

# SECURITIES ARBITRATION COMMENTATOR

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## The Role of the Expert Witness in Securities Arbitration

by Dr. Ronald W. Cornew\*

### Overview

The primary difference in the role of an expert in securities arbitration versus a courtroom securities case results from arbitration being a forum of equity, as opposed to a forum of law. In a forum of law it is important that the attorney trying the case be aware of each of the points of law that must be proven to establish his case and, further, that the expert be prepared to testify as to the facts that support these points of law. In securities arbitration and in arbitration in general, the role shifts more toward the persuasiveness of the testimony based upon the expert's knowledge of the industry and its customs and practices. If the conduct complained of is reprehensible and violates industry customs and practice, that needs to be said, and as forcefully as possible.

This is not to say that the expert is a mere spokesperson. He has still to fulfill his fundamental obligation to inform the panel of the facts of a matter where individual panelists may not be

cognizant of the area of controversy. As FINRA arbitration panels have typically consisted of two public panelists and an industry arbitrator, and now the expert in the future may face three public arbitrators, this function is vital. But the expert's function in arbitration is no longer to merely show that his client is right, based upon the preponderance of the evidence. It has to be done in a way that convinces the panel of the fairness of the client's position.

This may require the expert to concede points in arbitration that would be vigorously contested in a courtroom proceeding in order to establish that the expert himself is testifying in a fair and objective manner, and is not acting as an advocate for the client. In doing this, the expert also needs to be aware of the presence of any factors that could suggest that the party by whom he is retained may not appear to have clean hands, such as the client appearing to have sought the risk that caused the loss.

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A further difference results from the limited discovery in securities arbitrations, which adds to the difficulty of proving the claim in the manner than might be possible in a court of law. Here, again, the importance of showing the equitableness of the claim becomes paramount, as well as the tendency of arbitration panels to take evidence “for what it is worth” rather than applying the more rigorous rules of evidence that would apply in a court of law. Similarly, this more informal approach extends to the qualification of an expert whose testimony is often accepted on the same basis, rather than according to a strict *Daubert* standard.

**Background**

The need for legal services in the securities area has increased dramatically over the years since the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934. As the number of attorneys practicing in this area and the amount of litigation has grown, so too has the need for expert testimony.

The use of expert witnesses in securities and other financial cases dramatizes a broader trend in the legal profession to employ experts with increasing frequency, as the society itself and the litigation it spawns have grown increasingly complex and technical. The broadened role of expert witnesses in litigation and in securities arbitration today is, in fact, a consequence of widely felt trends in the general practice of law reaching back at least to the end of World War II.

As the role of the expert witness has become more important, so have the controversies that have attached themselves to the use of such experts over the years. At one extreme, the expert witness is viewed as an aide to the court or arbitration panel and the one who – through the application of statistical or industrial knowledge – ultimately determines the significance of the facts in a dispute. The expert’s opinions carry significant weight with the judge or jury or arbitration panel – or are supposed to – and his or her role is likened to that of an eye witness to knowledge of the securities industry.

At the other extreme, such witnesses are often only seen as partisan advocates beholden solely to their clients and expected to function much as a lawyer in making the best case possible for the client. From this perspective, the expert and the lawyer differ only in the role they play in putting forward the claimant’s or the respondent’s case.

While this is not the place to resolve this controversy, it can be shown to be one of long standing, with fundamental ties to development of our practice of justice. Fortunately, in securities arbitration, panels consist of relatively sophisticated individuals for whom, unlike with a jury in a courtroom case, this distinction is more apparent than real. Since panels have no power to investigate the case before them, they have no power to summon an expert of their own choosing as judges occasionally do. In newer cases with panels of three public arbitrators, one wonders

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if the securities arbitration system of FINRA may not become more like a trial before a jury, where this concern is more widely felt.

**History of The Expert Witness**

In 1665 a Dr. Brown of Norwich – “a person of great knowledge” – presented expert testimony in an English Colonial Court in the Massachusetts Bay Colony on the subject of whether witches did, in fact, exist<sup>1</sup>. Based partly on his expert opinion, two women were convicted of witchcraft and hanged.

The case illustrates in a macabre way the long-standing use of expert witnesses in the English and, later, the U.S. legal system. Actually, the long tradition of reliance on the expert predates modern trial procedure and the present laws of evidence. Indeed, the expert witness may well have been the first witness in the development of our legal system; records exist indicating the appearance in court of “experts” before the middle of the fourteenth century, long before it became the practice in the second half of the sixteenth century to call lay witnesses to present evidence<sup>2</sup>.

In medieval England, the expert was called to the court to serve either as an aide to the judge or as the actual determiner of fact in areas involving special knowledge or skills. If a dispute arose between craftsmen, for instance, a senior member of the appropriate guild or a jury of such guild members might be called to advise the court on the practices involved and in some cases to determine fault<sup>3</sup>. It is from these ancient origins that the ability of an expert witness to express opinions and to draw conclusions in the modern courtroom or before an arbitration panel, derives.

The lay witness, in contrast, lacking expert knowledge, was not allowed to draw conclusions in court. Even the lay person’s right to express opinions in court was lost as modern laws of evidence developed, which emphasized the judge or jury as the ultimate arbiter.

The emergence of the partisan expert witness became inevitable with the

development of the Common Law, in which the initiative for gathering evidence passed from the court to the litigants. With the court no longer taking an active role in this matter, how else would expert opinion enter? The partisan expert had emerged in England before the adoption of the U.S. Constitution<sup>4</sup>. Some believe that the practice existed as early as 1620.

The most prominent of the difficulties of the partisan expert system is a tendency, when experts clash, for the system to produce judgments against the party who carries the burden of proof<sup>5</sup>. Once again, in securities arbitrations the panel is presumed to possess sufficient sophistication to be able to judge which expert opinion is most likely to be relevant or correct, so that the expert reverts to his role as a helper to the trier-of-fact, rather than as an arbiter of the ultimate issue. For this reason, arbitration panels, as in a court of law, will often preclude an expert from testifying as to the ultimate issue in a case.

**Present Day Role of the Expert Witness**

In legal cases today, the role of the expert witness is inevitably that of the party witness. The function of the expert witness is, nonetheless, to tell the judge or jury or arbitration panel the truth, derived from personal knowledge and experience. The expert witness is not a judge and, even though he is testifying for one party in a case, he must maintain his objectivity.

In securities cases, for example, the issues range from those with industry-wide importance to those affecting only the litigants, such as those dealing with possible unauthorized trading of an account. Whatever the origin of a case, litigation including arbitration generally involves broad questions of fact, various types of data, careful analysis of multiple transactions, and the results of many separate actions taken over time. The questions that arise are frequently statistical and involve a detailed knowledge of the securities industry and its law and regulations.

The expert must, therefore, be very familiar with the industry and have a solid grounding in presenting statistical evidence. Only then can the witness highlight the relevant facts in a way that reveals the truth of the client’s case. This is particularly important in securities arbitration, because many standards of acceptable performance are increasingly not defined and the framework in which the facts are presented is often of paramount importance. As no body of precedence results from securities arbitration, the passage of time will result in more and more cases where the opinion of the more believable expert as determined by the panel will control the outcome. An example of this is the area of computerized trading, which has developed over the years since *Shearson v. McMahon (1987)*<sup>6</sup> elevated arbitration to its current position as the predominant forum for resolution of civil complaints in the securities area.

**Specific Areas of Usefulness of Experts in Securities Arbitration**

An attorney who has not yet used an expert, or who wishes to broaden his usage of experts, is likely to find the expert witness helpful in a number of ways during the arbitration process. While it is hard to imagine a case that would require use of each area of potential usefulness below, a witness is able to interact with and potentially assist the attorney at each step of the arbitration process, including arbitrator selection, case formulation, negotiation, prehearing preparation and at hearing and post-hearing. The expert witness’s role usually involves much hard work – not merely a cameo appearance in front of the panel.

**Arbitrator Selection**

An often-overlooked aspect of the expert’s role in securities arbitration is his potential role in arbitrator selection. Done correctly, the selection process involves analysis of the background and case decisions in which each prospective panel member has participated -- and all in a short period of time. The author has developed an approach to this problem based on his experience over the years

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in various securities arbitrations as both a panelist and as an expert witness and is often amazed at those attorneys who do not give this issue the attention it deserves. Regrettably, attorneys will often make selection decisions based upon various *ad hoc* approaches and “hunches,” rather than rigorous review and ranking of the panelists who will be deciding their case. Selection of the arbitrators is probably the single most important thing you will ever do in your securities arbitration.

#### Case Formulation

Usually one or more studies will be necessary to develop the relevant facts of a case. An expert hired early can help evaluate the case and shape it in a way that provides a bridge for the lawyer into a highly complex area. It is important that the expert be involved well before the hearing—in fact, before evidence is fully gathered. The expert can also be effectively involved at this stage as a consultant, developing questions with the lawyer to help expose the strengths and weaknesses of the technical aspects of the opposition's case.

#### Negotiation

Unlike trial work, in arbitration an expert report is usually not necessary. As arbitrators in FINRA cases are not paid for pre-hearing case study (unlike in arbitrations before the American Arbitration Association), they usually rely exclusively on information presented at hearing. So an expert report frequently serves only to inform the opposing counsel about your expert's factual analysis of the case.

There are only one or two exceptions; if you know that your case will not go to hearing and must be settled, the report of the expert can convey a message of seriousness to your opponent, making settlement more likely, as well as developing the appropriate number for damages in the case. In a securities case, for example, the expert may seek to resolve how much of the loss resulted from the alleged securities offenses involved versus other practices that may have occurred. It may also serve to eliminate extraneous elements

of damage setoffs for the other side that are tainted by wrongful behavior and, therefore, excludable as unjust enrichment.

A second exception occurs in large cases, where it is clear that both sides are expected to develop expert reports. Here, the expert should be encouraged to produce one or more interim versions leading to a final report. A second version of a report is usually much better than the first, as the facts are more thoroughly digested and a maturity of view develops with time. In cases in which I have generated reports and testified on the basis of the knowledge learned, I have found the process of committing ideas and analysis to paper has greatly sharpened my perception of the issues and thus helped make the resulting testimony more polished and to the point. Ideas for graphics to accompany the presentation of testimony also arise as the reports are prepared.

As noted, the use of an expert and his report in negotiation also conveys a “get-serious” attitude to the other side and often stimulates an early and more favorable pre-hearing settlement. Alternatively, if the expert's experience confirms the attorney's assessment of a no-win situation, this will be made clear at an early stage so that settlement possibilities can be fully explored with the client. The expert witness will frequently help the client see the vulnerability of his position. Of course, the above is only effective if the work is begun early, with a report available well before the 20-day requirement for such submissions.

#### Pre-Hearing

At this stage, the expert assists the attorney in developing questions, both for his own testimony and that of others in the case based upon his or her research and report if produced. This involves not only questions for direct examination, but also for cross-examination of the other side's experts, which necessarily involves review of the other side's expert witness reports, if any, and their expected testimony. It is also important at this stage for the attorney to assess

the weaknesses of his own factual case and prepare for redirect testimony in these areas, or to anticipate them in his direct testimony.

#### Hearing

At hearing, the role of the expert witness is to be dignified, restrained, and truthful. Projecting this in the arbitration hearing requires careful preparation and good communication between the attorney and the witness.

Above all, the witness must be knowledgeable. Expertise in the field and a full understanding of the case, are, of course, essential, but careful development and review of the testimony and preparation for cross-examination will assure that the witness is recognized as an expert by the panel. This is best accomplished through communication of the case to the expert witness, including possible traps the other side may lay or facts the attorney anticipates the other side may wish to have acknowledged. In testimony, the witness should let the attorney conducting the examination know that he is prepared to answer, on redirect, any questions to which he appears to have given unfavorable answers under the pounding of “yes-no” cross-examination.

#### Post-Hearing

While the attorney has the responsibility for post-hearing briefs, if any, including rebuttal briefs if the case requires, the witness can usefully critique drafts and contribute suggestions, particularly on complicated statistical or technical points on which the attorney's knowledge is limited. Having developed one or more expert witness reports and perhaps read others, and having participated in an extended hearing, the expert will have developed good arguments based on facts already in the record that may have a place in the briefs.

#### Selection and Use of an Expert Witness: Tips and Cautions

In the following section we cover some aspects of arbitration and securities arbitration practice which, while elementary, often go unspoken.

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As is the case with arbitrator selection, choosing the right expert witness can make the difference between winning and losing a securities arbitration. In selecting an expert, we suggest that three factors are particularly important. First, the best expert witnesses are extremely detail-conscious, demanding of themselves a thorough and specific command of all facts and issues involved in the case, if they have been given an adequate chance to become prepared. This often entails a great deal of reading both in the case materials and sometimes well beyond that. Second, an expert should know the industry and have a comprehensive understanding of its economics. Third, it is critically important that an expert have the ability to simplify and explain complex subjects. This combination implies that an effective expert witness will have the ability to locate and synthesize key sources of data and, as previously noted, act as a resource who can be relied upon for competent help in the preparation of testimony if, as noted, he or she has been given a chance to adequately prepare.

In arbitrations involving more than one expert witness, an attorney should attempt to find the smallest number of experts who can collectively provide the knowledge and expertise demanded by the case at hand. Many good ideas can emerge from the interactions among witnesses; this should be encouraged in important cases by arranging meetings at which the witnesses discuss their individual findings and the case in general.

Witnesses are, of course, hired first as consultants. In some cases – such as defense of damage claims where the appearance of any expert might dignify the other side's claims – the consultant might never appear as a witness, but instead assist in examining evidence and in helping prepare for arbitration. The expert's role in these cases is to uncover any adverse information, including that relevant to his own client's case. Indeed, this is the best way for the expert who has determined that his testimony would not be favorable to leave the case with his integrity intact and with no harm to the client.

When possible, the expert witness should attend the hearing prior to being called to give testimony. As an expert, the witness is permitted to base his testimony on what he has heard in the hearing, as well as on his familiarity with the subject matter and firsthand observation. An expert should not be brought to town the day of his testimony and expected to testify brilliantly in context. And while the practice of having transcripts prepared and allowing the witness to review them, as in a courtroom trial, is technically possible, it is usually not practical in an arbitration hearing. Also, when the dramatic emphasis of prior testimony has been more important in shaping impressions than the words themselves, something is lost. Further, the use of hypothetical questions often fails to produce compelling testimony.

Before direct testimony, anticipated questions should be put in writing for review. As noted above, the expert must be fully prepared with the attorney's view of the case as well as what the other side will be trying to accomplish, as well as how they might try to demonstrate bias on the expert's part in attempts to impeach his testimony. The witness needs time to read and analyze what the other side's expert's will submit to the panel, when such submissions have occurred, and should also be familiar with the relevant literature in the field, because he may be cross-examined on it. Recently, for example, an expert discovered a significant admission in a report written by the opposing side's expert. Unfortunately, the discovery was made after the hearing, because adequate time had not been made available for this kind of review prior to testimony.

The witness should prepare a full statement of his or her qualifications taking care not to overdo it. He should be knowledgeable and confident—but not to the point of arrogance. A self-confident presentation, based upon thorough preparation, will do the best job of establishing credibility in a courtroom or an arbitration hearing. The witness must be clear about the purpose of the

testimony and have a disclaimer ready about issues he has not analyzed. Again, a way should be established by which the attorney can know if the witness can rectify any seemingly damaging admissions from cross-examination on redirect, or whether it is simply best to go on.

As a caution, though, if on the side of the claimants, the lawyer should usually not hold back part of the expert's evidence for rebuttal of the respondent's case, as you might do in a courtroom trial. Arbitration panels are more likely to lose interest in statistics or other technical testimony than would occur in a formal trial and more than occasionally discourage the attorney where an opportunity for the witness to testify a second time is sought. This is not to say that experts should not be used in rebuttal, but only that all of the witnesses' important information should be put on in direct examination where it can be safely believed that it will be admitted. Of course, this assumes the case is simple enough that you know the other side's defense before it is put on.

### Panel Questions

An accomplished expert will often evoke questions from the panel. As the author has served as chair in previous arbitrations (a fact that is covered in his introduction to the panel), he is often questioned by panel members after his testimony is completed on different aspects of the case in which he is then appearing. This has sometimes led to colloquies between the panel and himself that have lasted as long as a half hour. Such questioning permits a deep insight into the thinking of the panel and allows testimony of remaining witnesses to be enhanced so as to deal with what is really troubling the panel. Also, it provides the witness the opportunity to expound on these points at length and really communicate effectively.

To encourage such interchanges, as attorney you can ask if the panel has any questions after the expert's testimony is completed. Further, if it happens, you may direct additional questions to the

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witness (your expert) to further clarify any points in his responses to panel questions that may have been unclear, or which you wish to emphasize. Such can be the informality of securities arbitration. Remember, the normal rules of evidence and related strictures do not apply in securities arbitration, where the goal is to be fully heard so as to achieve a fair and equitable result. Your chairperson sets the rules and, if knowledgeable, should permit reasonable departures from courtroom procedure if it promotes those goals.

**Cross-Examining the Other Side's Expert**

Another obvious but often overlooked point: in cross-examining the other side's expert, it is important not to give him a chance to expound on questions. With sufficient room to maneuver, an opposing witness can do substantial damage to your case. Instead, questions should be asked that require a "yes" or "no" answer, remembering that the panel will probably give the right to respond at length to any impeachment-type questions.

As you know, try to ask sharp questions and require precise answers from experts on cross-examination. Your expert can suggest appropriate questions for the opposing expert, as well as provide guidance in specialized areas where there may be hidden pitfalls. You should not let an expert under cross-examination escape with vague answers or question him in a manner that makes it obvious where the testimony is heading. One method of avoiding this is to develop a set of questions very logically and then mix the order during actual questioning with

enough questions from your own expert so as to require the other expert to have to cover all of the bases of his opinions and to expose their weaknesses.

Further, in securities arbitrations, panels are much more likely to permit leading questions during direct testimony than a judge would in a trial. Panels typically feel they can sort out the consequences of leading a witness, and it does speed up the process, while helping your expert's testimony to go in more smoothly.

**Fees**

Most consultants of widespread knowledge and reputation bill on a per-diem basis and earn substantial fees for their time. As with legal fees, they can mount up quickly. Yet it often comes down to a decision between saving the client money and winning the case.

Generally, more can be obtained for the same cost if preparation is begun early. This allows the expert to work with you and use his time efficiently, working around his other activities. The greatest single difficulty in the effective use of an expert witness results from the tendency on the part of many attorneys to wait until too late to get the witness involved, or too late to get involved themselves. Delay almost always causes fees to soar, as a mad scramble ensues to get the expert's testimony (and reports, if any) prepared with last-minute heroics.

If funds are limited, however, do not be coy. Say so at the outset and solicit the expert's help in determining the most critical areas of testimony. Brainstorming on how decisive testimony can be developed is often helpful here. If the expert has adequate staff resources to carry out his analyses, this can help as-

sure a cost-effective effort. Otherwise, having the client's own people do some of the groundwork associated with the expert's preparation (under the direction of the expert, of course) is sometimes a way to effect savings. Careful preparation for testimony almost always entails a great deal of work and asking for such help from the client introduces a note of realism if the client feels that projected fees are too high.

**Conclusion**

In using an expert witness, selecting and preparing the expert should be undertaken early in the case. More can be gained for the same cost by starting early. In addition, corollary benefits from the analysis can be more fully developed and exploited when there is sufficient time. In cases in which I have worked, I have seen such corollary benefits to the client develop, including identification of profitable changes in his money management practices, discovery of weaknesses in compliance procedures of a firm or development of information that was important in parallel legislative proceedings in which a client was involved on behalf of his industry. I have also seen cases where the analysis performed by an expert witness has produced useful marketing information for the client company.

The role of the expert witness and that of the attorney interact to a high degree. Given the opportunity to gain a thorough knowledge of the case and to skillfully assist in development of its technical or statistical facts, the expert witness can provide valuable assistance at various points throughout the life of a securities arbitration and be a source of invaluable testimony at hearing.

**ENDNOTES**

1. 6 Howell State Trials, 697.
2. Basten, John, "The Court Expert in Civil Trials—A Comparative Appraisal", *Modern Law Review*, vol. 40, March, 1977. *See also* Hand, Learned, "Historical and Practical Considerations Regarding Expert Testimony", *Harvard Law Review*, vol. 15, 40-58, 1901 for treatment of this and other subjects discussed in this section.
3. Basten, *op. cit.*, 175.
4. *Folkes v. Chadd* (1782), 3 Dougl. 157; 99E.R. 589.
5. Basten, *op. cit.*, 178.
6. *Shearson v. McMahon*, 482US220 (1987).