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**NASD OFFICE OF HEARING OFFICERS**

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| DEPARTMENT OF ENFORCEMENT,<br><br>Complainant,<br><br>v.<br><br>Respondent 1<br><br>and<br><br>Respondent 2,<br><br>Respondents. | Disciplinary Proceeding<br>No. C05050015<br><br>Hearing Officer—Andrew H. Perkins |

**ORDER FOLLOWING FINAL PRE-HEARING CONFERENCE AND RULINGS ON MOTIONS IN LIMINE**

The Complaint charges the Respondents with participating in private securities transactions in violation of NASD Conduct Rules 3040 and 2110. The Complaint contains three causes of action. The first two relate to Respondent 2, and the third relates to Respondent 1.

The first cause of action alleges that Respondent 2, between December 1999 and March 2000, "solicited and/or referred" 24 investors to purchase shares of Series B convertible preferred stock from e2 Communications, Inc. and that each customer bought shares of e2 Communications preferred B stock.[1] The Complaint further alleges that Respondent 2 received shares of e2 Communications common stock as compensation for his participation in the foregoing securities transactions.[2]

[1] Compl. ¶¶ 18, 20.

[2] *Id.* ¶ 21.

The second cause of action alleges that, in August and September 2000, Respondent 2 solicited another customer to purchase shares of e2 Communications common stock from a private party and shares of Series C convertible preferred stock from e2 Communications.[3] The Complaint alleges that Respondent 2 received shares of e2 Communications common stock as compensation for his efforts regarding these two transactions and for his services as an "advisory director" of e2 Communications.[4]

The third cause of action alleges that Respondent 1 similarly participated in private securities transactions related to e2 Communications. According to the Complaint, Respondent 1 "solicited and/or referred" nine investors to e2 Communications to purchase shares of e2 Communications Series B convertible preferred stock.[5]

The Complaint alleges that the Respondents participated in the foregoing securities transactions without providing written notice to, or obtaining written approval from, their member firms.

The Hearing Officer conducted a final pre-hearing conference in this disciplinary proceeding on January 19, 2006, at which the Hearing Officer heard arguments on the pending motions in limine. This Order addresses each of those motions. In addition, the parties discussed the length of the hearing, the theory of the case, and the parties' proposed witnesses.

Upon consideration of the parties' arguments and representations, the Hearing Officer orders as follows:

## I. Opening Statements

The parties submitted pre-hearing briefs. Accordingly, opening statements will be limited to 30 minutes per party.

[3] *Id.* ¶ 25.

[4] *Id.* ¶¶ 8, 28.

[5] *Id.* ¶ 33.

## II. Enforcement's Motion to Preclude Expert Testimony

The Department of Enforcement ("Enforcement") moved to preclude the Respondents from presenting expert testimony. Enforcement argues that the Respondents' expert designation is incomplete and that expert testimony is not needed in this case. Enforcement argues that the Hearing Panel possesses sufficient expertise to determine the issues in this case.

The Respondents did not file an expert witness designation containing the information required by Procedural Rule 9242(a)(5). Instead, the Respondents listed two experts, [Expert 1] and [Expert 2], on their joint witness list. Thereafter, the Hearing Officer ordered the Respondents to supplement their witness list to comply with the Order Establishing Pre-Hearing Procedures dated June 6, 2005. Their original witness list did not provide any information about the listed witnesses' proposed testimony.

On January 5, 2006, the Respondents filed their Supplemented Witness List and disclosed that they intended to have the two experts testify regarding:

> Industry Standards and Practices concerning receipt, review, ownership and control and retention of correspondence and other communications; outside business activities and investments; responsibilities of member firms and associated persons in regard to NASD [Conduct Rule] 3010, 3030, and 3040. Responsibilities and authorities of Supervisory and Compliance Personnel. Just and Equitable Principals of Trade.

At the Conference, Respondent 2's counsel expanded on Expert 1's anticipated testimony.[6] Counsel explained that Expert 1 was expected to testify in support of the following propositions:

1. Registered representatives routinely rely on their branch managers for instructions on compliance with industry rules and regulations, such as Conduct Rule 3040.

2. The lack of "material omissions" by the Respondents impacts the determination of sanctions if the Hearing Panel should find a violation.

[6] In their opposition to Enforcement's motion, the Respondents withdrew Expert 2.

3. It is common industry practice for registered representatives to avoid Conduct Rule 3040 by making purchases in family members' names, and that the Respondents acted reasonably in relying on such guidance from principals at their firm.

4. Conduct Rule 3040 permits selling to family members and that such activity fell within the regular course and scope of the Respondents' duties at their firm.

5. The Respondents adhered to high standards of commercial honor and just and equitable principals of trade as required by Conduct Rule 2110.

Respondent's counsel further argued that Expert 1 might be asked to testify on other subjects, depending on the nature of Enforcement's evidence.

The admissibility of evidence in NASD disciplinary proceedings is governed by Procedural Rule 9263, which provides that "[t]he Hearing Officer shall receive relevant evidence, and may exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial." There is no specific NASD rule concerning expert testimony; accordingly, NASD looks to Federal Rule of Evidence 702 for guidance.[7] Under Rule 702 of the Federal Rules of Evidence, expert testimony is admissible if it "will assist the trier of fact to understand the evidence or to determine a fact in issue." In NASD cases, respondents must show that the proposed expert has experience or expertise that the Hearing Panel lacks, or that the testimony would otherwise be helpful to the Hearing Panel.[8] Because NASD Hearing Panels include individuals from the securities industry with substantial relevant expertise, expert testimony is not ordinarily necessary in NASD proceedings.[9]

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[7] *See, e.g.*, OHO Order 99-11, No. C8A990015 (June 17, 1999); OHO Order 99-03, No. C02980073 (Mar. 23, 1999).

[8] *Cf. District Business Conduct Comm. v. Holland*, No. C3B930015, 1995 NASD Discip. LEXIS 247 (N.B.C.C. Feb. 17, 1995).

[9] *See Meyer Blinder*, Exchange Act Release No. 31095, 1992 SEC LEXIS 2019 (Aug. 26, 1992) (NASD is an expert body whose "businessman's judgment" may be brought to bear in reaching its decision); *Pagel, Inc.*, Exchange Act Release No. 22280, 1985 SEC LEXIS 988 (Aug. 1, 1985), *aff'd*, 803 F.2d 942 (8th Cir. 1986).

Here, the proffered testimony involves concepts well within the expertise of any NASD Hearing Panel. Moreover, much of the proffered testimony is not the proper subject of expert testimony. In large part, the Respondents seek to have Expert 1 give his opinion on conclusions of law. Such testimony is inadmissible because it invades the exclusive province of the Hearing Panel.[10] In addition, much of Expert 1's proffered testimony is irrelevant to the issues in this proceeding. For example, this case does not involve supervisory violations under Conduct Rule 3010, outside business activities violations under Conduct Rule 3030, or books and records violations. Thus, expert testimony on those subjects is unnecessary.

For the foregoing reasons, the Hearing Officer grants Enforcement's motion to preclude expert testimony.

## III. Enforcement's Motion to Strike Mark Dauer from Respondents' Witness List

Enforcement also moved for entry of an order striking Mark Dauer, co-counsel for Enforcement in this proceeding, from the Respondents' witness list.

The Respondents argue that they should be permitted to call Dauer to testify regarding admissions he made in a meeting attended by Respondent 2, his former attorney, and the NASD investigator assigned to this case. The Respondents contend that Dauer admitted that the facts did not show a violation of NASD's rule against private securities transactions, Conduct Rule 3040.

[10] *See, e.g.*, *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 (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"); *Department 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").

Enforcement objects to the Respondents calling Dauer as a witness because any comments he made at the meeting with Respondent 2 were made in the context of settlement discussions. Enforcement argues that such statements cannot be introduced at a hearing.

The Hearing Officer denies Enforcement's motion. The record is not sufficiently developed to warrant entry of an order precluding the Respondents from calling Dauer as a fact witness. Therefore, the Hearing Officer will not strike Dauer from the Respondents' witness list at this time.

On the other hand, it appears from the parties' proffers that Dauer's testimony is unnecessary. Several people attended the subject meeting and heard Dauer's comments, including Respondent 2 and the NASD investigator. Both of them are scheduled to testify at the hearing and can be questioned about any factual admissions Dauer may have made. Balanced against the lack of need for his testimony is the prejudice that will accrue to Enforcement by having trial counsel called to testify. Therefore, the Respondents' ability to call Dauer as a fact witness is dependent upon the Respondents demonstrating the need for his testimony taking into consideration the testimony of the other participants at the subject meeting.

Moreover, the Respondents will not be permitted to question Dauer about his opinions. His opinions are neither relevant nor binding on Enforcement. Furthermore, such testimony would be in the nature of expert testimony on conclusions of law. As discussed above, such opinion testimony is inadmissible.

## IV. Enforcement's Motion to Strike [Witness 1] from Respondents' Witness List

Enforcement also moved to strike Witness 1 from the Respondents' witness list because they added him to the list after the deadline to file pre-hearing submissions. Because he was added after the deadline, Enforcement requests that he be stricken from the Respondents' witness list and not be permitted to testify at the Hearing.

The Respondents admit that he was not included in their original submission due to an oversight. Without requesting leave to add this witness, the Respondents included him on their Supplemented Witness List, which they filed in response to the Hearing Officer's order directing them to provide information missing from their original witness list.

In the usual case, the Hearing Officer would grant Enforcement's motion. The parties in NASD disciplinary proceedings are expected to meet the scheduling deadlines set in the Code of Procedure and in the Hearing Officers' orders. And the Respondents have not shown good cause to excuse their failure to list Witness 1 timely. However, because the Hearing Officer granted the Respondents leave to supplement their witness list, the Hearing Officer denies Enforcement's motion.[11] The Hearing Officer finds that Enforcement had adequate time to prepare for Witness 1's anticipated testimony after the Respondents filed their Supplemented Witness List.

**IT IS SO ORDERED.**

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Andrew H. Perkins
Hearing Officer

January 20, 2006

[11] This Order does not dispose of any substantive objections to Witness 1's anticipated testimony. Indeed, the summary included with the Respondents' Supplemented Witness List fails to disclose that he intends to testify on any relevant issues. Enforcement may raise appropriate objections to Witness 1's testimony when the Respondents present his testimony.