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

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DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

RESPONDENT 1,

and

RESPONDENT 2,

Respondents.

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Disciplinary Proceeding  
No. 2014040501801

Hearing Officer – DRS

**ORDER DENYING MOTION FOR PERMISSION TO PRESENT  
EXPERT TESTIMONY**

**A. Introduction**

On January 22, 2016, Respondents moved for permission to present the expert testimony of Michael F. Krehel, Jr., a registered Professional Engineer (“Motion”).

In support of their Motion, Respondents represent that Krehel will (1) “assist the Panel in its consideration of the depth and sufficiency of the due diligence review required in an oil and gas transaction of the type set forth in the 4x4 Joint Venture;” (2) “evaluate the roles of various professionals and other parties as they relate to the allegation that Respondent 2 exerted too much control over the processes;” (3) “opine on the industry norms for oil and gas transactions of the type set forth in the 4x4 Joint Venture;” and (4) help the Panel evaluate the sufficiency of Respondent 1’s written supervisory procedures (“WSPs”), “especially in light of his knowledge of the oil and gas business.” Respondents also represent that their counsel lacks the “scientific knowledge or oil and gas industry experience to address issues pertaining to the adequacy of Respondents’ preparation and supervision for the offering.” They “believe that this insight can only be provided by an expert such as” Krehel.<sup>1</sup>

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<sup>1</sup> Mot. at 1–2.

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The motion proffers that Krehel would testify:

- That the persons engaged in the offering of the 4x4 Joint Venture and investing in the 4x4 Joint Venture were all provided sufficient technical and financial data for an adequate evaluation;
- That data provided to all relevant persons was consistent with standard oil and gas industry practice;
- That sufficient due diligence was conducted;
- That the allegations that the WSPs were insufficient are meritless; and
- Regarding the separate roles of the independent operator, the petroleum geologist, and the persons at the broker-dealer other than Respondent 2 "in support of the contention that Respondent 2 did not exert undue influence or control as alleged in the complaint."

Enforcement opposed the Motion on February 5, 2016. Enforcement submits that Respondents did not establish that expert testimony is necessary; that this case does not involve novel issues or new, complex, or unusual securities products; that the proposed expert testimony impermissibly seeks to provide legal conclusions; that expert testimony might assist Respondents' counsel is irrelevant; and that Respondents did not establish that Krehel has specialized expertise or experience that the Hearing Panel lacks.

As explained below, I deny the Motion.

## **B. Discussion**

A Hearing Officer has particularly broad discretion to accept or reject expert testimony.<sup>2</sup> FINRA Rule 9235 empowers a Hearing Officer to "do all things necessary and appropriate" to fulfill his or her duties in the conduct of the proceeding, including resolving all procedural and evidentiary issues that may arise. "With respect to evidence generally, relevance is the guiding principle in disciplinary proceedings such as this."<sup>3</sup> Under FINRA Rule 9263(a), a Hearing Officer shall admit evidence that is relevant, but may exclude evidence that is "irrelevant, immaterial, unduly repetitious, or unduly prejudicial."

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<sup>2</sup> *Dep't of Enforcement v. Brookstone Securities, Inc.*, No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at \*113 (NAC Apr. 16, 2015).

<sup>3</sup> OHO Order 16-02 (2014040295201), at 2 (Jan. 29, 2016) (citing OHO Order 12-01 (2009018771602), at 2 (Mar. 14, 2012)), <http://www.finra.org/sites/default/files/OHODecision/p126068.pdf>.

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It is the proponent’s burden to establish that an expert’s testimony satisfies the conditions for admission.<sup>4</sup> Although not binding in disciplinary proceedings,<sup>5</sup> Federal Rule of Evidence 702 is instructive regarding those conditions.<sup>6</sup> Rule 702, which governs the admissibility of expert testimony in federal court, provides that a witness who is “qualified as an expert by knowledge, skill, expertise, training or education” may provide expert testimony if the witness’s “specialized knowledge will help the trier of fact” and the testimony is reliable.<sup>7</sup> Here, the overarching and critical factor is whether Krehel’s proposed testimony would be helpful to the Hearing Panel.<sup>8</sup>

In determining whether expert testimony would be helpful, the nature of the forum must be taken into account.<sup>9</sup> FINRA Hearing Panels include two industry members. These industry panelists typically possess considerable industry experience and expertise. A Hearing Panel therefore acts as an “expert” body whose “businessman’s judgment” is based on the Panel’s collective experience.<sup>10</sup> In light of this collective experience, expert testimony is often unnecessary in disciplinary proceedings.<sup>11</sup> Indeed, such testimony is typically not offered “unless novel issues or new, complex, or unusual securities products are involved.”<sup>12</sup> While an

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<sup>4</sup> See, e.g., OHO Order 16-02 (2014040295201), at 2 (Jan. 29, 2016).

<sup>5</sup> FINRA Rule 9145(a).

<sup>6</sup> See, e.g., OHO Order 16-02 (2014040295201), at 2 (Jan. 29, 2016).

<sup>7</sup> *Id.* at 2.

<sup>8</sup> *Id.* at 3.

<sup>9</sup> *Id.* at 3.

<sup>10</sup> *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at \*66–67 & n.67 (May 27, 2011), *aff’d*, 693 F.3d 251 (1st Cir. 2012).

<sup>11</sup> *Dep’t of Enforcement v. U.S. Rica Fin., Inc.*, No. C01000003, 2003 NASD Discip. LEXIS 24, at \*27–28 (NAC Sept. 9, 2003); OHO Order 12-01 (2009018771602), at 4 (Mar. 14, 2012), <http://www.finra.org/sites/default/files/OHODecision/p126068.pdf>.

<sup>12</sup> See, e.g., OHO Order 00-29 (C9B0000), at 3 (Oct. 6, 2000), <https://www.finra.org/sites/default/files/OHODecision/p007941.pdf>.

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expert may opine on ultimate fact issues,<sup>13</sup> the expert may not give an opinion on the ultimate legal issue by applying the law to the facts of the case.<sup>14</sup>

In applying these principles to this case, I find that for several reasons, Respondents have not established that Krehel's testimony would assist the Panel.<sup>15</sup> First, this case does not involve "novel issues or new, complex, or unusual securities products." Rather, it primarily involves alleged violations relating to a private placement oil and gas offering and Respondent 1's supervisory procedures. The Complaint charges Respondents with making material misrepresentations and omissions in connection with the sale of units of joint venture interests; with misusing customer funds and acting toward the investors in a manner that was inconsistent with high standards of commercial honor and just and equitable principals of trade; with having a deficient supervisory system and procedures; and with violations relating to an allegedly falsified document. A typical FINRA Hearing Panel can resolve the issues relating to these charges without the need for expert testimony.

Second, the Motion describes Krehel's proffered testimony in one-sentence summaries, except for the description of his testimony regarding the WSPs, which consists of a two-sentence description. These summaries do not contain enough detail for me to conclude that the testimony would help the Panel understand or resolve any of the issues in this case. Nor are these descriptions sufficiently augmented elsewhere in the Motion to enable me to do so.

Third, in some instances, it is not clear from the descriptions whether the opinions will embrace not only ultimate fact issues, but impermissible ultimate legal conclusions. In particular, the testimony descriptions regarding the sufficiency of the information provided to investors, the sufficiency of the due diligence, the sufficiency of the WSPs, and whether Respondent 2 engaged in "undue influence or control," are unclear in this respect.

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<sup>13</sup> See, e.g., *Hurt v. Commerce Energy, Inc.*, No. 1:12-cv-00758, 2014 U.S. Dist. LEXIS 125321, at \*4 (N.D. Ohio Sept. 8, 2014) ("Although an expert's opinion may 'embrace[] an ultimate issue to be decided by the trier of fact[,] Fed. R. Evid. 704(a), the issue embraced must be a factual one.") (quoting *Berry v. City of Detroit*, 25 F.3d 1342, 1353 (6th Cir. 1994)).

<sup>14</sup> See, e.g., *Dep't of Enforcement v. Skelly*, No. CAF000013, 2003 NASD Discip. LEXIS 40, at \*13 (NAC Nov. 14, 2003) ("Although testimony concerning the ordinary practices in the securities industry may be received to enable a fact finder to evaluate [a party's] conduct against the standards of accepted practice . . . testimony encompassing an ultimate legal conclusion based upon the facts of the case is not admissible.") (quoting *Marion Bass Sec. Corp.*, 1998 SEC LEXIS 2690, at \*7, Admin. Proceeding Rel. No. 574 (Nov. 13, 1998)); *U.S. v. Bedford*, 536 F.3d 1148, 1158 (10th Cir. 2008) ("An expert may not state legal conclusions drawn by applying the law to the facts[.]"); *U.S. v. McIver*, 470 F.3d 550, 562 (4th Cir. 2006) ("[O]pinion testimony that states a legal standard or draws a legal conclusion by applying law to the facts is generally inadmissible.").

<sup>15</sup> Whether or not Respondents' counsel would benefit from Krehel's testimony, the issue is whether the Hearing Panel would benefit. And, as discussed above, I find that Respondents have not made this required showing.

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Finally, Respondents have not shown that Krehel is qualified to opine on the sufficiency of Respondents' due diligence and the WSPs, or to opine on the issues of undue influence or control. Krehel's resume reflects experience in oil and gas engineering and operations.<sup>16</sup> But it does not show that he has any securities industry experience or other experience that qualifies him to offer these opinions.

Because Respondents have not met the standards for offering expert testimony, I **DENY** the Motion.

**SO ORDERED.**

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David R. Sonnenberg  
Hearing Officer

Dated: February 22, 2016

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<sup>16</sup> RX-1.