

SEC's expanded use of administrative proceedings: How an expert can help

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Under Section 929P of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission has broad powers to impose civil monetary penalties in administrative cease-and-desist proceedings, or APs.

Before the enactment of the Dodd-Frank Act in 2010, such proceedings were generally limited to entities and individuals that the SEC regulated, such as SEC-registered broker-dealers and their registered representatives. If the SEC wanted to pursue anyone else, it had to commence proceedings in a federal district court.

them — will be brought under Dodd-Frank's administrative proceeding provisions.

The SEC has several reasons to favor APs. First, they are heard before SEC administrative law judges on an expedited schedule, after which appellate review by SEC commissioners is available. Respondents can appeal to federal courts only after such appellate review has been completed.

Second, APs are conducted using the SEC's Rules of Practice. Compared with the Federal Rules of Civil Procedure that are used in federal court proceedings, the SEC rules

Unlike most judges and juries, ALJs are highly specialized in that they hear only certain types of cases. SEC ALJs hear only securities-related cases, and this focus tends to provide them a great depth of knowledge in the subject-matter area.

LIABILITY EXPERTS

For the expert witness and the counsel who retains him, the trier of fact's greater depth of knowledge creates possibilities that generally do not exist when experts testify in other venues.

In a typical court setting, the expert must dedicate a significant amount of time making his or her subject matter understandable. That chore can limit the expert's ability to discuss the intricacies of complex analyses; it can require the expert to boil down testimony to just high-level findings.

Consider a matter in which the issue involves best-execution requirements for securities trading — that is, finding the best price when a stockbroker buys or sells for a customer.

In a federal or state courtroom, a securities trading expert testifying about whether a brokerage customer received the "best offer" when purchasing a given stock would have to present his or her discussion of trading rules and mechanisms at a fairly abstract level to avoid the possibility of losing the attention of the judge or jury.

The expert would have to explain the roles and responsibilities of the parties and probably provide a tutorial on how a stock is traded.

In an administrative proceeding, however, the same expert could move to the issue at hand without spending as much time on basic market principles.

The expert could more easily discuss the best-execution requirements imposed on a broker-dealer in light of the Regulation National Market System, which is a set of rules that were put in place to encourage fair price execution. The expert could also discuss the

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Dodd-Frank changed all that; now, even non-regulated entities and individuals can be charged in APs. Indeed, one of the first cases brought by the SEC under the new expansion involved a member of a public company board who allegedly disclosed material nonpublic information to a hedge fund trader.

A panel of past and former heads of SEC regional offices recently discussed the use of APs compared with federal trials. The message from the current SEC office directors was clear: More cases — and a wider variety of

provide for a relatively streamlined process that more closely approximates arbitration. Specifically, there is no right to depose witnesses, including expert witnesses.

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Experts in a civil or criminal proceeding are called to the stand to assist judges and juries, also known as triers of fact.



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specific standards and interpretations of the rule and respond to questions from opposing counsel — and perhaps even the ALJ — in greater detail.

APs even allow counsel the opportunity to call experts who may not be practical for other venues, such as technical experts who would prove too narrowly focused to merit extended trial time in a non-AP setting — especially for jurors who have jobs and responsibilities other than to sit and listen to sometimes longwinded experts.

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For the above best-execution example, counsel may consider calling an expert from a vendor of broker compliance monitoring systems to testify. Counsel might even call a trader who worked for the designated market maker in the stock at issue.

But neither of these experts would be likely to have any previous experience testifying. These experts may be kept from testifying in a federal or state trial because of a concern that they will not provide effective, understandable testimony.

In an administrative proceeding before an ALJ with some experience in the area of stock trading, calling these experts might make more sense.

DAMAGES EXPERTS

Economic analyses of damages can also be presented in more detail in APs.

A statistics expert analyzing changes in stock prices may encounter the problem of serial autocorrelation, whereby the change in price of a stock on one day influences a change the next day.

An expert can adopt a number of strategies to correct for autocorrelation, but they are subject to the expert's judgment and can produce markedly different results.

In a non-AP setting, the expert, the opposing expert and their respective counsel would all have to argue about these judgments

using as few technical terms as possible to avoid losing the judge and jury. Before an ALJ, however, the discussion may be able to incorporate more technical concepts, such as the computed Durbin-Watson statistic that is commonly used to assess the presence or absence of autocorrelation.

In other words, the administrative proceeding forum appears to accommodate more technically complex topics.

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SEC RULES

Getting an expert into the SEC forum involves a slightly different process than the process used to get one into federal or state court. Indeed, the procedure is more akin to arbitration in that there are usually no expert depositions prior to the hearing.

There may be depositions or on-the-record interviews of fact witnesses taken during the SEC's investigation prior to the agency's initiation of proceedings. But the lack of access to opposing experts prior to the hearing requires that an expert be prepared when responding to testimony as it is given in the hearing, just as is the case in most arbitration proceedings.

FEW REQUIREMENTS FOR EXPERTS

SEC Rule 222 states that, for all witnesses, counsel must provide the hearing officer "a list of witnesses who will testify on its behalf, including the witnesses' names, occupations, addresses and a brief summary of their expected testimony."

As to expert witnesses, the rule states that counsel shall provide "a statement of the expert's qualifications, a listing of other proceedings in which the expert has given expert testimony, and a list of publications authored or co-authored by the expert."

Note how the above SEC rule disclosure requirements differ with those of Federal Rule of Civil Procedure 26(a)(2), which requires that the expert disclose:

- The witness's qualifications, including a list of all publications authored by the expert in the last 10 years.
- A list of all other cases in which, during the previous four years, the witness testified as an expert at trial or by deposition

Under the SEC rules, there is no disclosure time limit on prior "proceedings" or "publications."

EXPERT REPORTS

Interestingly, there is no requirement under the SEC rules for an expert to submit a report, as is typical under the federal rules.

Under Rule 222, however, counsel must submit "an outline or narrative summary of its case or defense" and "copies and a list of documents that it intends to introduce at the hearing."

An expert will likely have a role in explaining at least a part of that "narrative." To be sure that the expert's positions are understood, both by counsel who retained that expert and by others, it is helpful to produce a report.

Also, given the role the expert will perform in addressing documents relevant at the hearing, as well as documents and demonstratives created by that expert to explain testimony, it makes sense for the expert to prepare and submit his or her own report with a listing of documents he or she considered prior to testimony and an explanation of the demonstratives.

The SEC's administrative hearing forum presents both challenges and opportunities for counsel. By working with a knowledgeable expert, counsel will be better prepared. **WJ**