

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of

District Business Conduct Committee
for District No. 2,

Complainant,

vs.

Nancy H. Martin
Tustin, California,

Respondent.

ORDER OF REMAND

Complaint No. C02970027

District No. 2 (LA)

Dated: July 28, 1998

Nancy H. Martin ("Martin") appealed this matter pursuant to NASD Procedural Rule 9311. Under review is a decision of the District Business Conduct Committee for District No. 2 ("DBCC") dated October 17, 1997.¹ We remand this matter to the DBCC for the reasons stated below.

Background. Martin entered the securities industry in 1982. She has been employed in and out of the industry since that time. Most recently, she was registered as a general securities representative and principal with Texas Capital Securities, Inc. ("Texas Capital") from October 1993 through July 1995, and with Shamrock Partners, Ltd. ("Shamrock") from June through August 1995. In mid-1995, Shamrock acquired the Newport Beach branch office of Texas Capital.

The complaint in this matter was filed on July 2, 1997. District No. 2 staff ("Staff") served Martin via certified and first-class mail at her address of record as indicated in the Central Registration Depository ("CRD"). The first-class mailing was not returned; the certified mailing was returned marked "unclaimed." The second notice of complaint was mailed on July 30, 1997 via certified and first-class mail. The first-class mailing was not returned; the certified mailing was returned marked "unclaimed." Martin failed to file an answer or otherwise respond to the complaint.

After concluding that Staff had served Martin properly with first and second notices of complaint in accordance with the NASD Code of Procedure, the DBCC, pursuant to NASD Procedural Rule 9215(f), deemed the allegations of the complaint as having been admitted by Martin.

¹ The DBCC filed the complaint in this matter on July 2, 1997, after its review of a staff investigation of Martin.

On appeal, Martin contends that she did not respond to the DBCC complaint because she had spent eight months in Europe and discovered the complaint only upon her return to the United States.

Complaint and Evidence

Cause One. Cause one of the complaint alleged that, from March through May 1995, Martin permitted two unregistered persons, David Bahr ("Bahr") and Tibor Komoroczy ("Komoroczy"), to use her account executive ("AE") number to engage in securities business at Texas Capital by actively trading in seven customer accounts (totaling 285 trades) without registration, in contravention of Membership and Registration Rule 1031 and Conduct Rule 2110. The DBCC sustained all allegations of cause one of the complaint.

The record demonstrates that, for six of the seven accounts referenced in cause one, Martin was identified on customer account statements as the account executive of record during 1995.² The account statements for the seventh customer (for customer SM) identified "house," not Martin, as the account executive of record. The record contains affidavits or letters supporting the allegation that Bahr and/or Komoroczy, rather than Martin, solicited the customers' purchases and sales as to three of the six accounts for which Martin was listed as AE of record (customers MM, MP, and AB). The record, however, does not contain similar supportive evidence as to the other four accounts.

On appeal, Martin denies responsibility for the misconduct. She contends that, although she was registered as a principal with Texas Capital, she did not have authority to hire, fire or reprimand members of the staff. She states that five of the seven accounts were institutional accounts, and that Bahr and Komoroczy were instructed by others at Texas Capital to direct the fund managers for those accounts to place orders directly with Texas Capital's trading department until Bahr and Komoroczy had transferred their licenses to Texas Capital. Martin contends that she opened these accounts using the "house" AE number, and that someone else at Texas Capital must have put her AE number on the accounts. She also contends that customer MD was actually a customer of registered representative Tariq Khan ("Khan"). She states that Khan and MD intended to purchase the Newport Beach branch of Texas Capital and that MD had asked that his account be transferred to her until he and Khan completed the purchase. She states that she did not earn any commissions in these accounts and that she never paid any commissions to Bahr or Komoroczy.

Cause Two. Cause two of the complaint alleged that, from May through July 1995, Martin, while acting as the branch manager of the Newport Beach branch of Shamrock, failed to follow procedures reasonably designed to carry out the supervision of Bahr and Khan to ensure compliance with the Membership and Registration Rules. The complaint also alleged that during the relevant period, Martin failed adequately to supervise Bahr and Khan in that she allowed Bahr, while unregistered, to trade actively in customer accounts using Khan's AE number.³ The complaint alleged that this conduct

² For two of the accounts, only March and April account statements were included in the record. For the other five accounts, the record contains statements for March through May.

³ The complaint alleged that the misconduct occurred with respect to two customer accounts, but the schedule of trades attached to the complaint identified three customer accounts.

violated Conduct Rules 2110 and 3010. Khan was listed as the account executive of record on the account statements for June through August 1995 as to two of the three accounts (customers MM and AS) and for June as to the third account (customer SP). The record includes excerpts from Khan's October 28, 1996 testimony that indicate that Khan was the account executive of record for the ML account, but that the account in fact belonged to Bahr. The record does not contain similar evidence with respect to the other two accounts referenced in the complaint.

On appeal, Martin contends that Khan was the president of the company that owned Shamrock and that he supervised her.⁴ She admits that she knew that Bahr was entering trades while unregistered, but asserts that she had no authority to fire or otherwise reprimand Bahr. She denies that she was the branch manager of the Newport Beach office of Shamrock, and she states that she eventually quit because Khan refused to limit Bahr's activities. Martin states that she was an operations manager who was compensated with a straight salary and that she did not earn any percentage of the branch office's profits (as, she contends, a branch manager would be compensated). Martin also contends that she resigned from Shamrock on July 15, 1995. Martin also claims that she complained about Bahr's unregistered activity to Khan and that she was advised by Khan that he would handle the matter.

Discussion

As a preliminary matter, we accept Martin's assertion that she was traveling in Europe for eight months, but we find that her travels do not amount to "good cause" for failing to participate in the proceedings below. We therefore do not view as improper the DBCC's decision to consider the case as a default.⁵

Based on a careful review of the record, however, we have determined to remand this matter to the DBCC. Our reasons for the remand are discussed below in detail. Since the problems with the record as to cause two are more extensive than those related to cause one, we discuss cause two first, followed by a discussion of cause one. As the basis for our remand, we rely on the decision of the Securities and Exchange Commission ("Commission") in *In re James M. Russen, Jr.*, 51 S.E.C. 675, 678 n. 12 (1993), which instructs us that, even in the case of a default decision (where allegations are deemed to be admitted), on *de novo* review by the National Adjudicatory Council ("NAC") and the Commission, there must be an evidentiary basis in the record to support the allegations contained in the complaint.

⁴ According to CRD records, Khan was associated with Shamrock from May through September 1995, but was never registered as a principal of Shamrock.

⁵ Under Procedural Rule 9216(c) (now Procedural Rule 9215(f)), the DBCC may consider the allegations of the complaint as admitted by the respondent when he or she does not file an answer with the DBCC within the time required by the second notice of complaint. In accordance with that rule, the DBCC determined that Martin's failure to file an answer constituted an admission by her of the complaint's allegations.

Cause Two (Failure to Supervise)

Evidentiary Problems under Russen. Under the Russen standard, the DBCC's decision with respect to cause two cannot be upheld because it assumes the existence of the firm's supervisory procedures when such procedures have not been included in the record.

Although the DBCC found that Martin failed to maintain or enforce procedures designed to prevent associated individuals from effecting securities transactions without being properly registered, the complaint did not specifically charge Martin with such a violation, nor does the evidence in the record support such a finding. Although Rule 3010(b) requires each member to establish, maintain, and enforce written procedures to supervise the types of business in which it engages, the complaint contained only the following vague allegation: that Martin "failed to follow procedures reasonably designed to carry out the supervision of Bahr and Khan to ensure compliance with Membership and Registration Rules [Rule 1031]." (emphasis added.) Had the DBCC intended to charge Martin with a failure to maintain and enforce written supervisory procedures, Shamrock Partners' written supervisory procedures should have been included as evidence in the record.⁶

With respect to the highlighted account numbers in Table B (attached to this decision),⁷ we note that Staff presented no evidence from individual customers as to whether they had conducted their transactions with Bahr or Komoroczy, who were unregistered, rather than with Martin, whose account executive number appears on the account statements at issue. See Russen, supra (noting that "[t]he Association did not base its conclusion simply on the complaint's allegations; rather, it reviewed the record evidence presented by its staff and determined that the evidence supported a finding of violation" and that "[t]his approach affords [the] Commission a basis for discharging its review function under Section 19 of the Securities Exchange Act"). Under Russen, evidence supporting the allegations involving each of those account numbers should have been included in the record.

⁶ The complaint charged that Martin also failed to:

carry out her supervisory responsibilities when confronted with, or exposed to, various situations (i.e., red flags), which indicated that Bahr, with the assistance of Khan, was engaging in the securities business of a member without being properly registered.

This allegation appears to have been brought under Rule 3010(a) and would thus be consistent with the rule.

⁷ The DBCC charged that Bahr and Komoroczy actively traded with Martin's knowledge in the accounts listed in the table we have entitled "Table A," using Martin's account executive number. The DBCC also charged that Martin failed to carry out her supervisory responsibilities when confronted with trading by Bahr (who was not registered), using Khan's account executive number, in the customer accounts listed in the table we have entitled "Table B" (attached to this decision).

The DBCC's sanctions as to cause two also present a Russen evidentiary problem.⁸ The DBCC stated that it had considered the following factors, among others, in arriving at the appropriate sanctions: that "the firm's written supervisory procedures and supervisory controls were adequate" and that "Martin, the responsible principal, permitted the firm's supervisory procedures and controls to be circumvented by allowing unregistered persons to offer and sell securities utilizing the account executive number of a registered person." Although the Sanction Guideline for supervision lists as a principal consideration in determining sanctions the "extent of inadequacy in written supervisory procedures and controls," there is no evidence of such procedures in the record before us.

Conflicting Evidence of a Non-Russen Nature. In addition to the problems under Russen, as noted above, we have found other conflicts in the record with respect to cause two. First, the DBCC decision states that Martin was the branch manager for the Newport Beach branch offices of both Texas Capital and (subsequently) Shamrock Partners. There is, however, no documentary evidence in the record establishing that either firm ever officially designated Martin as a branch office manager or that she had been informed that she was to act in that capacity, although CRD records suggest that the firm notified the CRD system that she was acting as such.⁹ Martin argues that she was the operations manager, as opposed to the branch manager, of those offices and that an individual by the name of Jeff Loth ("Loth") was the actual branch manager.¹⁰ Martin also argues that she never had any authority to hire and fire personnel at the Newport Beach offices of either firm and that all of the employees knew that Loth was the individual in charge. In support of this argument, Martin submitted documents on appeal in an attempt to show that Loth was the individual who was acting in the capacity of branch manager of the Newport Beach office.¹¹

⁸ The DBCC censured Martin, fined her \$20,000 (\$10,000 per cause), and barred her from associating with any member firm in any capacity. Martin asserts on appeal that the sanctions are excessive and that she does not have the financial means to pay the fine imposed by the DBCC.

⁹ The CRD record that was included as evidence in the record shows that Martin was designated as the supervisory principal at the Newport Beach branch of Texas Capital. There is no evidence in the record demonstrating that Martin was the supervisory principal at the Newport Beach office of Shamrock Partners. We can take administrative notice that Martin was listed as supervisory principal of the Newport Beach branch of Shamrock Partners in the records of the CRD, but we note that it would be preferable for Staff to include proof of such information in the record.

¹⁰ On appeal, Martin submitted copies of her business card, one of which included the designation "Branch Operations Manager" and the other of which included the designation "Operations Manager."

The record is devoid of evidence of Loth's title or registration status.

¹¹ One document consists of a memorandum from Loth to all "Department Heads" that explained the policy at the Newport Beach branch office regarding reimbursable travel expenses. Another document consists of a letter from Loth to an individual he was offering to hire as a trader at Texas Capital Securities.

Second, the DBCC's decision states that Martin was registered as a general securities principal with Shamrock Partners from May 26, 1995 through August 18, 1995, but Martin claims that she resigned from Shamrock Partners on or about July 15, 1995.¹² Martin further argues that she repeatedly called Shamrock Partners after July 15 asking for a copy of her Uniform Termination Notice for Securities Industry Registration ("Form U-5"), but that she received no response from Shamrock Partners. In view of the fact that certain trades at issue were executed after the date on which Martin claims to have resigned from Shamrock Partners, the record should establish the point at which Martin ceased to be associated with Shamrock Partners.

Third, the DBCC decision states that Martin was the branch office manager of Shamrock Partners during the relevant period and that, with Martin's knowledge, several former Bahr accounts were transferred from Martin's AE number to Khan's AE number. Martin argues, however, that she did not have an AE number while she was associated with Shamrock Partners because of "how Texas Capital had abused it without [her] consent." Martin further argues that Shamrock attempted to assign an AE number to her, but that she refused the attempt.

Fourth, the record should include evidence regarding whether or not Shamrock Partners was an office of supervisory jurisdiction ("OSJ"), since Rule 3010(a) makes distinctions between OSJ and non-OSJ offices with respect to the imposition of supervisory responsibility.

Fifth, the record refers to the Newport Beach branch of Shamrock Partners variously as "Shamrock Partners" and "Newport West Financial." In light of this conflict, the record should be supplemented to include information about the corporate structure of Shamrock Partners, including whether Shamrock Partners was doing business as "Newport West Financial" or whether Newport West Financial was a subsidiary of Shamrock Partners.

Sixth, the record does not contain evidence regarding whether Texas Capital and Shamrock Partners maintained back office operations. Given the allegations at issue in this case (i.e., that Martin had knowledge that unregistered individuals were using her account executive number and the account executive number of another registered representative to execute trades), such evidence should be included in the record. The record should be clarified to indicate which trading records (e.g., trade tickets and confirmations), if any, Martin would have seen in her capacity as the individual who was listed in the CRD records as the supervisor responsible for the Newport Beach branches of Texas Capital and Shamrock Partners.

Seventh, the record contains conflicting evidence about Khan's role at Shamrock Partners. Khan is referred to at times as the "president" of Shamrock Partners and at other times as the "president" of a holding company that owned Shamrock Partners. The record, however, contains no

¹² In one of her submissions on appeal, Martin states that she resigned on July 14, 1995, and in other submissions she states that she resigned on July 15, 1995. However, on appeal Martin submitted a copy of a memorandum that was from her to a "Thomas and Mike" that was dated July 19, 1995, which contains her reconciliation for the "JNG Branch." This evidence suggests that Martin might not have resigned as of July 15, 1995, as she contends.

evidence that Shamrock Partners was a subsidiary of another company. In view of Martin's claims that she consistently complained to Khan about Bahr's unregistered trading, the record should contain evidence that establishes the nature of Khan's position with Shamrock Partners and/or its holding company.¹³

Eighth, although Thomas Buckley (the chief financial officer of Texas Capital during the relevant period) represented in his June 26, 1996 letter to Texas Capital's bonding company that Martin had hired Bahr without the knowledge or consent of the home office's compliance department, Martin submitted two memoranda (one of which is dated June 19, 1995, and one of which is undated) on appeal, which indicate that they were written by an individual by the name of "Thomas." Both memoranda specifically mention Bahr's name. We note that the June 19, 1995 memorandum, which mentioned Bahr by name, preceded Buckley's 1996 letter by one year, and that Buckley represented in the 1996 letter that, until an arbitration case with respect to Bahr had been filed against Texas Capital, the home office of Texas Capital had never heard of Bahr.¹⁴ The DBCC should resolve this apparent conflict on remand.

Ninth, we note that Schedule B to the complaint and decision (which contains the same information as the table we have designated as Table B and attached to this decision) refers to trading by Komoroczy and Bahr, when, in fact, the evidence demonstrates that the accounts at issue in cause two were traded by Bahr, using Khan's AE number. There is no evidence in the record to sustain a finding that Komoroczy traded those accounts.

Cause One (Use of Account Executive Account Number by Unregistered Individuals)

Russen Evidentiary Problems. Russen evidentiary problems are also raised by the findings and sanctions under cause one. First, we note that there is no evidence in the record showing that the highlighted trades in Table A were transacted with Komoroczy and Bahr, who were unregistered individuals, rather than with Martin, whose account number appeared on the account statements for those trades. Thus, the record does not contain evidence to support the allegations as to those accounts. See Russen, supra.

Second, although there is evidence in the record to support the allegation in cause one as to the non-highlighted accounts, we note that there is no evidence in the record to support the DBCC's sanctions as to those accounts.¹⁵ The DBCC stated that in arriving at appropriate sanctions it had

¹³ Martin claims that she did not have the authority to terminate Bahr. See In re Douglas C. Black, 51 S.E.C. 791 (1993) (finding that sanction was excessive because supervisory principal had attempted to terminate registered representative but was overruled by the firm's chairman of the board and chief executive officer).

¹⁴ Buckley stated in his 1996 letter that Texas Capital was then "currently" a respondent in an arbitration action involving claims that, from March through May of 1995, Bahr engaged in unauthorized transactions in large numbers of highly speculative, low-priced securities.

¹⁵ As to the non-highlighted accounts, the record contains affidavits from the customers stating that the trades at issue were transacted with Komoroczy and Bahr (who were unregistered) rather than with

considered, among other things, that "the supervisory procedures in place at the time of the violation were sufficient to detect and prevent registration deficiencies" and that "Martin circumvented the firm's supervisory procedures by allowing unregistered persons to utilize her account executive number to prevent detection by the firm." Although the Sanction Guideline for registration violations lists the "[e]xtent of supervisory procedures in place at time of violation to detect and prevent registration deficiencies" as a principal consideration for determining sanctions, the record, as discussed above, does not contain any evidence as to the supervisory procedures that were in effect at Texas Capital during the relevant period. See Russen, supra.

Evidentiary Problems of a Non-Russen Nature. The record also contains conflicting evidence with respect to the account number in boldface in Table A. That account was designated as a "house" account on the account statement that is included in the record. The complaint, however, alleged that Bahr and Komoroczy actively traded in that account using Martin's AE number. Martin, on the other hand, argues that the account that is designated in the account statement as a "house" account was MD's account and that MD had given Komoroczy written authorization to trade his account.

Martin, whose account number appeared on their account statements. The record also contains conflicting evidence about whether commissions that were generated by Bahr and Komoroczy were paid to Martin. The record contains a letter from Thomas Buckley, who was Texas Capital's chief financial officer during the relevant period, to Texas Capital's bonding company, in which he represented that commissions that were generated by Bahr and Komoroczy were paid to Martin. Martin disagrees with that representation and argues that the commissions generated under her AE number were not paid out, but were retained by the "house" and used to cover office overhead, and that she "did not ever" pay commissions to either Bahr or Komoroczy.

On the basis of the foregoing, we remand this matter to the DBCC so that an evidentiary hearing can be held to allow for a complete presentation of the documentary and testimonial evidence, and for reconsideration of the complaint, findings, and sanctions.¹⁶

On Behalf of the National Adjudicatory Council,

Joan C. Conley, Corporate Secretary

¹⁶ Martin's opening and reply appeal briefs contain factual assertions that are new evidence not previously entered into the record for this proceeding. In view of our decision to remand the matter to the DBCC, we have not ruled on the admissibility of these assertions. On April 7, 1998, the Subcommittee of the National Adjudicatory Council ("Subcommittee") that considered this matter on the record requested that the parties brief the sufficiency of the record evidence with respect to accounts JNG-94-1209, JNG-941187, JNG-941055, and JNG-004159, under cause one, and accounts JHOO-7663-4105 and BGOO-7474-4726, under cause two. As a result of that request, both parties submitted briefs that included additional evidence that had not been adduced at the proceedings below. In light of our decision to remand this matter to the DBCC, we have not ruled on the admissibility of such additional evidence on appeal.

We also note that the DBCC did not apportion the sanctions it imposed by cause.

TABLE A

Cause One

Bahr and Komoroczy Accounts Using Martin's AE Number

Account Name	Account Number	Number of Trades
SP	JNG-941209	47
MM	JNG-941012	36
MP	JNG-941039	24
DP	JNG-941187	2
SG	JNG-941055	6
AB	JNG-003888	54
SM	JNG-004159	116

TABLE B

Cause Two

Accounts Where Martin Failed to Supervise Securities Trading
By Bahr, Who Was Unregistered

Account Name	Account Number	Number of Trades
SP	JHOO-7663-4105	7
MM	JHOO-5747-4912	24
AS	BGOO-7474-4726	7