

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondents.

Disciplinary Proceeding
No. CAF000013

Hearing Officer—Andrew H. Perkins

**ORDER GRANTING COMPLAINANT’S MOTION TO PRECLUDE THE
INTRODUCTION OF EXPERT TESTIMONY**

On April 16, 2001, Respondents _____ and _____ (the “Respondents”), through their counsel, filed a submission pursuant to Code of Procedure Rule 9242(a)(5) designating three proposed experts that they intend to call to testify at the hearing in this proceeding. On April 30, 2001, the Department of Enforcement (Department) filed a motion seeking to preclude the Respondents’ introduction of expert testimony. For the reasons set forth below, the Department’s motion is granted.¹

¹ On May 9, 2001, the Respondents submitted a reply to the Department’s opposition. Rule 9146(h) of the Code of Procedure prohibits a moving party from filing a reply absent permission of the adjudicator and, accordingly, provides for the filing of a reply only after the adjudicator has granted the moving party leave to do so. The Respondents failed to comply with these procedures. The Hearing Officer therefore did not consider the Respondents’ Reply in ruling on the Department’s motion.

I. Factual Background and the Proposed Expert Witness Testimony

According to the Complaint, Respondent _____ (“_____” or the “Firm”) entered into an agreement with _____ on or about July 24, 1996, by which the Firm agreed to act as a placement agent for a private placement of _____ securities. (Compl. ¶ 8.) According to the private placement memorandum, the private placement was a minimum/maximum offering of 50 to 70 units. Each unit was offered at \$50,000 and consisted of 16,667 shares of _____ common stock and 16,667 redeemable common stock purchase warrants. (Id.) The Complaint further alleges that between September and November 1996 1.2 million shares of _____ common stock were sold through the private placement. (Id. ¶ 9.) On or about November 25, 1996, a registration statement was filed with the Securities and Exchange Commission (“SEC”), pursuant to SEC Rule 415, to register 2,293,208 shares of _____ common stock. The registration statement covered shares of common stock owned by certain individuals, which are identified in the Complaint as the “Selling Stockholders.” (Id. ¶ 10.) The Selling Stockholders had acquired their shares of _____ common stock through private placements in March and November 1996. _____ began trading _____ common stock on February 19, 1997, but it did not register as a market maker in _____ until April 8, 1997. (Id. ¶¶ 11, 12.)

The Complaint alleges that, on March 7, 1997, _____ purchased 740,928 shares of _____ common stock in 58 retail transactions from the Selling Stockholders and charged excessive and fraudulent markdowns on those transactions. Specifically, the Complaint alleges that the Firm, acting through Respondents _____ (“_____”) and _____ (“_____”) charged the Selling Stockholders markdowns greater than ten percent from the prevailing maker price. (Id. ¶¶ 13, 21.) Based on the foregoing, the Respondents are charged with violating Section 10(b) of the

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Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2110, 2120, and 2440.²

The Respondents denied most of the substantive allegations against them and asserted, among its affirmative defenses, that: (1) neither the NASD nor the SEC has adopted the NASD's markup/markdown policy as a "rule"; (2) _____ met the requirements and exceptions set out in IM 2440; (3) the Respondents did not act with scienter; and (4) the NASD's markdown policy is illegal and unenforceable.

The Respondents seek to offer the testimony of three "expert witnesses," _____, regarding the reasonableness of the prices the Respondents charged their customers on the transactions at issue. More particularly, they propose offering the expert witnesses to discuss the fairness and reasonableness of markdowns for block trades and the mechanics of entering such trades into the NASDAQ system; explain the prevailing market and the trading characteristics of that market; and discuss the factors set forth in IM 2440. (Submission at 1.)

II. Discussion

In support of their expert witness designation, the Respondents argue that the issues in this proceeding are sufficiently complex to warrant the use of expert witness testimony. The Respondents further assert that if the Complainant's staff witnesses are allowed to give opinion testimony, the Respondents likewise should be given the right to present opinion testimony. The Department argues

² The Firm and _____ also are charged with failing to establish, maintain, and enforce adequate written supervisory procedures with respect to markdowns, and Respondents _____ and _____ also are charged with failing to provide information to NASD Regulation in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110.

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that: (1) in NASD disciplinary proceedings, expert witness testimony is not ordinarily required on the issues Respondents have identified; (2) the issues in this case are not so complex or unique as to require the use of an expert; and (3) the two “industry Panelists” possess sufficient expertise to decide the issues on which Respondents propose offering expert testimony.

NASD Rule 9263(a) gives the Hearing Officer authority to “exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial.” This includes the authority to deny a party’s request to offer expert testimony. Under the Federal Rules of Evidence, “[i]f scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert . . . may testify . . . in the form of an opinion or otherwise” about such matters. Fed. R. Evid. 702.³

In proceedings before a body such as an NASD Hearing Panel, where two of the three panelists will have substantial relevant specialized knowledge, expert testimony is often of little value, and may be excluded. See Pagel, Inc., 48 S.E.C. 223 (1985), aff’d, sub nom. Pagel, Inc. v. SEC, 803 F.2d 942, 947 (8th Cir. 1986) (affirming SEC Administrative Law Judge’s exclusion of expert testimony). Typically, therefore, expert witness testimony is not offered in NASD disciplinary matters, unless novel issues or new, complex, or unusual securities products are involved. The fundamental question is whether the proposed testimony would assist the Hearing Panel in understanding the evidence or a fact at issue in the proceeding.

³ Because the NASD Code of Procedure does not set forth a standard to assess the admissibility of expert testimony, the Hearing Officer has looked to the Federal Rules of Evidence for guidance.

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In this case, the proposed expert testimony is unnecessary. The NASD Board of Governors Mark-Up Policy (IM-2440) provides specific guidance on pricing equity securities,⁴ and matters pertaining to the fairness and reasonableness of the mark-downs charged on such securities, including the determination of prevailing market price, are well within the expertise of the industry members of the Hearing Panel. Likewise, the Hearing Panel members do not require expert assistance to understand the relatively common concepts of handling block trades.

Further, as the Department has recognized, the two “industry members” who will serve on this particular Hearing Panel possess extensive industry experience and are well qualified to decide this matter without expert assistance. These two individuals have more than 55 years of combined experience in the securities industry; both have served as members of NASD District Business Conduct Committees; and one has served on the Market Regulation Committee (formerly known as the Market Surveillance Committee) and was a member of the NASD’s Board of Governors.

Finally, that Enforcement intends to elicit testimony concerning the mark-down and supervisory issues in this case from an NASD Regulation employee—who is not designated as an expert witness—does not alter the equation or the conclusion as to the propriety of expert testimony.

The Hearing Officer concludes that Respondents have failed to demonstrate that the proposed expert witness testimony would assist the Hearing Panel in deciding the issues in this case and,

⁴ Under the NASD’s policy, mark-ups and mark-downs on equity securities exceeding 5% of the prevailing market price generally are considered excessive, and mark-ups and mark-downs exceeding 10% of the prevailing market price generally are considered fraudulent.

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accordingly, the Complainant's motion to preclude the introduction of expert testimony at the hearing is granted.

IT IS SO ORDERED.

Andrew H. Perkins
Hearing Officer

May 23, 2001