

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent.

Disciplinary Proceeding
No. 2005003437102

Hearing Officer – LBB

ORDER DENYING MOTION FOR LEAVE TO OFFER EXPERT TESTIMONY

Respondent has filed a motion seeking permission to offer expert testimony from FB, a non-practicing attorney, consultant, and former FINRA district director. Respondent describes the subject matter of FB's proposed testimony as follows:

(a) the mechanics, background and application of regulations pertaining to "directed brokerage" agreements, (b) the supervisory role of [Respondent's] broker/dealer [Firm S] and whether Respondent could justifiably rely upon his firm's approval (and participation in) the alleged "special arrangement," (c) the Department's attempt to enforce Rules 2830(k)(7) and (k)(4) against an individual like [Respondent] and mischaracterization of the FINRA rules, and (d) the propriety of mutual fund companies directing brokerage "specifically to the benefit of an individual broker" – an issue of first impression before this (or any other) forum.

Respondent's Motion for Leave to Offer Expert Testimony at Hearing, filed January 21, 2008, at pages 3-4. At a pre-hearing conference, Respondent explained that FB will also discuss custom and practice with respect to directed brokerage, although the testimony on custom and practice would be, at least in part, how FB regarded directed brokerage issues when he was with FINRA.

The subject matter of the testimony appears to be almost entirely questions of law that are more properly the subject matter of briefing by the parties. To the extent that the proposed

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testimony is intended to encompass opinions concerning the custom and practice of members of the industry with respect to directed brokerage or compliance issues, the Hearing Panel will possess more than sufficient expertise to make the appropriate determinations, and Respondent has not established that FB is qualified to testify concerning directed brokerage or compliance issues. Whether the expert testifies solely to legal questions or also testifies to some non-legal opinions for which he might have the factual basis and expertise, the testimony will not be helpful to the Hearing Panel. The motion is denied.

NASD Procedural Rule 9263(a) gives the Hearing Officer authority to “exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial.” This includes the authority to allow or to preclude expert testimony. Expert testimony is often excluded in FINRA proceedings because the hearing panels include people who have substantial relevant specialized knowledge themselves. *See Pagel, Inc.*, Exchange Act Release No. 22280, 33 S.E.C. Docket 1003 (Aug. 1, 1985), *aff'd, sub nom. Pagel, Inc. v. SEC*, 803 F.2d 942, 947 (8th Cir. 1986) (affirming SEC Administrative Law Judge's exclusion of expert testimony).

Expert testimony on legal issues is inadmissible, and if such testimony is admitted it should be given no weight. *See Dep't of Enforcement v. Respondent*, OHO Redacted Decision No. CAF030014 at 8 (O.H.O. Mar. 3, 2006)¹ (declining to give any weight to expert testimony on conclusions of law);² OHO Order 00-29 (C9B000013) (Oct. 6, 2000) (denying motion for permission to offer expert testimony on law); OHO Order 05-42 (CE3050003) (Dec. 11, 2005)

¹ Available at www.finra.org/OHO.

² The hearing panel cited the following cases in declining to consider legal conclusions: *Snap-Drape, Inc. v. Commissioner*, 98 F.3d 194, 198 (5th Cir. 1996) (Tax Court properly declined to admit expert witness reports offered by taxpayer that “improperly contain[ed] legal conclusions and statements of mere advocacy”); *United States v. Scop*, 846 F.2d 135, 138-40 (2d Cir. 1988), *modified*, 856 F.2d 5 (2d Cir. 1988) (“repeated statements [by expert] embodying legal conclusions exceeded the permissible scope of opinion testimony”); *In the Matter of Potts*, 53 S.E.C. 187, 1997 SEC LEXIS 2005, at *45 (1997) (ALJ properly excluded testimony of law professor and former SEC commissioner that would have consisted of “mere opinion of law” and “would not [have] provide[d] evidence”); *Dep't of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at *91 (N.A.C. Oct. 28, 2002) (“the lawyers for the parties, not expert witnesses, ha[ve] the task of arguing to the Hearing Panel what the applicable legal standards [are]”). *Id.* at fn.7.

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(withholding decision on admissibility of proposed testimony, but noting that legal argument “could be better and more efficiently presented in the parties’ briefs.”).³ Testimony that is within the expertise of a hearing panel is also not helpful and is generally excluded. For example, a FINRA Hearing Officer recently rejected a motion to offer expert testimony similar to the proposed testimony by JB, both because the proposed testimony “involve[d] concepts well within the expertise of any NASD Hearing Panel,” and because the subject matter of the testimony was inadmissible opinion on matters of law. OHO Order 06-14 at page 5 (C05050015) (Jan. 20, 2006).

The NAC has upheld hearing panel decisions excluding expert testimony. For example, the rejection of testimony on the applicability of an Interpretive Memorandum was upheld in *Dep’t of Enforcement v. Respondent Firm*, No. CAF000013, 2003 NASD Discip. LEXIS 40 at page 13, fn.10 (N.A.C. Nov. 14, 2003). The respondents had sought to introduce expert testimony that IM-2440, NASD’s “Mark-Up Policy,”⁴ did not apply to the transactions at issue in the case. In affirming the hearing panel’s refusal to permit the expert to testify, the NAC stated, “The issue of whether Respondent Firm’s purchase transactions fell within an exemption to IM-2440 is a legal issue.”

The NAC upheld the refusal of a hearing officer to permit expert testimony on legal issues in *Dep’t of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at **90-91 (N.A.C. Oct. 28, 2002). The NAC first noted that “Hearing Panel members often have

³ Testimony concerning legal conclusions is generally inadmissible under the Federal Rules of Evidence. 4-704 *Weinstein’s Federal Evidence* § 704.04[1]; *John Klaczak v. Consolidated Medical Transport Inc.*, 2005 U.S. Dist. LEXIS 13607, at * 9 *et seq.* (N.D. Ill. May 26, 2005); *In re Initial Public Offering Servs. Litig.*, 174 F. Supp. 2d 61, 64 (S.D.N.Y. 2001) (“In fact, every circuit has explicitly held that experts may not invade the court’s province by testifying on issues of law.”) (collecting numerous cases). Testimony on law is excluded in bench trials as well as jury trials. *Sparton Corporation v. United States*, 77 Fed. Cl. 1, 8 (2007) (“Whereas, in a jury trial, expert testimony on the law may be excluded in part to prevent jury confusion, the primary reason for exclusion of such testimony in a bench trial is that it invades the province of the court and is not helpful.”).

⁴ “IM-2440 states that it is a violation of Rules 2110 and 2440 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security.” *Id.* at **11-12.

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industry experience, and the Hearing Officer’s discretion to accept or reject expert testimony is particularly broad.” The panel found that expert testimony “regarding the requirements during the period at issue for compliance with NASD’s affirmative determination rule” was improper testimony on an issue of law. It also upheld the rejection of testimony regarding the elements of proof necessary to establish market manipulation because that too was a question of law.⁵

These cases support the exclusion of JB’s testimony. Although the scope of the proposed testimony regarding “the mechanics, background and application of regulations pertaining to ‘directed brokerage’ agreements,” is unclear, most, if not all, of the testimony would clearly be on matters of law, similar to the testimony rejected in *Fiero* and OHO Order 06-14 (rejecting testimony that “Conduct Rule 3040 permits selling to family members and that such activity fell within the regular course and scope of the Respondent’s duties at their firm...”).

Testimony about “the supervisory role of Respondent’s broker/dealer [Firm S] and whether Respondent could justifiably rely upon his firm’s approval (and participation in) the alleged ‘special arrangement’” is clearly a pure question of law. Respondent can argue this issue in his pre-hearing brief and, if permitted, post-hearing brief.

It is somewhat unclear what the expert will say about “the Department’s attempt to enforce Rules 2830(k)(7) and (k)(4) against an individual like Respondent and mischaracterization of the FINRA rules....” It appears that this is also a pure question of law – whether these provisions apply – and is thus the same kind of testimony that was rejected in *Fiero, Dep’t of Enforcement v. Respondent Firm*, and OHO Order 06-14. To the extent that

⁵ The NAC also held that it was proper to reject expert testimony on several general topics, such as short selling, market making, small-cap securities, clearing firms, net capital, and block trading, because the topics are the kind that are within the expertise of hearing panels. *Id.* at fn.54.

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Respondent intends to offer expert testimony about the motives of Enforcement in bringing this case, such testimony would be pure speculation and beyond Respondent's expertise.⁶

Similarly, "the propriety of mutual fund companies directing brokerage 'specifically to the benefit of an individual broker'" is also a pure question of law.

Respondent stated at a pre-hearing conference that JB would testify about industry practice with respect to directed brokerage as a result of the applicable laws and rules. The scope of this proposed testimony is somewhat unclear, and it appears to relate more to regulatory issues rather than the practices of industry members. To the extent it is intended to relate to industry practices, this is an area well within the expertise of experienced people in the industry, and the Hearing Panel collectively will have more than sufficient knowledge and experience with respect to industry practices. Additionally, there is nothing in JB's credentials that suggests that he has any special expertise concerning industry practices with respect to directed brokerage, especially with respect to payments to individuals. To the extent JB's statement is intended to refer to the internal practices of FINRA, as Respondent stated at the pre-hearing conference, such testimony is of, at best, questionable relevancy.

The proposed testimony would not be helpful to the Hearing Panel. It largely, if not entirely, consists of testimony about legal issues that are more appropriately briefed by the parties' attorneys than the subject of expert testimony. To the extent that there is factual content, Respondent has not demonstrated that the issues are beyond the expertise of the Hearing Panel,

⁶ The testimony would be inadmissible regardless of the relevancy of the issue. The relevancy of the issue is not decided here.

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or that JB possesses sufficient expertise to qualify him to offer expert testimony that would be helpful to the Hearing Panel. Accordingly, the motion is denied.

SO ORDERED.

Lawrence B. Bernard
Hearing Officer

Dated: February 26, 2008
Washington, DC