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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. Respondent.	Disciplinary Proceeding No. 2009017798201 Hearing Officer—Andrew H. Perkins

Order Denying Respondent's Motion for Leave to Offer Expert Testimony

I. INTRODUCTION

The Department of Enforcement ("Enforcement") brings this disciplinary proceeding against Respondent, alleging that (1) he made unsuitable sales of securities to a non-profit animal shelter in 2008, (2) he refused to follow his customer's order to sell securities, and (3) he participated in securities transactions away from his firm without providing it with prior written notice of the proposed transactions. Although the Complaint contains four causes of action, Respondent's present motion for leave to present expert testimony pertains only to the second and fourth causes. The second cause of action alleges that Respondent recommended and sold to the animal shelter tenants-in-common ("TIC") interests in undeveloped real estate, in violation of NASD Conduct Rules 2310 and 2110. The Complaint further alleges that the TIC interest was a security, as that term is defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. The fourth cause of action alleges that Respondent participated in the sale of TIC interests without providing his FINRA registered firm prior notice of the proposed transactions, in violation of NASD Conduct Rules 3040 and 2110 and FINRA Conduct Rule 2010.

In preparation for the hearing, Respondent has retained an expert. Respondent now moves for leave to offer the expert's proposed testimony. For the reasons discussed below, that motion is denied.

II. BACKGROUND

A. Scope of Proposed Testimony

Respondent has retained LR, an attorney, as an expert on "whether or not the TIC interests sold by Respondent to various purchasers constitutes the purchase and sale of a security, as that term is defined under The Securities Act of 1933 and The Securities Exchange Act of 1934."[1] At the hearing, LR intends to opine that the TIC interests Respondent sold were not securities because the purchasers' expectation of profits was not dependent solely upon the efforts of others, which is one of the four required elements for a security under *SEC v. Howey Co.*, 328 U.S. 293 (1946).[2] According to the motion, LR will testify that "while Respondent was involved in the continued development of the North Carolina property, the deals were specifically structured such that the continued development of the subject property involved the efforts of the purchasers, many of whom were and continue to be vitally important to the development process."[3]

B. Relevant Qualifications

LR is the CEO and owner of a private equity and investment banking firm that manages real estate funds and provides investment banking services for owners, operators, developers, managers and sponsors of real estate programs, including TIC programs, REITs, and real estate funds. In addition, he is the CEO of a holding company for a registered investment advisor.

[1] Mot. at 1.

[2] Mot. at 6.

[3] Mot. at 6. Respondent did not file an expert report with his motion.

Between 1987 and 2004, LR was a partner with the HF law firm in Virginia, where he chaired the firm's Real Estate Securities Practice Group. LR is a registered securities principal and broker with FINRA.[4]

C. Applicable Law

Hearing Officers have broad discretion to accept or reject expert testimony.[5] FINRA Procedural Rule 9263(a) gives Hearing Officers authority to "exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial."

While the Federal Rules of Evidence are not applicable to FINRA proceedings per se, those rules and the case law applying them can provide helpful guidance. Rule 702 of the Federal Rules of Evidence governs the admissibility of expert testimony. It states that:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

For expert testimony to be admissible under Fed. R. Evid. 702, three requirements must be met. First, the witness must be "qualified as an expert by knowledge, skill, experience, training, or education[.]"[6] Second, the expert's knowledge must be of the type that will "assist the trier of fact to understand the evidence or to determine a fact in issue[.]"[7] Thus, expert witnesses are generally not permitted to address issues of fact that a jury is capable of

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[4] Curriculum Vitae of LR, Ex. A to Respondent's Mot.

[5] *Department of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at *89-90 (N.A.C. Oct. 28, 2002) (citing *Pagel, Inc.* 48 S.E.C. 223, 230 (1985), *aff'd sub nom. Pagel, Inc. v. SEC*, 803 F.2d 942 (8th Cir. 1986).

[6] Fed. R. Evid. 702. Generally, courts have liberally construed expert qualification requirements. *See, e.g., McCullock v. H.B. Fuller Co*., 61 F.3d 1038, 1042-43 (2d Cir. 1995) (expert allowed to testify as to matters within his general expertise even though he lacked qualifications as to certain technical matters within that field).

[7] Fed. R. Evid. 702. *See also* Advisory Committee's Note, Fed. R. Evid. 702 ("Whether the situation is a proper one for the use of expert testimony is to be determined on the basis of assisting the trier.").

understanding without the aid of expert testimony.[8] In addition, it is well-established that expert witnesses are not permitted to testify about issues of law—which are properly the domain of the trial judge and jury.[9] Third, the proposed expert testimony must be based "on a reliable foundation."[10]

"In short, expert testimony is admissible only if it is both relevant and reliable."[11]

III. DISCUSSION

Enforcement requests that LR be precluded from testifying on the grounds that his experience and training provide an insufficient basis for his proposed testimony and that his proposed testimony impermissibly embraces a question of law.

First, the Hearing Officer notes that courts generally take a liberal approach to the qualifications requirement under Fed. R. Evid. 702. Hearing Officers likewise apply a liberal approach when evaluating a proposed expert's qualifications. Here, however, the Hearing Officer does not need to address LR's qualifications because the Hearing Officer finds that the proposed expert testimony is inadmissible on two other grounds.

First, LR's proposed testimony would not assist the Hearing Panel. Contrary to Respondent's argument, the Hearing Officer concludes that application of the four-prong test in *Howey* to the facts of this case does not present a complex issue beyond the understanding of the hearing panelists. Indeed, the specific question Respondent proposes that LR address—whether the "the deals were specifically structured such that the continued development of the subject property involved the efforts of the purchasers, many of whom were and continue to be vitally

[8] *See, e.g., Andrews v. Metro N. Commuter R.R. Co.*, 882 F.2d 705, 708 (2d Cir. 1989) (stating that expert testimony is inadmissible when it addresses "lay matters which [the trier of fact] is capable of understanding and deciding without the expert's help").

[9] *Rezulin Prods. Liab. Litig*., 309 F. Supp. 2d 531, 548-49 (S.D.N.Y. 2004).

[10] *See Daubert v. Merrell Dow Pharms., Inc*., 509 U.S. 579, 597 (1993).

[11] *Pipitone v. Biomatrix, Inc*., 288 F.3d 239, 244 (5th Cir. 2002).

important to the development process"—is a relatively straightforward factual question to be determined from the face of the contracts and from the testimony of the parties to the contracts. As such, expert testimony is unnecessary and irrelevant.[12]

Second, LR's proposed testimony must be excluded because it encompasses an ultimate legal conclusion.[13] FINRA's disciplinary process reserves to the Hearing Officer the role of adjudicating the law for the benefit of the industry panelists.[14] Therefore, the expert testimony of an attorney is superfluous.[15]

IV. CONCLUSION

For the aforementioned reasons, Respondent's motion for leave to offer expert testimony is denied.

IT IS SO ORDERED.

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Andrew H. Perkins
Hearing Officer

Dated: March 24, 2011

[12] *Pipitone*, 288 F.3d at 245 (to be relevant expert testimony must assist the trier of fact to understand the evidence or to determine a fact in issue).

[13] *See, e.g., Aguilat v. Int'l Longshoreman's Union*, 966 F.2d 443, 447 (9th Cir. 1992) (noting matters of law are for the court's determination, not that of an expert witness); *see also Marx & Co. v. Diners' Club, Inc.*, 550 F.2d 505, 509-10 (2d Cir. 1977) (expert testimony consisting of legal conclusions inadmissible).

[14] *Cf. United States v. Brodie*, 858 F.2d 492, 496-97 (9th Cir. 1988) ("[I]t is well settled that the judge instructs the jury in the law. Experts 'interpret and analyze factual evidence. They do not testify about the law because the judge's special legal knowledge is presumed to be sufficient, and it is the judge's duty to inform the jury about the law that is relevant to their deliberations.'").

[15] *See, e.g.*, *Marx*, 550 F.2d at 510 (finding expert testimony on law unnecessary and superfluous because of the special legal knowledge of the judge).