

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES AND EXCHANGE ACT OF 1934
Rel. No. 51046 / January 14, 2005

Admin. Proc. File No. 3-11523

In the Matter of the Application of

PAUL JOSEPH BENZ
c/o H. Thomas Fehn, Esq.
Fields, Fehn & Sherwin
11755 Wilshire Blvd., #1500
Los Angeles, CA 90025

For Review of Action Taken by
NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION - - REVIEW OF DISCIPLINARY
PROCEEDING

Violation of Rules of Fair Practice

Failure to Comply with Net Capital Requirements

Former president and general securities principal of a former member firm of registered securities association was responsible for firm's failure to comply with net capital requirements. Held, the findings of violation and the sanctions imposed are sustained.

APPEARANCES

H. Thomas Fehn, of Fields, Fehn & Sherwin, for Paul Joseph Benz.

Marc Menchel, Alan B. Lawhead, and Gary J. Dernelle, for NASD.

Appeal filed: June 15, 2004
Last brief received: September 8, 2004

I.

Paul Joseph Benz, formerly a general securities principal and the president of Beacon Trading, LLC ("Beacon" or "the Firm"), formerly an NASD firm, seeks review of NASD disciplinary action. NASD found that Benz violated NASD Rule 2110 1/ by permitting Beacon to conduct a securities business when it did not meet its net capital requirement under Securities Exchange Act of 1934 Rule 15c3-1. 2/ As a result, NASD imposed on Benz a \$5,000 fine, a thirty-day suspension from acting as a general securities principal, and a requirement that he requalify as a principal before serving in that capacity again. 3/ We base our findings on an independent review of the record. 4/

II.

In June 1998, Benz and his brother, Christopher Benz, 5/ formed Beacon, an introducing broker-dealer 6/ with a \$5,000 net capital requirement. Beacon's customers included traditional retail clients and approximately 200 day traders. During the relevant time period, Benz served as president and his brother served as the Financial and Operations Principal of the Firm.

Beacon cleared its securities trades on a fully disclosed basis through its clearing broker, 7/ Computer Clearing Services ("CCS"). The clearing agreement between Beacon and CCS, dated October 30, 1998 (the "Clearing Agreement"), provided in relevant part that Beacon

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- 1/ NASD Rule 2110 requires compliance with high standards of commercial honor and just and equitable principles of trade.
- 2/ 17 C.F.R. § 240.15c3-1.
- 3/ NASD also assessed costs.
- 4/ In addition, NASD found that Benz violated NASD Rules 2110 and 8210 by failing to respond timely to NASD requests for information. For these violations, NASD imposed a \$2,500 fine, a thirty-day suspension, and a requirement that Benz requalify as a principal. Benz does not challenge this finding on appeal before us.
- 5/ Christopher Benz did not appear before the Hearing Panel and stated through counsel that he would accept a decision by default. Thus, a default decision was entered against him on March 20, 2003, which imposed a six-month suspension and a fine of \$25,000.
- 6/ An introducing broker deals directly with the public and originates customer accounts. See Katz v. Fin. Clearing & Serv. Corp., 794 F. Supp. 88, 90 (S.D.N.Y. 1992).
- 7/ A clearing broker handles functions related to the clearance and settlement of trades in the accounts of the customers of its introducing broker. See Dillon v. Militano, 731 F. Supp. 634, 636 (S.D.N.Y. 1990).

agreed to indemnify and hold CCS harmless in the event "any customer of [Beacon] fail[ed] to make payment for securities purchased." 8/

On October 10, 2000, Beacon established a margin account with CCS on behalf of its customer, Dan Rubin, doing business as Rubin Investment Group. Rubin indicated on the account forms that he completed that he was a self-employed investment banker with an annual income of \$300,000 and a liquid net worth of \$2 million.

The net capital violation at issue stems from Beacon's failure to recognize an approximate \$5 million liability arising from Rubin's failure to pay CCS for securities he purchased through this margin account. Rubin made this securities purchase, an unsolicited order to purchase 999,000 shares of GlobalNet, Inc. ("GlobalNet") stock at \$5.015 per share, at the end of the trading day on October 31, 2000. Because the trade occurred late in the trading day on October 31, CCS did not book the trade until November 1.

On November 2, 2000, CCS employees Steve Wooster and Brad Kaiser contacted Christopher Benz regarding their concern about Rubin's ability to pay for the GlobalNet trade given his stated income and net worth. Kaiser, associated with CCS as a general securities principal, testified before the hearing panel that Christopher Benz told him during the call that he knew Rubin personally, that Rubin's net worth was greater than what he disclosed on his account forms, and that Rubin had the ability to pay for the trade. Later that same day, CCS placed a second call to Beacon in which both Benz and Christopher Benz participated. During this call, Benz told CCS employees to use their discretion in deciding whether to accept or cancel the Rubin trade. CCS did not cancel the Rubin trade, and the trade settled on November 6, 2000. Kaiser testified that he relied on Christopher Benz's statements as well as information he received from Rubin's accountant in deciding that CCS should accept the trade.

CCS contacted Rubin and his accountant directly on several occasions to discuss payment for the GlobalNet trade. Benz was not involved in any of these discussions. On November 2 and November 8, 2000, Rubin wired to CCS two payments, each in the amount of \$200,000, towards the GlobalNet purchase. Rubin failed to pay for the remainder of the purchase, leaving a debit balance of \$4.6 million in his account. 9/

8/ The record also contains a clearing agreement dated December 15, 1998, which includes indemnification provisions that are identical to those in the October 30, 1998 Clearing Agreement. The record does not indicate the significance of the December Clearing Agreement.

9/ Ultimately, CCS sold a small portion of the GlobalNet stock in Rubin's account and purchased the remainder of GlobalNet stock in Rubin's account.

(continued...)

On December 19, 2000, NASD staff examiners contacted Benz by telephone to inform him that Beacon no longer met its minimum net capital requirement of \$5,000 because of the unsecured debit balance in the Rubin account, and, as a result, Beacon was prohibited from conducting a securities business. Although Benz disagreed with NASD's determination that the Rubin account deficit should be considered in calculating Beacon's net capital, Benz nevertheless sought to halt Beacon's securities business after receiving the NASD call. He and other Beacon employees attempted to contact all of Beacon's traditional retail and day-trading customers by telephone, email, and facsimile to advise them that they should not effect any transactions except to liquidate positions in their accounts. Beacon's attempt to halt the business of its day-trading customers was difficult since these traders effected transactions directly through CCS using CCS' proprietary software on their home computers. Thus, despite Beacon's efforts to halt securities trading, three day traders effected a total of nineteen trades after NASD's December 19 notification.

III.

Exchange Act Rule 15c3-1, the net capital rule, sets forth the net capital requirements for brokers and dealers. Exchange Act Section 15(c)(3) prohibits broker-dealers from effecting any securities transactions in contravention of the Commission's rules establishing, among other things, financial responsibility requirements, including the net capital rule. ^{10/} The purpose of the net capital rule is to ensure that a broker-dealer has sufficient liquidity to protect the assets of its customers and to be able to cover its indebtedness to other broker-dealers. ^{11/}

Benz does not dispute that he did not include the Rubin account deficit in calculating Beacon's requisite net capital. Nor does he dispute that, had the deficit been included, the Firm would have sustained a net capital violation. Thus, whether Beacon had a net capital deficiency

^{9/} (...continued)

On April 16, 2001, Beacon filed an arbitration claim against CCS and CCS filed a counterclaim with NASD Dispute Resolution to determine liability for the Rubin stock. On June 30, 2003, the NASD arbitration panel found Beacon to be liable and determined it should pay CCS the sum of \$1,312,742 in compensatory damages. (2003 WL 21694002 (N.A.S.D.)).

^{10/} NASD specifically found that Benz, by conducting a securities business when the Firm did not meet its net capital requirement under Exchange Act Rule 15c3-1, violated Conduct Rule 2110, which requires conduct consistent with just and equitable principles of trade.

^{11/} Russo Securities, Inc., Securities Exchange Act Rel. No. 44186 (Apr. 17, 2001), 75 SEC Docket 1124A, 1124G; L.H. Alton & Co., 53 S.E.C. 1118, 1121 (1999), petition denied, 229 F.3d 1156 (9th Cir. 2000) (Table).

hinges on whether the Rubin account deficit should have been treated as Beacon's liability for purposes of its net capital computation.

Benz contends that Beacon was not required to consider the Rubin account deficit in calculating its net capital requirement. Instead, Benz contends that Beacon's liability to CCS for Rubin's failure to pay for the GlobalNet stock was abrogated when CCS, without Beacon's knowledge or consent, negotiated and allegedly agreed to payment terms with Rubin. Benz reasons that, as a result of CCS' unilateral actions, Rubin ceased to be a customer of Beacon and became exclusively a customer of CCS; Beacon was no longer responsible for indemnifying CCS for Rubin's failure to pay.

We reject Benz's contention and find that Beacon, under the express terms of its Clearing Agreement with CCS, was required to treat the Rubin account deficit as a liability in determining its net capital. The Clearing Agreement provided that Beacon would indemnify CCS for any Beacon customer's failure to pay for securities purchased, such as the Rubin purchase of GlobalNet stock. The discussions between CCS and Rubin did not alter this indemnification obligation. Any change in Beacon's liability to CCS for the Rubin trade required, pursuant to NASD Conduct Rule 3230(e), a written amendment to the Clearing Agreement be made and submitted to NASD for review and approval. ^{12/} As we have explained previously, NASD approval of amendments "to clearing agreements is important precisely because, among other things, the approval process ensures that any amendments effectively clarify net capital obligations." ^{13/} Here, no such amendment was submitted to NASD. Thus, we conclude that Beacon was required to deduct the Rubin account deficit in calculating the Firm's net capital. The effect of that deduction caused the Firm to have insufficient net capital.

Because Beacon customers effected securities transactions while the Firm had a net capital deficiency, the Firm operated a securities business in violation of Exchange Act Rule 15c3-1 and therefore engaged in conduct inconsistent with Conduct Rule 2110. Benz, as president of Beacon, was responsible for the Firm's violation. Benz had actual knowledge of the Firm's net capital insufficiency as a result of NASD's notification and was responsible for ensuring that the Firm complied with all regulatory requirements. ^{14/} We recognize, as did

^{12/} William H. Gerhauser, 53 S.E.C. 933 (1998) (finding without submission to NASD for approval, there was no effective amendment to the clearing agreement).

^{13/} Gerhauser, 53 S.E.C. at 939.

^{14/} He had not delegated his responsibility for compliance to others in the Firm. See Gerhauser, 53 S.E.C. at 940-41 (finding president of a broker-dealer responsible for compliance with requirements imposed on the firm "unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has

(continued...)

NASD, that Benz made a good faith effort to halt the trading of the Firm's customers, but violations of the net capital rule do not require a finding of scienter. 15/

IV.

We may reduce or cancel sanctions imposed by NASD if we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary burden on competition. 16/ We do not make such a finding on this record.

The NASD Sanction Guidelines with respect to net capital violations provide for a fine of \$1,000 to \$50,000 and a suspension of up to 30 days or a lengthier suspension or bar in egregious cases. 17/ The Sanction Guidelines further provide that the principal consideration in determining sanctions is, among other factors, whether the firm continued in business while knowing of deficiencies or voluntarily ceased conducting business because of the deficiencies. 18/ NASD concluded that Benz acted in good faith to cease his securities business

14/ (...continued)
reason to know that such person's performance is deficient"); David M. Haber, 52 S.E.C. 201, 207 n.22 (1995) (same).

15/ See W. N. Whelen & Co., Inc., 50 S.E.C. 282, 287 (1990) (finding proof of intent to violate is unnecessary to establish a net capital violation). See also Hutchison Fin. Corp., 51 S.E.C. 398, 403-04 (1993) (explaining that officers of securities firms are responsible for ensuring a firm's compliance with applicable rules and regulations, including net capital requirements).

Conduct Rule 2110 requires the observance of high standards of commercial honor and just and equitable principles of trade. The Commission has found that a violation of the securities laws, including the net capital rule, is a violation of Conduct Rule 2110. See Gerhauser, 53 S.E.C. at 942-43.

16/ See Exchange Act Section 19(2)(2), 15 U.S.C. § 78s(e)(2). Benz does not claim, and the record does not show, that NASD's action has imposed an undue burden on competition.

17/ NASD Sanction Guidelines at 33 (2001).

18/ Id.

and imposed sanctions near the low end of the Guidelines, a \$5,000 fine and a 30-day suspension in a principal capacity. NASD further determined it was appropriate to require Benz to requalify as a principal in order to impress upon him the importance of complying with the net capital rule and of the obligations that a principal has for the Firm's compliance with NASD rules. We do not find these sanctions either excessive or oppressive.

An appropriate order will issue. 19/

By the Commission (Chairman DONALDSON and Commissioners CAMPOS and ATKINS); Commissioners GLASSMAN and GOLDSCHMID not participating.

Jonathan G. Katz
Secretary

19/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
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ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES
ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NASD against Paul Joseph Benz be, and
NASD's assessment of costs, be, and they hereby are, sustained.

By the Commission.

Jonathan G. Katz
Secretary