

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent 1,

Respondent 2,

Respondent 3,

Respondent 4,

and

Respondent 5

Respondents.

Disciplinary Proceeding
No. 2010024522103

Hearing Officer - DRS

ORDER DENYING MOTION PURSUANT TO FINRA RULE 9234

A. Introduction

The Complaint charges that Respondents made misrepresentations and unsuitable recommendations in connection with the sale of notes issued in a private placement offering. The Complaint also alleges that Respondents recklessly failed to conduct a reasonable investigation of the viability and legitimacy of the issuer in light of numerous red flags that it was a fraud. Finally, by failing to obtain basic information about the issuer, Respondents allegedly lacked a reasonable basis to recommend the notes to investors. For their defense, Respondents assert that they reasonably relied on their firm's review, approval, and structuring of the offering, as well as on its due diligence and representations.

To support their defense, on February 20, 2015, Respondents moved for permission to introduce expert testimony from an investment banking industry expert and from an investment banking compliance expert ("industry experts") on various subjects, such as suitability and due

diligence standards for private placement offerings; disclosure obligations; the firm's compliance and investment banking structure; the procedures, rules, and regulations that Respondents allegedly violated; the permissibility of Respondents' reliance on the firm's investment banking department; and a comparison of the firm's overall structure to their industry peers. Respondents also sought to introduce the testimony of an expert on certain scientific and technical subjects related to the offering ("science expert"). On March 18, 2015, the Hearing Officer granted the request regarding the science expert. The Hearing Officer, however, denied Respondents permission to offer testimony from the industry experts, primarily because their proposed testimony fell within the expertise of typical industry hearing panelists, constituted legal opinions, or intruded upon ultimate determinations that are within the province of the hearing panel.

On March 25, 2015, the Chief Hearing Officer announced the appointment of the extended hearing panelists, whereupon Respondents investigated their backgrounds based on publically available information relating to their industry experience. On March 27, 2015, two days after the panelists' appointment, Respondents moved to disqualify them, having concluded that neither panelist "has experience, let alone, expertise in connection with investment banking standards and compliance efforts in small member firms."¹ Alternatively, Respondents request that their proposed industry experts be permitted to testify, notwithstanding the Hearing Officer's previous denial of their motion to call those experts. The gravamen of the motion is that Respondents will be deprived of a fair hearing because the panelists lack the expertise required to understand the issues in the case and will not have the benefit of the expert testimony that Respondents proffered.

The Department of Enforcement filed its opposition on April 1, 2015, arguing that the motion is the equivalent of a motion to reconsider the denial of Respondents' expert testimony request; that there are no grounds for granting reconsideration; that the argument questioning the panelists' competence is meritless; and that Respondents violated the Case Management and Scheduling Order ("CMSO") by not first consulting with Enforcement to determine whether Enforcement would consent to the relief requested in the motion.

Under FINRA Rule 9234(d), the Hearing Officer promptly investigated whether disqualification is required and, for the reasons explained below, finds that neither panelist should be disqualified.

¹ Respondents' Motion at 3.

B. Discussion

Respondents moved for disqualification under FINRA Rule 9234. This Rule requires that a motion to disqualify “be based upon a reasonable, good faith belief that a conflict of interest or bias exists or circumstances otherwise exist where the Panelist’s fairness might reasonably be questioned.”² The National Adjudicatory Council has explained that this standard was derived from “the conflict of interest standard that is applicable to federal judges. Thus, the correct test for a recusal motion is ‘whether an objective, disinterested observer fully informed of the facts underlying the grounds on which recusal [is] sought would entertain a significant doubt that justice would be done in the case.’”³

Respondents have not raised a significant doubt that justice would be done if the panelists were permitted to serve. First, Respondents do not assert any of the grounds for disqualification enumerated in Rule 9234. Specifically, they do not contend that the panelists have a conflict of interest, or bias, or that their fairness might reasonably be questioned. Instead, Respondents submit that they will be deprived of a fair hearing given the panelists’ alleged lack of expertise and the denial of the expert testimony motion. But alleged lack of expertise is not a basis for a motion to disqualify panelists under Rule 9234.

Second, although expertise is one of several factors the Chief Hearing Officer should consider when appointing panelists,⁴ a respondent generally does not have the right to dictate the qualifications of the panel members.⁵ The Hearing Officer finds no basis to permit Respondents to dictate the qualifications of the extended hearing panelists in this case.

Finally, as a result of the Hearing Officer’s investigation triggered by the filing of the motion, the Hearing Officer finds that disqualification of neither panelist is required. The panelists were selected in accordance with FINRA Rule 9232, and no grounds for disqualification exist.

² FINRA Rule 9234(b).

³ *Dep’t of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at *93 (NAC Oct. 28, 2002) (quoting *Pepsico, Inc. v. McMillan*, 764 F.2d 458, 460 (7th Cir. 1985)).

⁴ Rule 9232(d)(1).

⁵ See *Dep’t of Enforcement v. Sathianathan*, No. C9B030076, 2006 NASD Discip. LEXIS 3, at *53–54 (NAC Feb. 21, 2006) (rejecting respondent’s challenge to hearing panel and holding that respondents generally cannot dictate the qualifications of panelists), *aff’d*, Exchange Act Release No. 54722, 2006 SEC LEXIS 2572 (Nov. 8, 2006), *aff’d*, 304 F. App’x 883 (D.C. Cir. 2008); *Dist. Bus. Conduct Comm. v. Guevara*, No. C9A970018, 1999 NASD Discip. LEXIS 1, at *38 (NAC Jan. 28, 1999) (same). Cf. *Rita H. Malm*, Exchange Act Release No. 3500, 1994 SEC LEXIS 3679, at *28–29 (Nov. 23, 1994) (rejecting argument that “hearing panel members were associated with large brokerage houses and were therefore unable to understand the organization and problems of a small firm” and explaining that “[w]hile SRO panels are intended to permit review by peers of the conduct of members of the securities industry,” the panel members were not required “to be associated with firms of the same size and business mix as those of the respondents’ firm.”).

This Order has been published by FINRA's Office of Hearing Officers and should be cited as OHO Order 15-09 (2010024522103).

In conclusion, Respondents have failed to demonstrate that the panelists should be disqualified under Rule 9234 or that the Hearing Officer should grant their alternative requested relief. Accordingly, the motion is **DENIED**.⁶

SO ORDERED.

David R. Sonnenberg
Hearing Officer

Date: April 8, 2015

⁶ Respondents' failure to confer with Enforcement before filing the disqualification motion constitutes grounds for denying the motion. *See* CMSO at 4. But given the importance of the issues raised by the disqualification motion, the Hearing Officer considered its merits in issuing this ruling. Nevertheless, Respondents are reminded of their obligation to comply with the consultation and certification requirement in connection with any future motions.