatisfied and a high percentage questioned the health of the organization. Just over half of the survey's respondents believed that division morale, trust, and teamwork were acceptable. This low level of support was more pronounced when looking at how staff felt they were treated individually. Figure 3.2 shows selected responses for some individual-based questions.

**Figure 3.2 Selected Survey Results on Division Personnel Satisfaction.**

| Question  | Percentage of Staff Who Agreed |
|---|--------------------------------|
| My section effectively resolves employee-related issues of conflicts.   | 47%                            |
| I can trust the managers outside my section.  | 47                             |
| My supervisor takes appropriate action towards desired performance through counseling, mentoring, tutoring and development. | 47                             |
| Office policies and procedures are fair and applied equally to all.   | 41                             |
| I enjoy my job more than I did one year ago.  | 53                             |

At the time of the survey, staff had concerns with the lowest satisfaction level clearly focused on one section's supervisor. Less than half of the respondents expressed satisfaction with that section's leadership. However, the former division director's interpretation of the survey focused his concerns on a different section supervisor.

The former director cited concerns that a few employees were undermining his authority and that the survey results indicated that one supervisor "was encouraging employees to support him (the supervisor) at my expense." He also criticized the supervisor for viewing their relationship as a power struggle by insisting that the old ways were superior. The supervisor was reprimanded as a result of the former director's interpretation of the survey.

There may have been appropriate reasons for reprimanding the supervisor. However, the former director's conclusions misinterpreted the study's results. As an example, the former director's conclusion that one section was not supportive is contrary to the survey results which showed little difference between sections. In fact, when asked if the former director accepted constructive criticism, three of four staff members in the accused section supported the former director. Overall, six staff declined to answer that question.

### **Conflict Has Not Been Resolved**

Conflict within the division has continued. Some staff are concerned their jobs are threatened for expressing their concerns. One employee filed a grievance that he was demoted in retaliation for contesting how the former director was handling cases. The Career Services Review Board chose not to hold an evidentiary hearing. They concluded they did not have jurisdiction over the grievance because the actions taken were not considered a demotion without a change in his pay or job title. The former director contends the action was not a demotion, rather, it was an organizational restructuring designed to improve the division's effectiveness. A number of staff have expressed concerns their jobs are threatened for cooperating with this audit.

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**Conflict has not been resolved with employees concerned their jobs are threatened.**

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**Close to half of the division's employees, attorneys, and others have concerns with the former director.**

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Our recent interviews with division staff show that almost half of the office have concerns with how the former director managed the office. Some of those that did not have concerns were not involved in conflicts and several employees felt the former director had actually made improvements overall. After the former director resigned, two employees who previously had not criticized him related their concerns with the former director's management style. In addition, attorneys involved with the division also objected to both how the former director handled cases and his management style.

### **Section Restructuring Was of Questionable Value**

After continuing conflicts with the supervisor, the former director restructured the licensing section. The supervisor felt it was a punitive action rather than a sincere move to improve organizational effectiveness. The reorganization was not well-planned. The former director temporarily took over the responsibility of supervising the majority of the licensing staff involved in compliance. As their supervisor, he could no longer serve as the presiding officer for their cases, which is the responsibility of the director. This level of direct case involvement was contrary to later instructions from the department director that he not be involved in cases to ensure that he would be impartial. Only after the former director resigned was a different employee given those responsibilities.

Separating the audit function from the compliance function may not have been an organizational improvement because compliance issues often originate from audits. In addition, the compliance staff continued to rely on the past licensing supervisor to provide guidance on their cases.

Additional actions taken by the former director reinforced staff feelings that the licensing section restructure may have been for punitive reasons. The former director identified that the supervisor's actions prior to the director's involvement caused the problems with two controversial cases (Cases One and Two from Chapter I). According to a memo from the former director, the restructuring was to resolve concerns about cases and complaints that the licensing section overreached in its sanctions and legal analysis. Thus, the supervisor had compromised the successful conclusion of those cases.

Problems continued with both cases even after the former director became directly involved.

The former director reprimanded the supervisor for openly discussing concerns and warned him in a memorandum to “not complain to others in the division, department, or elsewhere about how you feel you are being treated . . . Any further instances of such conduct will result in further disciplinary action which may include suspension, demotion, or termination.”

As a result of the restructuring, the supervisor was required to immediately move out of his walled office into a cubicle. The walled office has remained vacant for the past year. Management has kept the office open for a new supervisor, yet to be hired.

### **Additional Personnel Conflicts Further Hamper the Division’s Operations**

Personnel conflicts are not confined to disagreements and animosity between the former director and the division staff. During the course of this audit, other personnel problems surfaced between: the department and the division’s former director, the department and division staff, and attorneys and the division’s former director. In each of these cases, decisions were made by both staff and management that were either questionable or contrary to existing policies and practices.

After being hired in October 2005, a number of the former director’s actions have been questionable. He was reprimanded and received a one-day suspension without pay for instructing staff to hold fine payment checks without processing them within the three-day time period required by statute (*Utah Code* 51-4-1). Delaying the deposit would allow the division to retain funds in the division rather than transfer them to the state general fund. By statute, if a balance in the division’s education fund exceeds \$100,000 at the close of a fiscal year, the excess must be transferred to the General Fund (*Utah Code* 61-1-18.7(6)).

Staff related other instances in which they feel the former director gave them inappropriate directions. For example, staff provided information showing the director:

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**The former director was reprimanded for inappropriate actions.**

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- directed staff to sign pleadings that the former director had either drafted or modified, possibly to prevent his name, as the presiding officer, from appearing on documents. Administrative rules state “the signature shall be deemed to be a certification that the signer has read the pleading and that, to the best of his knowledge and belief, there is good ground to support it.”
- directed staff to provide protected information to an influential person which violates Utah securities law prohibiting employees from disclosing non-public information filed with or obtained by the division (*Utah Code* 61-1-18.3).
- used coercive settlement tactics by instructing staff to keep unwarranted allegations in the pleadings to serve as a bargaining chip for the negotiations. The respondent agreed to the settlement after the allegations were removed.

In addition, attorneys representing the division related concerns about how the former director managed cases. One attorney told us he was excluded from meetings involving a case after disagreeing with the former director’s position. A second attorney was concerned the former director was not independent of cases in his role as presiding officer. Instead he co-mingled roles by being involved in cases as an investigator, attorney, and presiding officer. Cases have been contested because of the former director’s involvement and reluctance to recuse as presiding officer. Issues involving the role of the attorney general were discussed in the previous chapter.

### **Departmental Actions Have Added to Staff Conflicts**

Although the former director resigned, some staff problems have continued. A number of division staff distrust the department director because they believe that she did not act in good faith when they voiced their concerns with division operations. Staff feel they have not been fairly treated because the department executive director has, in their opinions, firmly supported the division’s former director and his activities. In addition, the department executive director, just as with the division’s former director, has at times become involved in division licensing cases which has created similar presiding officer conflicts. As shown in Appendix A (number 8), an order can be appealed to the

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**Some staff are concerned with the department’s actions when they voiced their concerns.**

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department director who may uphold, reverse, or modify the order. However, the department director said these were isolated instances and that she became involved in these cases at the request of a concerned legislator.

The department director's handling of division staff complaints was contrary to department policy. Department policies include an "open door" access to the executive director for staff to discuss problems. This policy states "the reporting employee's confidentiality will be respected as requested." The purpose of the open door policy is to informally facilitate conflict resolution, communication, and/or employee assistance. It states that "forthright airing of complaints . . . is encouraged to foster a climate of openness, honesty, mutual respect, and positive change."

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**Department's open door policy has inherent problems in maintaining confidentiality.**

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When division staff discussed their concerns, they contend the department director did not maintain their confidentiality. The department director points out the difficulties with this policy. A problem can be resolved only if it is addressed. Therefore, discussions were shared with the division's former director in an effort to resolve the concerns. In fact, the former division director was reprimanded based on information staff provided. Staff, however, believe that the department director's negative feelings for employees who had complained were well known. Other staff members, attorneys, and even a plaintiff in a licensing case have claimed that the department director has spoken publicly about problem employees.

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**Some staff continue to fear reprisal for speaking up.**

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Since the division director's resignation, staff believe that little has changed. Some employees have retained legal counsel to represent them because they distrust management, feel threatened, and fear reprisal for speaking up. A recent case involves the transfer of an employee to another section in which some prior conflicts existed. The employee saw the transfer as a retaliatory action and has hired legal counsel. The department stated the transfer was necessary to balance work loads in a time of reduced staff. In our opinion, while all of the conflicts are not personnel driven, neither side trusts the other and a great deal of work is necessary to resolve the division's personnel problems and correct the negative culture.

## Recommendations

1. We recommend that the Division of Securities examine methods for improving communication within the division and within the department.
2. We recommend that the Department of Commerce evaluate its open door policy offering conflict resolution and assuring confidentiality.

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## **Appendices**

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## Appendix A

### The Division of Securities Administrative Action Process

1. Investigation opened. Cases come from a variety of sources including investor complaints, audits, surveillance, industry inquiries, and referrals from other state and federal agencies. After assessing the information, the section supervisor determines which cases warrant an investigation.
2. Staff investigates. If a significant violation is found, staff submits an audit or case report to the section supervisor who determines if an administrative action should be filed. The division can seek civil court-imposed injunctions and restitution. Criminal cases are referred for prosecution to the AG or to the district or county attorney where the crime occurred. The division initiates administrative enforcement actions. Division staff or an assistant attorney general assigned to the matter drafts a petition or an Order to Show Cause. Disciplinary cases may sometimes be resolved with warning letters or settlements (Stipulation and Consent) negotiated prior to actions being filed.
3. The director, as the presiding officer, issues and signs a Notice of Agency Action (summons). If the director is, or has been, involved in the case, he assigns another supervisor in the division (or a department manager) to serve as the presiding officer. The presiding officer may serve as the hearing officer or assign the case to a different hearing officer.
- 4a. Respondent may settle prior to litigation. Settlement terms are negotiated by the section supervisor and proposed settlements (Stipulation and Consent Orders) are submitted to the director or presiding officer for approval. Settlements involving a revocation, bar, censure, or fine against a licensee must also be approved by a majority of the advisory board.
- 4b. Respondent may request a hearing. In that case, the respondent contacts the division's counsel in the attorney general's office or files their response to the Notice of Agency Action directly with the division. The Administrative Law Judge (ALJ) or hearing officer will set a date for the hearing. The ALJ generally is an employee of the department but not of the division.
5. After the hearing, the ALJ or hearing officer issues a Findings of Fact and Conclusions of Law and an order which includes a recommended decision and recommended sanctions. If the director is not the hearing officer, he may reject the ALJ's decision. The director must accept the Findings of Fact but may disagree with the Conclusions of Law or sanctions set forth in the order.
6. The director conducts an independent review of the recommended decision and signs the order if he agrees. If he disagrees, the director may enter his own order but it must be based on evidence presented in the ALJ's Findings of Fact.
7. A majority of the advisory board must approve sanctions involving a revocation, bar, censure, or fine against a licensee by signing the order.
8. An order can be appealed to the department director who may uphold, reverse, or modify the order. The department director generally would assign a department ALJ to hear the appeal and, if she has been involved in the matter, she recuses and appoints an unbiased person to approve the order.
9. The order can be appealed to the Supreme Court or Utah Court of Appeals (UCA 63-46b-16).

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## Appendix B Selected Results From 2006 Employee Survey

Responses to the division's survey revealed significant employee conflict and dissatisfaction. The survey had a total of 87 questions. The following lists those questions where 60 percent (10 of 17) or fewer of the staff agreed with the survey question.

| Question   | Percentage of Staff Who Agreed |
|--|--------------------------------|
| I'm encouraged to participate in decisions that affect the goals and objectives of my section.                             | 59%                            |
| I'm encouraged to participate in decisions that affect the goals and objectives of the division.                           | 47                             |
| The division works as a team.  | 59                             |
| I'm satisfied with the quality of information I receive about what is going on in my section.                              | 59                             |
| I'm satisfied with the quality of information I receive about what is going on in the division.                            | 59                             |
| There is an identity and sense of community in the division.   | 59                             |
| Morale is good in the division.  | 59                             |
| There is a climate of trust in the division.   | 59                             |
| My section effectively resolves employee-related issues of conflicts.  | 47                             |
| When disagreements occur in my section, we work together to achieve agreement and resolve problems.                        | 47                             |
| I am able to take reasonable risks on the job without worrying about criticism and failure.                                | 53                             |
| My supervisor provides honest and timely feedback that results in mutual understanding of what I can do to improve.        | 59                             |
| My supervisor deals fairly with complaints or grievances.  | 53                             |
| My supervisor handles crises and stress calmly and effectively.  | 53                             |
| My supervisor accepts constructive criticism.  | 47                             |
| The director accepts constructive criticism/the director.  | 53                             |
| I can trust the managers outside my section.   | 47                             |
| I have a mentor in the division who is interested in me professionally and is willing to help develop my career.           | 59                             |
| My supervisor takes appropriate action toward desired performance through counseling, mentoring, tutoring and development. | 47                             |
| Office policies and procedures are fair and applied equally to all.  | 41                             |
| My job description matches my actual job duties.   | 59                             |
| I enjoy my job more than I did one year ago.   | 53                             |
| Since Oct 2005, I feel more supported by management in performing my job.  | 59                             |
| The division has a good reputation with the public.  | 59                             |
| The division has a good reputation within the department.  | 59                             |

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**Agency Response**



JON M. HUNTSMAN, JR.  
*Governor*

GARY R. HERBERT  
*Lieutenant Governor*

# State of Utah Department of Commerce

FRANCINE A. GIANI  
*Executive Director*

THAD LEVAR  
*Deputy Director*

June 17, 2008

John M. Schaff, CIA  
Auditor General  
Office of the Legislative Auditor General  
W315 Utah State Capitol Complex  
Salt Lake City, UT 84114

**Re: Report No. 2008-07, A Performance Audit of the Division of Securities**

Dear Mr. Schaff:

I want to thank you and your audit team for the time and energy that has been spent on this performance audit, and for the opportunity to respond. The Division of Securities is an important agency that has done remarkable work for the investment community and citizens of Utah for many years, and I am glad this audit will help the Division improve that crucial work. The recommendations of the audit should help the Division more effectively accomplish its mission. We've already begun to work on all of them. I'm happy to say that some are already implemented and others will have to be evaluated during the 2009 Legislative Session.

I am a little disappointed that the auditors did not discuss, address, or interview any members of what is one of the most important stakeholders with the Division: investors. Each year the Division's work results in millions of dollars of investor restitution throughout Utah. I believe the perspectives of those investors could have been valuable to this audit. In many of the specific cases addressed by the audit the Division obtained significant investor restitution. As an example, in Case One from the audit the Division negotiated thousands of dollars in refunded investor fees.

Having said that, I appreciate the auditor's work and recommendations. We have been working on them in several ways.

- The audit recommends policies to clearly define the roles of the division director and presiding officer. The Division addressed this issue with two actions: the designation on March 11, 2008 of a Lead Examiner to remove the Division Director from decision-making on investigations, and a change in procedures on March 5, 2008 designating the Administrative Law Judge as presiding officer for all pre-hearing matters. These changes were further formalized in a written Division policy issued June 4, 2008.
- The audit recommends developing baseline policies and procedures outlining interaction with the Attorney General's office. The Division policy issued on June 4, 2008 clarifies interaction by Division employees with both the Attorney General's office and other agencies throughout the state that prosecute securities violations.

- The audit recommended consideration of changing the advisory board to a commission. I proposed draft language to some members of legislative leadership during the final weeks of the 2008 General Session, and look forward to continuing that discussion next year.
- The audit recommends written policies and procedures to guide case management, which was addressed in the June 4, 2008 policy. I anticipate the Division's new director will continue to evaluate those and other potential guidelines.
- The audit recommends examining methods for improving communication. Starting in 2005 the Division began utilizing the Certified Public Manager course to help improve internal communications, and this effort has been successful. Additionally, to address external communication the Division provided written guidelines and reminders to its employees on April 16, 2008.
- The audit notes inherent problems with the Department's previous open door policy. I discussed this issue at length with the audit team and revoked that policy on May 21, 2008.

Thank you again for the opportunity to respond. While I don't agree with all of the allegations in the audit, I'm hopeful that its recommendations will help the Division be more successful. I look forward to continuing to work to ensure the Division of Securities is able to accomplish its mission in the most effective ways possible.

Sincerely,



FRANCINE A. GIANI, EXECUTIVE DIRECTOR  
UTAH DEPARTMENT OF COMMERCE