

This Order has been published by NASD's Office of Hearing Officers and should be cited as OHO Order 05-15 (CAF040058).

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent 1

and

Respondent 2

Respondents.

Disciplinary Proceeding
No. CAF040058

Hearing Officer – DRP

**ORDER DENYING RESPONDENTS' MOTION FOR LEAVE TO INTRODUCE
EXPERT TESTIMONY AND TO COMPEL PRODUCTION OF DOCUMENTS**

I. Introduction

Enforcement filed a four-count Complaint charging Respondents with fraudulently interpositioning a hedge fund between their firm and retail customers in convertible bond transactions and charging excessive and fraudulent markups that were not disclosed.

Respondents filed an Answer in which they deny wrongdoing and assert that the trades at issue were effectuated at prices determined by the firm's trading desk and that the markups or markdowns charged were not excessive. A disciplinary hearing is scheduled to commence on September 19, 2005.

On March 4, 2005, Respondents filed a motion seeking leave to introduce expert testimony at the hearing in this matter and for an order compelling the production of documents from several member firms pursuant to Rules 9252 and 8210. Respondent seeks to offer expert

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testimony regarding the pricing methodology for convertible bonds, the industry practice of interpositioning, and the appropriateness of the markups Respondents charged. Respondents also seek production of documents from several member firms regarding transactions in the convertible bonds at issue on the relevant dates. Respondents assert that the documents are material, that no comparable records have been produced or are readily available, and that they were unsuccessful in prior attempts to obtain voluntary production from the firms. They contend there is nothing unreasonable or oppressive about this request.

On March 17, 2005, Enforcement filed its opposition to the motion.¹ Enforcement notes that expert testimony is often unnecessary in NASD proceedings, because Hearing Panels include experienced securities professionals. Enforcement argues that Respondents, who failed to identify their prospective expert witness, cannot demonstrate that he or she possesses expertise or experience that the Hearing Panelists lack. With respect to Respondents' request for production of documents, Enforcement notes that the deadline for filing motions pursuant to Rule 9252 has passed and contends that Respondents have improperly invoked the rule for discovery purposes. Finally, Enforcement asserts that Respondents have not met the requirements of Rule 9252 and have failed to demonstrate that the requested documents are relevant or material.

For the reasons stated below, Respondents' motion is denied in its entirety.

II. Motion for Leave to Introduce Expert Testimony

Under Rule 9263(a), the Hearing Officer may "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 NASD proceedings because

¹ On March 22, Respondents sought leave to file a reply to Enforcement's opposition in order to "reinforce the rationale for the introduction of expert testimony." The Hearing Officer did not permit Respondents to file a reply.

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Hearing Panels include individuals who have substantial relevant specialized knowledge. *See Meyer Blinder*, Exch. Act Rel. 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.*, Exch. Act Rel. No. 22280, 1985 SEC LEXIS 988 (Aug. 1, 1985), *aff'd*, 803 F.2d 942 (8th Cir. 1986).

In the Scheduling Order, the Hearing Officer set a deadline of June 13, 2005 for the filing of pre-hearing motions, including motions for leave to offer expert testimony. Respondents have filed the instant motion well in advance of that date, because they cannot afford the expense of identifying and preparing such an expert without a ruling that expert testimony will be permitted.

Without identifying a proposed witness and providing other pertinent information, the Hearing Officer is unable to ascertain whether an expert witness could assist the Hearing Panel. Accordingly, Respondents' motion for leave to offer expert testimony is denied. Respondents may renew their motion on or before June 13, if they identify the proposed witness, list the witness's qualifications and area of expertise, provide a detailed narrative summary of the witness's proposed testimony, and otherwise comply with the notice provisions of Rule 9242(a)(5).

III. Motion to Compel Production of Documents

Rule 9252(a) permits a respondent to request that the Association invoke Rule 8210 to compel the production of documents or testimony at a hearing, provided such request is made in writing at least 21 days before the scheduled hearing and an appropriate showing is made.² Such

² A Rule 9252(a) request shall: ... "describe with specificity the Documents, the category or type of Documents, or the testimony sought; state why the Documents, the category or type of Documents, or the testimony are material; describe the requesting Party's previous efforts to obtain the Documents, the category or type of Documents, or the testimony through other means; and state whether the custodian of each Document, or the custodian of the category or type of Documents, or each proposed witness is subject to the Association's jurisdiction."

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requests shall be granted only upon a showing that: (1) the information sought is relevant, material, and non-cumulative; (2) the requesting Party has previously attempted in good faith to obtain the desired Documents and testimony through other means but has been unsuccessful in such efforts; and (3) each of the persons from whom the Documents and testimony are sought is subject to the Association's jurisdiction. Rule 9252(b). In addition, the Hearing Officer shall consider whether the request is unreasonable, oppressive, excessive in scope, or unduly burdensome, and whether the request should be denied, limited, or modified. *Id.*

Respondents assert that they need to obtain copies of records from other broker-dealers of contemporaneous transactions to determine how other firms priced the convertible bonds at issue during the relevant period. As noted above, and in the Hearing Officer's Order dated January 14, 2005, Rule 9252 permits a respondent to request the production of documents or testimony at the hearing. Respondents have again impermissibly invoked Rule 9252 for discovery purposes.

Moreover, Respondents have not met the requirements of Rule 9252. They have failed to demonstrate that the requested documents are relevant. In their Answer, Respondents assert they had neither "the capability or the authority to determine the price for a convertible bond," a determination that "rested exclusively" with the firm's trading desk, "upon whose pricing [Respondents] necessarily and justifiably relied." Furthermore, trades were "always processed through [the firm's trading d]esk, always executed at customer indicated levels, and always fell within the range determined by the [d]esk." Thus, documents from other broker-dealers to determine how those firms priced the convertible bonds at issue would not be relevant.

Nor did Respondents make a good faith attempt to obtain the requested documents. Respondents provided copies of letters dated October 12, 2004, in which their counsel requested the firm's "formula or model ... to calculate the pricing of convertible bonds ... and the

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underlying components or factors ... upon which the [f]ormula's calculation is based...." They never sought copies of records of contemporaneous transactions to determine how a firm priced the convertible bonds at issue during the relevant period. For all the reasons stated above, Respondents' motion to compel production of documents is hereby denied.

SO ORDERED.

Dana R. Pisanelli
Hearing Officer

Dated: April 7, 2005
Washington, DC