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Attorneys for the CSI

**BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE
MONTANA STATE AUDITOR**

IN THE MATTER OF:)	CASE NO. SEC-2014-188
)	
PHX FINANCIAL, INC., a.k.a Blackwall)	NOTICE OF PROPOSED AGENCY
Capital, a Montana licensed broker-dealer;)	ACTION AND OPPORTUNITY
WILLIAM HORBATUK, JR., individually and in)	FOR HEARING
his capacity as a salesperson for PHX Financial, Inc.;)	
HALIL KOZI, a PHX Financial, Inc. employee and)	
Registered Options and Security Futures Principal;)	
ROBERT DELAPLAIN, a PHX Financial, Inc.)	
employee and Chief Compliance Officer;)	
KEVIN CHEN, PHX Financial, Inc.'s Chief)	
Executive Officer; and KENNETH WILLIAMS, a)	
PHX Financial, Inc. employee,)	
)	
Respondents)	

Staff of the Office of the Commissioner of Securities and Insurance, Montana State Auditor (CSI), pursuant to the authority of the Securities Act of Montana, Mont. Code Ann. § 30-10-101 et seq. (the Act), is proposing to the Commissioner of Securities and Insurance, Montana State Auditor (Commissioner), that she take specific action against PHX Financial, Inc., a.k.a. Blackwall Capital; William Horbatuk, Jr.; Halil Kozi; Robert Delaplain; Kevin Chen; and Kenneth Williams (collectively Respondents) for violations of the Act. The Commissioner has authority to take such action under the provisions of §§ 30-10-102, 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, and 30-10-309. Service of process is pursuant to § 30-10-107(8).

In particular, the CSI recommends specific action against Respondents including, but not limited to, the imposition of appropriate fines, restitution, and licensure revocation pursuant to the provisions of the Act.

REASONS FOR ACTION

There is probable cause to believe that the following facts, if true, justify and support such specific action.

ALLEGATIONS OF FACT

1. Respondent PHX Financial, Inc., a.k.a. Blackwall Capital (PHX), is a CSI registered broker-dealer, CRD #144403.
2. Respondent Horbatuk (Horbatuk) was a CSI registered salesperson, CRD #4316672, with PHX and has a pending salesperson application with the CSI for Legend Securities. He was employed as a PHX salesperson during the relevant time period.
3. Respondent Kozi (Kozi) is not registered with the CSI in any capacity. He served as the PHX Registered Options and Security Futures Principal (ROSFP) during the relevant time period.
4. Respondent Delaplain (Delaplain) is not registered with the CSI in any capacity. He served as the PHX Chief Compliance Officer during the relevant time period.
5. Respondent Chen (Chen) is not registered with the CSI in any capacity. He served as the PHX Chief Executive Officer (CEO) during the relevant time period.
6. Respondent Williams (Williams) is not registered with the CSI in any capacity. He served as Horbatuk's direct supervisor during the relative time period.
7. On or about May 7, 2013, the CSI contacted CEO Chen and informed him that PHX would need a heightened supervision plan because Horbatuk had eight reportable items on the CRD.
8. As part of his duties as Chief Compliance Officer, Delaplain stated PHX would:
 - a. Contact all Montana customers transacting business with Horbatuck every 60 days;

- b. Ensure all transactions and representations made by Horbatuk complied with PHX's policies and the Montana Securities Act (Act);
 - c. Maintain a record of the aforementioned communications in Horbatuk's employment file and within PHX's compliance department;
 - d. Notify the CSI of any complaint against Horbatuk;
 - e. Notify the CSI of any investigation of Horbatuk conducted by state, federal, or self-regulatory organization; and
 - f. Notify the CSI of any violation, within one day of discovery of the violation, of PHX policy or Montana regulation discovered as a result of the aforementioned communications.
9. As part of his duties as ROSFP, Kozi was required to:
- a. Supervise all options trading, including all transactions and accounts;
 - b. Review and propose appropriate action to secure PHX's compliance with securities laws and regulations, and FINRA rules in respect to its options business;
 - c. Review all options trade tickets on a daily basis to determine irregularities, including:
 - i. The compatibility of options transactions with investment objectives and with the types of transactions for which the account was approved;
 - ii. The size and frequency of options transactions;
 - iii. Commission activity in the account;
 - iv. Profit and loss in the account;
 - v. Undue concentration in any options class or classes; and
 - vi. Compliance with the provisions of Regulation T of the Federal Reserve Board.
 - d. Review and approve option accounts;
 - e. Review selected options accounts on a period basis;
 - f. Approve all discretionary options trades and the accounts related to those trades;
 - g. Develop training programs for Registered Persons and options supervisors;

h. Establish recordkeeping requirements for required records of options accounts and transactions including approval of accounts and customers' verification of background and financial information;

i. Review accounts without required approval and placing restrictions on accounts until deficiencies are cleared (missions options agreements or trading outside approved levels);

j. Maintain PHX's central option complaint file;

10. Supervise the preparation of option-related forms including account approval forms and agreements, standard options worksheets, and period account statements;

a. Review PHX's method of allocation of exercise notices;

b. Establish procedures to ensure only qualified Registered Persons are permitted to solicit or sell options.

11. As part of his duties as a PHX employee, Williams was required to directly supervise Horbatuk.

12. On or about May 20, 2013, and based on PHX's representations within the heightened supervisory agreement, the CSI approved Horbatuk's Montana application, Form U-4, to register as a salesperson.

13. Between May 2013 and June 2014, the CSI had no communication with PHX.

14. On or about June 27, 2014, Montana investor and Horbatuk client T.K. submitted a complaint to the CSI regarding Horbatuk. That complaint alleged that Horbatuk traded excessively in T.K.'s account, charged him excessive commissions, failed to provide account statements, traded on margin without authority, and generally failed to act in T.K.'s best interest. It also alleged PHX failed in its supervisory responsibilities by not adequately tracking and monitoring its agent's activities, and by failing to act on its agent's abusive tactics.

15. On or about June 30, 2014, the CSI requested PHX to provide the CSI with various documentation regarding T.K.'s account including, but not limited to:

- a. All documentation relating to T.K.'s account including new account forms, monthly statements, trade tickets, correspondents, and desk notes;
 - b. A call log of all telephone billing records for telephone numbers used by Horbatuk;
 - c. Horbatuk's employment file, including records of communication pursuant to the heightened supervision agreement;
 - d. Copies of all desk notes, diaries, or similar records composed by PHX employees who contacted Montana clients pursuant to the heightened supervision agreement;
 - e. A complete list of all PHX Montana clients and the corresponding account information;
 - f. A copy of PHX's supervisory manual(s).
16. On or about July 3, 2014, PHX responded to the CSI's request for information.
17. A CSI analysis of T.K.'s account revealed the following occurred over the 18-month period in which Horbatuk acted as T.K.'s salesperson:
- a. T.K. invested \$147,443 with PHX;
 - b. Horbatuk initiated 125 transactions in 51 securities in T.K.'s account, of which 105 were marked as solicited (the remaining 20 were marked unsolicited);
 - c. All trades were actually solicited;
 - d. Several stocks were bought and purchased several times over short periods including, but not limited to:
 - i. Ampio Pharmaceutical, Inc. (purchased and sold 23 times over eight months).
 - ii. Northrop Grumman Corp. (purchased and sold 10 times over 3 weeks).
 - iii. International Business Machines (purchased and sold 8 times over 1 week).
 - iv. Questcor Pharmaceuitcals, Inc. (purchased and sold 19 times over 9 weeks).

e. The total of all trades resulted in \$2,017,715.40 in purchases and \$2,020,613.21 sales, with corresponding Looper¹ turnover rates of 33.62 and 33.67 respectively;

f. Horbatuk made 85 option calls trades and 5 option puts trades in T.K.'s account;

g. The average hold period for a securities position in T.K.'s account was 42 days;

h. PHX and Horbatuk received commissions totaling \$75,779.91;

i. T.K.'s account lost \$147,078.71.

18. A CSI review of all documentation relating to T.K.'s account revealed the following occurred during the 18-month period in which Horbatuk acted as T.K.'s account:

a. PHX contacted T.K., via letter, one time to verify that he had approved all transactions in his account. PHX did not specify which transactions;

b. T.K. did not receive monthly account statements despite repeated attempts to do so over the life of the account. In response to these attempts, the following occurred:

i. Horbatuk sent an illegible picture text message of a computer screen supposedly detailing the account;

ii. Horbatuk informed T.K. the head of operations would get in touch with him regarding the remaining accounts;

iii. PHX staff sent documents piecemeal rather than sending T.K. all statements as requested;

iv. PHX staff repeatedly sent the same statements rather than sending all statements as requested;

¹ The Looper turnover rate generally calculates the total dollar amount of purchases during a time period divided by the average account equity and then annualized. See generally 38 S.E.C. 294 (1958). The rule of thumb concerning turnover is often referred to as the "2-4-6 Rule." The guideline views annual turnover rates as follows:

- Twice a year turnover is "suggestive" of excessive trading;
- Four times a year turnover is "indicative" of excessive trading; and
- Six times a year turnover is "conclusive" of excessive trading.

c. A review of Horbatuk's options call patterns was not performed, nor was T.K. contacted regarding options calls or puts transactions;

d. Delaplain signed off on 24 exception reports, generally citing T.K.'s status as a "Max Risk Investor," including:

i. 7 for commission excess, wherein the trade as a percent of principal amount is greater than the expected maximum percentage commission on a trade,

ii. 15 for large orders, wherein trades exceeded the threshold for large orders of the type of product and/or quantity, and/or a percentage of the client's holdings;

iii. 1 for a low priced, solicited security, wherein a low-priced equity is purchased and the trade record indicates it is a solicited purchase; and

iv. 1 for market timing, wherein the client completed two round trips in the fund associated with the trade;

e. 20 of the aforementioned exception reports related to options trades. Neither Kozi (the person assigned to options trading), nor Delaplain, the person who signed off on the reports, ever contacted T.K. regarding those exceptions.

f. Trades were placed on days when call logs indicate no communication took place between Horbatuk and T.K.

19. As a result of the T.K. account review, the CSI reviewed all other Horbatuk Montana accounts. A review of those four accounts revealed the following::

a. J.C. invested \$31,336.39 with PHX. During a one-month period of investment, Horbatuk initiated \$92,889.90 in purchases, resulting in a Looper turnover rate of 7.78, and \$77,464.05 in sales, resulting in a Looper turnover rate of 6.49. PHX billed J.C.'s account for \$5,374.66 in commissions. These 45 transactions were performed in 17 different securities;

b. D.K. invested \$250,819.22 with PHX. During a seven-month period of investment, Horbatuk initiated \$889,407.80 in purchases, resulting in a Looper turnover rate of 6.74, and \$816,146.40

in sales, resulting in a Looper turnover rate of 6.12. PHX billed D.K.'s account \$19,882.82 in commissions. These 74 transactions were performed in 20 different securities.

c. T.A. invested \$3,034.00 and B.R. invested \$6,292.98. Horbatuk trading in each account resulted in Looper turnover rates greater than 2.

d. Horbatuk traded on margin and used discretionary trading in J.C.'s account without permission to do so.

20. PHX procedures and policies require designated supervisors to look for unusual trading activity or patterns of transactions or other indications of wrongdoing, including, but not limited to, unusual numbers of cancels and rebills.

21. PHX procedures and policies define churning as entering transactions for a client primarily to generate commission income and without regard for the financial objectives of the client. Churning may be evidenced by frequent in-and-out trading or by repeated, rapid turnover of the portfolio and high commissions in relation to the equity in the account. Churning is likely to be found where there is excessive activity and a registered representative controlled the account.

22. Williams, as Horbatuk's designated supervisor, was directly responsible for sending any irregularities up through the PHX system.

23. In response to its request for information, PHX provided the CSI with copies of two complaints made against Horbatuk, one dated October 14, 2013, by client R.R.; and one dated April 11, 2014, by client J.C., alleging unethical sales practices. PHX did not notify the CSI of these complaints within 24 hours, as it had promised pursuant to the heightened supervisory agreement it signed on May 7, 2013;

24. Chen, who was aware of the heightened supervision agreement, was made aware of the constraints put upon Horbatuk regarding the agreement when Delaplain CC'd him on the heightened supervisory agreement.

25. Horbatuk has reapplied for Montana registration with the Broker-Dealer Legend Securities, Inc. The CSI has not approved that application, nor allowed for the application to be withdrawn.

CONCLUSIONS OF LAW

1. The Montana State Auditor is the Commissioner of Securities and Insurance (Commissioner) pursuant to §§ 30-10-107, 2-15-1901, and 2-15-1903.

2. The Commissioner has jurisdiction over this matter pursuant to §§ 30-10-102, 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, and 30-10-307.

3. The Commissioner administers the Act, pursuant to §§ 2-15-1901 and 30-10-107.

4. The Commissioner shall administer the Act to protect the investor, persons engaged in securities transactions, and the public interest, pursuant to § 30-10-102(1).

5. At all times relevant to this action, Respondent Horbatuk was a registered salesperson pursuant to § 30-10-201.

6. At all times relevant to this action, Respondent PHX was a registered broker-dealer pursuant to § 30-10-201.

7. Section 30-10-301 states a salesperson may not participate in fraudulent and other prohibited practices.

8. Fraudulent and other prohibited practices include any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person. § 30-10-301(1)(c). Admin. R. Mont. 6.10.401 defines such practices. Each unethical practice is a separate violation of § 30-10-301(1)(c).

9. Admin. R. Mont. 6.10.401(1)(b) states that it is fraudulent and unethical for a broker-dealer or salesperson to induce trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account.

10. Horbatuk violated Rule 6.10.401(1)(b) when an account under his control was traded with an effective Looper turnover rate in excess of 33. Moreover, two separate accounts traded with Looper turnover rates above 6. Finally, two additional accounts were traded with Looper turnover rates above 2.

11. Rule 6.10.401(1)(c) states that it is fraudulent and unethical to recommend to a customer the purchase, sale, or exchange of a security without grounds to believe that the transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer.

12. Horbatuk violated Rule 6.10.401(1)(c) when he engaged in excessive trading and traded on margin without explicit permission to do so. Horbatuk also violated this rule when he made option calls and puts purchases and sales without permission.

13. Admin. R. Mont. 6.10.401(1)(d) states that it is fraudulent and unethical for a broker-dealer or salesperson to execute a transaction on behalf of a customer without authorization to do so.

14. Horbatuk violated 6.10.401(1)(d) when he executed trades without consulting clients and failed to document such trading.

15. Admin. R. Mont. 6.10.401(1)(e) states that it is a fraudulent and unethical for a person to exercise discretionary power in effecting a transaction for a customer's account without first obtaining written discretionary authority from the customer.

16. Horbatuk violated 6.10.401(1)(e) when he made discretionary trades without T.K.'s authorization to do so.

17. Admin. R. Mont. 6.10.401(1)(k) states that it is fraudulent and unethical for a broker-dealer or salesperson to charge unreasonable and inequitable fees for services performed.

18. Horbatuk and PHX violated 6.10.401(1)(k) when they charged T.K. commission of \$75,779.91, out of the \$147,443.00 principal he originally invested.

19. Cumulatively, these violations also constitute a business practice that operated as a fraud or deceit upon a person or persons under § 30-10-301(1)(c).

20. Section 30-10-301(1)(b) states that it is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly, in, into, or from this state to make any untrue

statements of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

21. Horbatuk violated 30-10-301(b) when he completed new account forms with inaccurate information.

22. Section 30-10-201(13)(g) states a salesperson may not participate in dishonest and unethical practices. Admin. R. Mont. 6.10.401(2) defines unethical practices under this section. Each unethical practice is a separate violation of § 30-10-201(13)(g).

a. Admin. R. Mont. 6.10.401(2)(g) states a salesperson may not engage in conduct such as manipulative or deceptive practices.

b. Respondent violated 6.10.401(2)(g) when he traded on margin without permission and engaged in discretionary trading.

23. Administrative Rule of Montana 6.10.401(1)(t) requires a person to furnish a customer, upon reasonable request, information to which he is entitled.

24. Horbatuk and PHX repeatedly failed to provide T.K. with account statements despite several requests both orally and in writing.

25. Section 30-10-201(13)(k) states a person who fails to reasonably supervise the person's salespersons or employees has violated the Act.

26. PHX violated § 30-10-201(13)(k) failed to supervise Horbatuk when it failed to comply with its heightened supervision agreement, including, but not limited to failing to contact Horbatuk's clients every 60 days, failing to review option trades in his accounts, and failing to report complaints to the CSI.

27. Kozi violated § 30-10-201(13)(k) when he failed to supervise Horbatuk and Delaplain as noted by option puts and calls placed in T.K.'s account without confirmation with the client in light of the heightened supervision agreement.

28. Delaplain violated § 30-10-201(13)(k) when he signed exception agreements without contacting the client pursuant to its heightened supervisory agreement with the CSI.

29. Williams violated § 30-10-201(13)(k) by failing to monitor and review Horbatuk's work when he was Horbatuk's direct supervisor.

30. Chen violated § 30-10-201(13)(k) when he, as CEO, was aware of the heightened supervisory agreement and did nothing to ensure it was complied with.

31. Section 30-10-321 states that for purposes of any action brought by the commissioner under 30-10-301, any person that knowingly provides substantial assistance to another person in violation of a provision of this part or of any rule or regulation issued under this part must be considered to be in violation of that provision to the same extent as the person to whom the assistance is provided.

32. PHX, Kozi, Delaplain, Williams and Chen all violated § 30-10-321 when they ignored Horbatuk's actions, neglected to report his actions to the CSI, and allowed trades to go through without contacting Horbatuk's clients, thereby providing substantial assistance to Horbatuk's fraudulent actions as defined in the administrative rules which work in conjunction with § 30-10-301.

RELIEF REQUESTED

WHEREFORE, the CSI seeks the following relief:

1. Order Respondents severally to pay fines not to exceed \$5,000 for each identifiable violation of the Act, pursuant to § 30-10-305(3).
2. Order Respondents to pay restitution pursuant to § 30-10-309(1).
3. Order Respondent PHX's registration as a broker-dealer in Montana be revoked for violating provisions of the Act, pursuant to § 30-10-201.
4. Order Respondent Horbatuk's pending application (Form U-4) to register as a salesperson for Legend Securities be denied.

PUBLIC INTEREST

For any and all of the reasons set forth above, it is in the public interest and will protect Montana investors to take the actions listed in the relief requested, and to take any other action necessary to ensure Montana investors are protected.

STATEMENT OF RIGHTS

You are entitled to a hearing to respond to this notice, and to present evidence and arguments on all issues involved in this case. You have a right to be represented by an attorney at any and all stages of this proceeding. You may demand a formal hearing before a hearing examiner appointed by the Commissioner pursuant to the Montana Administrative Procedure Act, § 2-4-601 et seq. including § 2-4-631. If you demand a hearing, you will be given notice of the time, place, and the nature of the hearing.

If you wish to contest the proposed action under the jurisdiction of the Commissioner, you must advise the Commissioner within 15 days of the date you receive this notice. You must advise the Commissioner of your intent to contest the proposed action by writing to Brett O'Neil, State Auditor's Office, 840 Helena Avenue, Helena, Montana 59601. Your letter must clearly indicate whether you demand a hearing, or whether you waive formal proceedings and, if so, what informal proceedings you prefer for disposition of this case. Pursuant to § 2-4-603(2), you may not request to proceed informally if the action could result in suspension, revocation or any other adverse action against a professional license. Should you request a hearing on the matters raised in this Notice, a hearing must be held within a reasonable period of time unless postponed by mutual consent of the parties, pursuant to § 30-10-305.

Should you request a hearing, you have the right to be accompanied, represented, and advised by counsel. If the counsel you choose has not been admitted to practice law in the state of Montana, he or she must comply with the requirements of *Application of American Smelting and Refining Co.* (1973), 164 Mont. 139, 520 P.2d 103, and *Montana Supreme Court Commission on the Unauthorized Practice of Law v. O'Neil*, 2006 MT 284, 334 Mont. 311, 147 P.3d 200.

CONTACT WITH COMMISSIONER'S OFFICE

If you have questions or wish to discuss this matter, please contact Jesse Laslovich and Brett O'Neil, legal counsel for the CSI, at 840 Helena Avenue, Helena, MT, 59601, 406-444-2040. If an attorney represents you, please make any contacts with the CSI through your attorney.

POSSIBILITY OF DEFAULT

Failure to give notice or to advise of your demand for a hearing or informal procedure within 15 days will result in the entry of a default order imposing the disciplinary sanctions against you without further notice to you, pursuant to Mont. Admin. R. 6.2.101, and the Attorney General's Model Rule 10, Mont. Admin. R. 1.3.214.

DATED this 20th day of October, 2014.



JESSE LASLOVICH
BRETT O'NEIL
Attorney for CSI

CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was served on the 28th day of October, 2014, by US mail, certified first-class postage paid, to the following:

Kevin Chen, CEO
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