

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

DEPARTMENT OF MARKET
REGULATION,

Complainant,

v.

JAMES GABRIEL COLLARD
(CRD No. 2812378),

JOSEPH MICHAEL ARAIZ,
(CRD No. 1278925),

and

FURTHER LANE SECURITIES, L.P.
(CRD No. 38162),

Respondents.

Disciplinary Proceeding
No. 20120342425-01

Hearing Officer—MJD

**ORDER CONCERNING PARTIES' MOTIONS FOR
LEAVE TO PRESENT EXPERT TESTIMONY**

I. Introduction

The Department of Market Regulation alleges in cause one of its Complaint that Respondents James Gabriel Collard and Further Lane Securities, L.P., charged customers excessive markups in 55 corporate bond transactions in early 2012. For this alleged misconduct, Market Regulation charges Collard and the firm with violating NASD Rules 2440, IM-2440-1, and IM-2440-2, and FINRA Rule 2010. In cause two, Market Regulation charges Joseph Michael Araiz and the firm with failing to establish a reasonable supervisory system, including written supervisory procedures, to ensure compliance with FINRA's markup rules, in violation of NASD Rule 3010 and FINRA Rule 2010.

Araiz and Collard filed Answers¹ contesting the allegations in the Complaint. A five-day hearing of this matter is scheduled to begin October 31, 2016.

On July 15, 2016, Market Regulation filed a motion for leave to present expert testimony. The same day, Respondents Collard and Araiz jointly moved to allow expert testimony but did not identify an expert. Instead, Respondents say that they "are currently considering the use of certain individuals" to present expert testimony. They also say that because they are in the

¹ Further Lane did not file an Answer and accordingly was held in default on April 29, 2016. A default decision as to Further Lane will be issued after the resolution of the case against Araiz and Collard.

middle of attempting to mediate a resolution of the case with Market Regulation they wish to conserve their financial resources in the event the matter is resolved. Accordingly, Respondents ask that they be given until September 9, 2016, to provide Market Regulation the information about expert testimony required by Rule 9242(a)(5) and the Case Management and Scheduling Order entered in this case on May 12, 2016.

On July 22, 2016, Market Regulation filed an opposition to Respondents' motion on the grounds that they failed to comply with Rule 9242(a)(5). The same day, Araiz (but not Collard) opposed Market Regulation's motion to permit expert testimony on issues concerning the adequacy of Araiz and the firm's supervision of Collard.

II. Market Regulation's Motion for Leave to Permit Expert Testimony

A. Subject Matter of Proposed Expert

Market Regulation moves for leave to admit the expert testimony of Mr. Stanley Fortgang. It contends that the proposed expert will assist the Hearing Panel in understanding why the markups Collard charged were excessive under the specific circumstances of this case, even though some of them were under 5.00 percent.² More specifically, Mr. Fortgang will testify that each transaction included two markups—one from the firm's trader to Collard, and a second from Collard to the clients—resulting in total markups that were allegedly unfair and unreasonable. He is also being offered to testify that Araiz failed to establish a reasonable system of supervision that would have detected the total markups Collard charged to customers and prevented or remedied the excessive markups. Market Regulation says that Araiz reviewed Collard's trades but never detected that any of the transactions identified in the Complaint were excessive even though he knew each transaction included two markups. Market Regulation states that Mr. Fortgang will testify on the following eleven subjects:

1. The prevailing market price of the corporate bonds when Collard sold them to the investment advisers for placement in the investment advisers' customers' accounts;
2. Information that was publicly available relating to the corporate bonds when Collard bought them and sold them to the investment advisers for their customers;
3. Industry customs, standards, and practices for markups to customers on sales of corporate bonds;
4. Further Lane's purchases of the bonds in the market at fair and reasonable prices;

² As Market Regulation notes in its motion, under NASD Rule IM-2440-1, a markup of five percent or less may be considered unfair or unreasonable. According to the Complaint, ¶ 24, the allegedly excessive markups ranged from 3.06 percent to 6.94 percent. In 32 instances, the markups exceeded five percent and eight of those exceeded six percent. The average markup was 5.07 percent.

5. The highest fair prices, including appropriate or permissible markups, at which Collard should have sold the corporate bonds to the investment advisers for the investment advisers' customers;
6. Collard's sales of the bonds to the investment advisers for the investment advisers' customers at unfair and unreasonable prices, considering the relevant factors;
7. The absence of any material market risk by virtue of the fact that Collard bought the bonds in the market after receiving orders from the investment advisers and then sold them to the investment advisers for their customers the same day;
8. The duties that a registered person owes to his firm's customers when he purchases bonds in the market and sells them to customers on the firm's behalf;
9. Collard's breach of the duties in Item 8 with respect to his sales of the bonds to the investment advisers for their customers with excessive markups;
10. The standards of supervision that apply to supervising markups on corporate bond transactions with respect to ensuring compliance with former NASD Rules 2440, IM-2440-1, IM-2440-2 and FINRA Rule 2010; and
11. Araiz's failure to institute an adequate system of supervision with respect to compliance with NASD Rules 2440, IM-2440-1, IM-2440-2, and with FINRA Rule 2010, and his failure to reasonably supervise Collard with respect to the transactions in the Complaint.

B. Qualifications of Proposed Expert

Mr. Fortgang has nearly 25 years of experience in trading fixed-income securities. From 2001 to 2009, he was a managing director at Morgan Stanley and Jefferies & Company, specializing in fixed income securities, including the sorts of corporate bonds that are the subject of this Complaint. From 1985 to 2000, he was registered with First Boston Corporation and Goldman, Sachs & Co. He also has served as a producing manager on trading desks where he worked with other fixed income traders.³ Mr. Fortgang provides consulting and expert services through Etzion Consulting Group, which he formed in 2009. His services focus on fixed income products, including trading strategies, pricing, and execution. Mr. Fortgang's *curriculum vitae* shows that he has been qualified and testified as an expert in 19 federal and state securities actions and FINRA arbitrations, including one FINRA disciplinary action.

³ Market Regulation states that Mr. Fortgang supervised fixed income trading but acknowledges that he has only Series 7 and 63 licenses. Department of Market Regulation's Motion for Permission to Present Expert Testimony From Stanley Fortgang at 3, 8.

C. Araiz's Opposition to Market Regulation's Motion for Leave to Permit Expert Testimony

Araiz was Collard's supervisor and Further Lane's owner, chief executive officer, and chief compliance officer. He objects to Market Regulation's presenting expert testimony on supervisory issues but consents to his presenting testimony on the pricing of the transactions. Araiz's fundamental objection is that supervisory issues are generally within a hearing panel's expertise. He adds that the issue of the adequacy of supervision presented in this case "does not rise to the level of an unusual or technical issue" that is beyond a hearing panel's experience. Araiz also objects on the grounds that Market Regulation has not demonstrated that Mr. Fortgang has sufficient experience on the issue of supervision.

D. Discussion

The Hearing Officer has broad discretion to determine whether to permit expert testimony.⁴ In applying that discretion, the Hearing Officer determines whether the proposed expert testimony is relevant⁵ and reliable.⁶ The Hearing Officer may admit evidence that is relevant, but may exclude evidence that is "irrelevant, immaterial, unduly repetitious, or unduly prejudicial."⁷ In determining whether to permit expert testimony, the Federal Rules of Evidence, and related case law, are instructive.⁸ Under Evidence Rule 702(a), a witness who is "qualified as an expert by knowledge, skill, expertise, training or education" may provide opinion testimony if the witness's "scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue."

The key factor is whether the anticipated expert testimony would be helpful to the Hearing Panel.⁹ The Securities and Exchange Commission has found that expert testimony can be helpful in cases involving the appropriate pricing of debt securities.¹⁰ Hearing Officers in FINRA disciplinary actions consistently have permitted expert witnesses to testify on the pricing of fixed income securities.¹¹

⁴ See, e.g., OHO Order 15-04 (2011025706401) (Feb. 3, 2015) at 2, <http://www.finra.org/sites/default/files/OHO-Order-15-04-ProceedingNo.2011025706401.pdf>; OHO Order 12-07 (2010020846601) (Nov. 9, 2012) at 1, <http://www.finra.org/sites/default/files/OHODecision/p229431.pdf>.

⁵ OHO Order 12-01 (2009018771602) (Mar. 14, 2012) at 2, <http://www.finra.org/sites/default/files/OHODecision/p126068.pdf>.

⁶ See OHO Order 15-04 at 2 (citing *Pipitone v. Biomatrix, Inc.*, 288 F.3d 239, 244 (5th Cir. Apr. 18, 2002) ("In short, expert testimony is admissible only if it is both relevant and reliable.")).

⁷ FINRA Rule 9263.

⁸ OHO Order 12-07 at 2 n.3.

⁹ OHO Order 15-04 at 2; OHO Order 12-01 at 3.

¹⁰ *F.B. Horner & Assocs., Inc.*, Exchange Act Release No. 30884, 1992 SEC LEXIS 1568, at *9 n.11 (July 2, 1992), *aff'd*, 994 F.2d 61 (2d Cir. 1993).

¹¹ See, e.g., *Dep't of Enforcement v. Grey*, No. 2009016034101, 2013 FINRA Discip. LEXIS 24 (OHO June 20, 2013) (permitting expert testimony on pricing of municipal bonds), *aff'd findings and modified sanctions*, 2014

I find Mr. Fortgang qualified to give expert testimony about the pricing of the corporate bond transactions and I find that expert testimony on those topics would be helpful to the Hearing Panel.

On the other hand, I find that it would not be helpful to the Hearing Panel for Market Regulation to present Mr. Fortgang's expert testimony on Araiz's alleged supervisory deficiencies. This case does not present unusual issues relating to supervision that are outside the scope of the typical panel member's expertise. Supervisory issues in the sales of fixed income products are not so complex as to require expert testimony. Hearing Officers in disciplinary proceedings have often denied requests to present expert testimony addressing standards of supervision.¹²

Furthermore, Mr. Fortgang's anticipated testimony appears to encroach on the role of the Hearing Panel with respect to topics 8 and 9—the duties that a registered representative such as Collard owes to his customers when selling them bonds. Market Regulation seems to be saying that it anticipates that Mr. Fortgang will testify that Collard breached his duties to his customers when he engaged in the bond transactions. From the brief descriptions contained in topics 8 and 9, it appears that Market Regulation expects Mr. Fortgang to interpret the applicable law. Such testimony is beyond the bounds of proper expert testimony.¹³ It is appropriate for Mr. Fortgang to testify about the manner in which Collard and the firm's conduct in selling the bonds departed from ordinary practice in the securities industry. Testimony that includes an ultimate legal conclusion based on the facts of this case is not admissible.

III. Respondents' Motion to Permit Expert Testimony

A. Respondent's Motion

Collard and Araiz jointly move for leave to permit an expert—whom they have not identified—to testify on the “reasonableness and propriety of the mark-ups on the transactions in light of the locality, number of transactions involved in each sale, the size of the sale, and other factors that suggest that the mark-ups were reasonable and fair.” They also seek to have an

FINRA Discip. LEXIS 31 (NAC Oct. 3, 2014), *aff'd sub nom.*, *Anthony A. Grey*, Exchange Act Release No. 75839, 2015 SEC LEXIS 3630 (Sept. 3, 2015); OHO Order 05-35 (CAF040058) (Oct. 19, 2005) <http://www.finra.org/sites/default/files/OHODecision/p015999.pdf> (allowing expert testimony on the pricing of convertible bonds).

¹² See, e.g., OHO Order 15-08 (201102562001) (Apr. 8, 2015) http://www.finra.org/sites/default/files/OHO_Order15-08_2011025622001.pdf (denying motion to present expert testimony concerning compliance with supervisory requirements applicable to variable annuity products).

¹³ See, e.g., *Dep't of Enforcement v. Skelly*, No. CAF000013, 2003 NASD Discip. LEXIS 40, at *13 n.10 (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 (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.”).

expert testify that Market Regulation's calculation of restitution owed "was not performed in a reasonable manner" and, if any restitution is owed, it is "considerably less" than the amount Market Regulation claims. Respondents state that they have "severely limited financial resources" and "any monies currently expended on retaining an expert witness could best be used toward a resolution of this proceeding." They claim to be "working diligently and in good faith" and have made "substantial progress" in mediation.

Accordingly, Respondents ask that their obligation to identify an expert and provide the information required by Rule 9242(a)(5) be extended until September 9, 2016. This would allow time for the parties to complete mediation, the outcome of which, they say, "will be apparent in relatively short order."

B. Market Regulation's Opposition

Market Regulation opposes the motion primarily on the grounds that Respondents did not comply with the Case Management and Scheduling Order in this case, which obligated the parties to file motions for leave to present expert testimony by July 15, 2016. Other than stating generally that they intend to "offer reliable and credible expert testimony," without more particularly describing the expected testimony, Market Regulation argues that Respondents have failed to provide a basis for determining whether or not their expert is qualified. Market Regulation further argues that Respondents' disregard for the deadlines established in this case places it at a disadvantage considering that Market Regulation has already made its disclosures under Rule 9242(a)(5).

C. Discussion

Respondents' motion falls far short of what is required under Rule 9242(a)(5). Their motion is effectively only a request for an extension of time to file a motion for leave to present expert testimony. Given the hearing schedule, however, it is inappropriate to grant an extension of nearly two months, to September 9, 2016, as Respondents ask.

After carefully weighing Market Regulation's opposition and the circumstances present in this case, I instead grant Respondents an extension to August 19, 2016, within which to file their motion for leave to present expert testimony, including the information required by Rule 9242(a)(5). Market Regulation shall file any opposition to Respondents' motion by August 26, 2016.

IV. Order

I **GRANT**, in part, and **DENY**, in part, Market Regulation's motion for leave to permit the expert testimony of Stanley Fortgang, as follows:

I **GRANT** Market Regulation's motion to present expert testimony regarding the first seven topics it listed in its motion, specifically:

1. The prevailing market price of the corporate bonds when Collard sold them to the investment advisers for placement in the investment advisers' customers' accounts;
2. Information that was publicly available relating to the corporate bonds when Collard bought them and sold them to the investment advisers for their customers;
3. Industry customs, standards, and practices for markups to customers on sales of corporate bonds;
4. Further Lane's purchases of the bonds in the market at fair and reasonable prices;
5. The highest fair prices, including appropriate or permissible markups, at which Collard should have sold the corporate bonds to the investment advisers for the investment advisers' customers;
6. Collard's sales of the bonds to the investment advisers for the investment advisers' customers at unfair and unreasonable prices, considering the relevant factors; and
7. The absence of any material market risk by virtue of the fact that Collard bought the bonds in the market after receiving orders from the investment advisers and then sold them to the investment advisers for their customers the same day.

Market Regulation's motion is **DENIED** to the extent it intends to present expert testimony by Mr. Fortgang on supervision-related topics and his interpretations of the law, as generally described in topics 8 through 11 of its motion.

Respondents' request for an extension of time to file their motion for leave to permit expert testimony including the information required by Rule 9242(a)(5) and the Case Management and Scheduling Order is **GRANTED** until **August 19, 2016**.

Market Regulation shall file an opposition to Respondents' motion for leave to permit expert testimony by **August 26, 2016**.

As currently set forth in the Amended Case Management and Scheduling Order, the deadline to file expert reports will remain **September 23, 2016**. Market Regulation's and Respondents' (should their motion for leave to present expert testimony be granted) expert reports shall contain a description of the expert's qualifications; his expert opinions; the basis and reasons for such opinions; and a list of all documents he relied on in forming the opinions. Copies of such documents, along with any related demonstrative exhibits, shall be served with the report by **September 23, 2016** (to the extent not previously provided to the Respondents by Market Regulation).

This Order has been published by FINRA's Office of Hearing Officers and should be cited as OHO Order 16-20 (20120342425-01).

To the extent an expert report is admitted at the hearing, it will be considered part of the expert's direct testimony. At the hearing, the parties' direct examination of their respective expert shall consist of a summary direct examination, presenting opinions subject to the scope of the expert report, and the bases and explanation for the opinions presented. As a guideline, the parties should plan to complete their direct examination of the expert within 90 minutes. After the direct examination of each expert, the opposing party will be permitted to cross-examine the expert. In addition, the Hearing Panel may question the experts.

SO ORDERED.

Michael J. Dixon
Hearing Officer

Dated: July 28, 2016

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