

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

RESPONDENT FIRM,

and

RESPONDENT 2,

Respondents.

Disciplinary Proceeding  
No. 2008012925001

Hearing Officer – MAD

**ORDER REGARDING PENDING MOTIONS AND PRE-HEARING ISSUES**

On July 15, 2011, the Hearing Officer held a Pre-Hearing Conference (“Conference”) to address the parties’ pending motions and objections, as well as other pre-hearing matters. The following orders address the topics presented during the Conference.

**I. Respondents’ Motion to File Additional Exhibits**

On April 25, 2011, Respondents filed a motion to add two additional exhibits, RX-54 and RX-55, to their pre-hearing submission. The Department of Enforcement (“Enforcement”) did not file a response. Respondents’ motion is granted.

**II. Respondents’ Motion for Production of Materials Relating to Enforcement’s Expert and Exclusion of the Expert and the Expert’s Report**

On April 19, 2011, Respondents filed a motion seeking the production of Enforcement’s expert’s materials and the exclusion of Enforcement’s expert and his report. Specifically, Respondents request that Enforcement produce all affidavits, expert reports, deposition

testimony and trial testimony prepared or provided by its expert. Enforcement filed its response on May 27, 2011.

Enforcement provided Respondents with a list of the all the cases for which its expert has testified. It represented that its expert does not obtain or keep transcripts of any of his deposition or trial testimony. Further, Enforcement represented that it has reviewed all of its expert's reports and turned over any report that related to the allegations in this case; namely, cherry picking. While Respondents seek copies of *all* of Enforcement's expert's reports from *any* case, they are not entitled to materials that are unrelated to the subject matter at issue (*i.e.* cherry picking).<sup>1</sup> Enforcement provided Respondents with a report and accompanying exhibits, relating to another cherry picking case for which its expert provided opinions.<sup>2</sup>

Respondents also move to exclude Enforcement's expert and his report. Specifically, Respondents argue that Enforcement's expert did not meet the requirements set forth in *Daubert v. Merrell Dow Pharmaceuticals, Inc.* *Daubert* requires the trial court to act as a gatekeeper to insure that speculative and unreliable opinions do not reach the jury.<sup>3</sup> "[T]he trial judge must have considerable leeway in deciding in a particular case how to go about determining whether particular expert testimony is reliable."<sup>4</sup> Sometimes the specific *Daubert* factors will aid in determining reliability; sometimes other questions may be more useful.<sup>5</sup>

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<sup>1</sup> See *In re Air Crash Disaster at Stapleton Int'l Airport*, 720 F. Supp. 1442, 1444 (D. Colo. 1988); *Surles v. Air France*, 2001 U.S. Dist. LEXIS 10048, at \*19-20 (S.D.N.Y. July 17, 2001); *Trunk v. Midwest Rubber & Supply Co.*, 175 F.R.D. 664, 665 (D. Colo. 1997).

<sup>2</sup> Enforcement represents that its expert has only rendered an opinions in two cases relating to cherry picking: (1) *SEC v. K.W. Brown*, an enforcement action, and (2) *Rodriguez v. K.W. Brown*, an arbitration. Because of the similar facts and issues in the two cases, the claimants in the *Rodriguez* matter resubmitted the expert's report from the SEC action and did not submit an additional report. Dept of Enforcement Response to Respondents' Motion for Production of Expert Materials at 14.

<sup>3</sup> *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 589 (1993).

<sup>4</sup> *Kumho Tire Co., Ltd. v. Carmichael, etc.*, 526 U.S. 137, 152 (1999).

<sup>5</sup> *United States v. Frazer*, 387 F.3d 1244, 1262 (11<sup>th</sup> Cir. 2004).

“[T]he court’s gatekeeping role is necessarily different” in a bench trial versus a jury trial.<sup>6</sup> Here, unlike a jury trial, the factfinders consist of the Hearing Officer and two industry panelists with a considerable amount of securities expertise. Accordingly, “where the factfinder and gatekeeper are the same, the court does not err in admitting the evidence subject to the ability later to exclude it or disregard it if it turns out not to meet the standard of reliability.”<sup>7</sup>

Consistent with the Hearing Officer’s December 20, 2010 Order, the Hearing Officer will allow Enforcement’s expert to testify and will allow his report to be admitted. In the context of the hearing, the Hearing Panel will evaluate the expert’s principles or methods and determine if the testimony is reliable and helpful.

Respondents’ motion for production of expert materials and the exclusion of Enforcement’s expert and his report is denied. Enforcement is directed to thoroughly search its expert’s records to ensure that all related expert reports have been provided to Respondents and to file a declaration, attesting that it has conducted such a search by August 12, 2011.

### **III. Respondents’ Motion for Production of Draft Versions of Testifying Expert Report and Related Documents**

On April 20, 2011, Respondents filed a motion for production of draft versions of Enforcement’s expert report and related documents, such as notes and communications between Enforcement and its expert or his firm in connection with this case. Enforcement filed its opposition on May 26, 2011.

FINRA Rule 9251(a) defines the scope of discovery in FINRA disciplinary proceedings, and requires Enforcement to allow Respondents to inspect and copy non-privileged documentation in connection with the underlying investigation. Rule 9251(b)(1) limits the scope

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<sup>6</sup> *In re Salem*, 465 F.3d 767, 777 (7<sup>th</sup> Cir. 2006).

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

of discovery and permits Enforcement to withhold documents that are privileged or constitute attorney work-product. Draft versions of expert reports and communications between counsel and an expert that reflect counsel's mental impressions, conclusions, opinions or legal theories are opinion attorney work-product.<sup>8</sup> Accordingly, they are exempt from discovery under FINRA Rule 9251.

Respondents cite to the Federal Rules of Civil Procedure and Federal case law to support their position that draft expert reports are discoverable. The Federal Rules of Civil Procedure do not apply in FINRA proceedings; however, Hearing Officers may look to those rules for guidance in appropriate cases. Respondents cite to Federal Rule 26(a)(2), which governs expert testimony. On April 28, 2010, the United States Supreme Court amended Federal Rule 26(a) and (b), which address the scope of expert discovery. In an effort to restrict disclosure of attorney-expert communications and draft reports, Rule 26(a)(2) was amended to require the disclosure of "facts or data" considered by the expert in forming his opinion. And, Rule 26(b)(4)(C) was amended to extend additional work product protection to draft reports and attorney-expert communications.<sup>9</sup> The amendments to Rule 26 apply to cases filed after December 1, 2010, and to pending proceedings "insofar as just and practicable."<sup>10</sup>

The Hearing Officer finds that it is "just and practicable" to apply the amended Rule 26 to the instant case for the following reasons. First, the expert phase of this proceeding commenced after December 1, 2010. On December 20, 2010, the Hearing Officer granted Enforcement's motion for expert testimony. The December 20 Order directed Enforcement to

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<sup>8</sup> *Estate of Moore v. R. J. Reynolds Tobacco Co.*, 194 F.R. D. 659, 662 (S.D. Iowa 2000); *Nexus Products Co. v. CVS New York, Inc.*, 188 F.R.D. 7, 10-11 (D. Mass. 1999).

<sup>9</sup> See Notes Fed. R. Civ. P. 26, Notes of Advisory Committee on 2010 Amendments.

<sup>10</sup> April 28, 2010, Order of the Supreme Court of the United States (available at <http://www.supremecourt.gov/orders/courtorders/frev10.pdf>).

file an expert report and provide the documents relied upon by its expert to Respondents. On March 18, 2011, Enforcement filed the expert report. The report listed all of the documents that the expert reviewed, which were produced to Respondents prior to the filing of Enforcement's expert report.<sup>11</sup> Second, the Federal Rule 26 amendments were announced on April 28, 2010, prior to the filing of the Complaint on May 11, 2010. Accordingly, Respondents were on notice regarding the restricted expert discovery under the Federal Rules. Third, all the "facts or data" that Enforcement's expert considered and communications regarding the expert's compensation have been provided to Respondents.

For the foregoing reasons, the Hearing Officer rules that the documents requested by Respondents need not be produced. Respondents' motion is denied.

#### **IV. Summary Exhibits**

When summaries are offered, the offering party does not need to offer the underlying voluminous materials; however, the underlying materials must have been made available to the opposing parties, and must be available in the hearing room. To that end, if either party offers a summary exhibit, it must provide the underlying materials, or, if the materials were previously provided in discovery, a list or description of the documents supporting the exhibit with sufficient identifiers so that opposing counsel can locate the source materials. If the source material came from a public source, the offering party should also provide the website and search parameters used in creating the summary exhibit.

During the Conference, the parties agreed to provide each other with all underlying source materials for their summary exhibits. The parties are ordered to review each other's

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<sup>11</sup> In Enforcement's Opposition to Respondents' Motion for Production of Draft Versions of Testifying Expert Report and Related Documents, Enforcement represented that it produced all of those documents to opposing counsel during discovery. Dep't of Enforcement Opposition to Respondents' Motion for Production of Draft Versions of Testifying Expert Report and Related Documents at 1.

summary exhibits to verify the accuracy of the data and any calculations. Prior to filing any motions in limine or objections regarding summary exhibits, the parties are required to confer in an effort to resolve any issues regarding the exhibits. If there are data or calculation errors, the parties will be permitted to file motions for leave to amend their exhibit lists and exhibits by September 1, 2011.

**V. Respondents' Objections to Enforcement's Witnesses and Exhibits**

During the Conference, the Hearing Officer and the parties reviewed Respondents' objections to Enforcement's witnesses and exhibits. Regarding witnesses, Respondents object on relevancy grounds to two of Enforcement's witnesses: Kim Chung and Ling Zhong. Enforcement stated that both witnesses are FINRA employees who participated in the investigation. Enforcement also stated that it may not need both witnesses but it is not certain at this time. The Hearing Officer defers ruling on this objection. Respondents also objected to Enforcement's expert, asserting that he does not meet the requirements in *Daubert*. For the reasons stated above, this objection is overruled.

The Hearing Officer defers ruling on Respondents' objections to Enforcement's exhibits. Certain of Respondents' objections to Enforcement's exhibits related to completeness of the documentation. Respondents explained that in certain instances Enforcement's exhibits did not contain all the attachments. During the Conference, the Hearing Officer granted Respondents additional time to review Enforcement's exhibits and determine if they needed to amend their exhibit list to add certain documents and attachments that may not have been included in Enforcements' pre-hearing submission. Should Respondents elect to amend their exhibit list, they shall file a motion for leave to amend their exhibit list and exhibits by September 1, 2011.

**VI. Enforcement's Objections to Respondents' Witnesses and Exhibits and Motion in Limine**

During the Conference, the Hearing Officer and the parties reviewed Enforcement's objections to Respondents' witnesses and exhibits. Regarding witnesses, Enforcement objected to Respondents' 13 proposed witnesses whose testimony relates, at least in part, to character issues. Respondents stated that they are uncertain at this time which individuals they may call. The Hearing Officer cautioned the parties to avoid repetitious testimony. Both parties are directed to review their witness list to avoid cumulative testimony. The Hearing Officer defers ruling on this objection.

Enforcement also objected to Respondents' proposed but unidentified rebuttal expert witness. The Hearing Officer sustains this objection. If Respondents elect to call an expert, they shall file a motion for leave to permit expert testimony by September 1, 2011. The motion shall conform to the requirements set forth in the Scheduling Order, dated August 2, 2010.

Regarding exhibits, Enforcement objected to RX-1, RX-2, RX-3, RX-5, and RX-6. It asserts that these exhibits exceed the scope of this proceeding because they go beyond the relevant time period identified in the Complaint and utilize customer data for customers that are not at issue in the Complaint. Respondents acknowledge that their exhibits (1) use a time period that is larger than that identified in the Complaint and (2) are not restricted to the customers described in the Complaint; however, they argue that the exhibits are essential to their defense. The Hearing Officer directed Respondents to submit a brief, describing why these exhibits (and any other exhibits, such as RX-53, that go beyond the time period identified in the Complaint) are admissible, by August 19, 2011. Enforcement may file its response by September 2, 2011.

**This Order has been published by FINRA's Office of Hearing Officers and should be cited as OHO Order 11-10 (2008012925001).**

Enforcement also objected to several of Respondents proposed summary exhibits because it did not have the underlying source materials. The Hearing Officer defers ruling on the objections to the summary exhibits. As stated above, the parties are directed to exchange source materials so that the accuracy of all summary exhibits can be verified.

The Hearing Officer defers ruling on the remaining objections to Respondents' exhibits.

**SO ORDERED.**

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Maureen A. Delaney  
Hearing Officer

Dated: July 28, 2011