

THE USE OF EXPERT WITNESSES  
IN SECURITIES ARBITRATION

PRESENTED TO THE  
"SECURITIES ARBITRATION - EVALUATION PREPARATION PRESENTATION"  
SEMINAR

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DOUGLAS J. SCHULZ RECEIVED HIS UNDERGRADUATE EDUCATION AT AMERICAN UNIVERSITY IN WASHINGTON D.C. WHERE HE RECEIVED A BACHELOR OF SCIENCE IN CRIMINAL JUSTICE. HE FIRST WORKED FOR THE NEW MEXICO STATE PUBLIC DEFENDER'S OFFICE AS AN INVESTIGATOR AND ACCUMULATED MANY HOURS GIVING LIVE TESTIMONY IN COURT. MR. SCHULZ ENTERED THE SECURITIES FIELD 10 YEARS AGO. SINCE THEN HE HAS BEEN A SECURITIES SALESMAN FOR INVESTMENT DIVERSIFIED SERVICES (IDS); A SECURITIES BROKER FOR MERRILL LYNCH AND BEAR STEARNS IN DALLAS, TEXAS; AND OWNED HIS OWN COMMODITY FIRM. MR. SCHULZ' SECURITIES EXPERIENCE WAS DOMINATED BY HIGH VOLUME ACTIVITY AND PRODUCTION IN STOCKS, BONDS, OPTIONS AND COMMODITIES. IN 1989 MR. SCHULZ FORMED INVEST IN ORDER TO SPECIALIZE IN SECURITIES CONSULTATION.

MR. SCHULZ SERVES AS A SECURITIES EXPERT WITNESS AND IS A NEW YORK STOCK EXCHANGE ARBITRATOR. HE IS ALSO A LICENSED PRIVATE INVESTIGATOR AND DOES GENERAL INVESTIGATION, AS WELL AS DUE DILIGENCE WORK FOR BROKERAGE HOUSES, INVESTMENT BANKERS, MERCHANT BANKERS AND THE LEGAL COMMUNITY.

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EXHIBIT

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1. **WHY USE A SECURITIES EXPERT WITNESS**

A. **WHO ELSE CAN TESTIFY ABOUT BROKEN LAWS, REGULATIONS AND NORMS?**

The attorney gives an opening and closing argument, but that is not evidence. The client can testify about how he was wronged, but he has a financial interest to gain. The brokerage firm representatives can testify that they did things "by the book", but they have assets to protect.

B. **USE BY THE VETERAN ATTORNEY VERSUS THE NOVICE**

The veteran securities attorney will most likely use a securities expert for select projects, such as document review and testimony; whereas the novice securities attorney will have more extensive needs such as drafting the initial complaint, citing the law, analyzing the entire case in preparation for arbitration, and even helping negotiate case settlement. The securities expert is nonetheless equally valuable to both veteran and novice securities attorneys.

C. **BROKERAGE FIRMS' USE VERSUS CUSTOMERS/CLAIMANTS' USE OF SECURITIES EXPERTS**

Customers and claimants are presently the ones hiring securities experts. Brokerage firms reason that they don't need to hire an expert to tell them about their own business. Consequently, brokerage firms use their own employees, such as their operations manager, compliance manager or office manager to serve as their expert witnesses - a big mistake. Brokerage firm personnel appear more biased to the arbitration panel, they

usually do not have an industry wide perspective, and they are more susceptible to believing the broker who may be hiding facts from the firm. Additionally, brokerage firms tend to brand any expert who works for the other side "untouchables".

While this may be an understandable reaction, it is unfortunate because emotions set aside, there is no valid basis for a brokerage firm not to employ a securities expert who has testified for the other side.

#### **D. ARBITRATION PANELS VIEW THEM AS LESS BIASED THIRD PARTIES**

All experts are hired guns, and securities experts are no different. However, securities experts are viewed by arbitration panels as interpreters of the laws, norms, and regulations and as probably the most knowledgeable person in the hearing with less to gain or lose than any other person in the hearing.

#### **E. OFFSET THE OPPOSING SIDE'S EXPERT**

Whether you represent a claimant or a brokerage firm, it will be crucial to have an expert witness if the other side does. Your expert will neutralize any conflicting or damaging opinions by the other side's expert, even where the opposition is an in-house operations manager, compliance manager or office manager. Brokerage firms come loaded to the hilt with people and documents. You need a team too.

**F. EXPERIENCE LENDS TO CREDIBILITY**

Your securities expert should have two types of experience. First, he should have an extensive trading background and will therefore be the most knowledgeable about the trading environment for the particular investments. Second, he should have experience in analyzing cases and sitting through securities arbitrations, thereby knowing what to expect and how to handle himself. All of these attributes will lend to the securities expert witness' credibility.

**2. WHAT SERVICES A SECURITIES EXPERT CAN PROVIDE**

**A. ASSISTANCE IN DETERMINING WHETHER A CASE SHOULD BE TAKEN**

The securities expert can be employed to determine if there is a case. This determination can be made based on a review of all documents that are available and conversations with the client. The securities expert knows what to look for in documents and he can do it fast. He can also ask your client the appropriate questions to determine the viability of a winning suit. The expert may advise that the best approach, though by no means required, is to first send a settlement demand letter.

**B. EARLY VALUATION**

Once the decision is made to take on a case, the securities expert can be used to help you determine whether or not to take the case on an hourly rate or contingency.

**C. REVIEW OF DOCUMENTS TO DETERMINE WHAT SECURITIES LAWS HAVE BEEN BROKEN**

Many novices write their initial complaint before consulting with an expert. The expert will find numerous additional laws broken which discovery may be too late if you have filed your complaint. Additionally, the expert will find violations of exchange rules, industry norms, and internal policies of brokerage firms that most attorneys are not familiar with.

**D. USE OF INDUSTRY FORMULAS TO MEASURE, CHURNING, DISCRETION, TURNOVER ETC.**

The expert knows all the formulas used by the regulatory and legal community to measure if a customer or his account has been abused. These reports are usually the core of the expert's testimony in arbitration. Sometimes a separate account is used and may cause problems. If the expert does not review all of the figures, he may not catch key items. Secondly, he may not want to testify to figures he did not produce.

**E. REVIEW DOCUMENTS AND INTERVIEW CLIENT TO FIND DISCREPANCIES AND MINOR INFRACTIONS**

Each and every document should be reviewed by the expert. It is absolutely crucial that your expert have access to all of the resources you do, in order to effectively do his job. Your expert should know the documents better than anyone. It is his job to find the little things that do not match up. Signatures, check marks, dates, proper documents filled out, etc. Many times it is these little things that end up winning cases.

**F. ANALYZE EACH INVESTMENT AS TO ITS MAKEUP, HOW IT WORKS AND ITS APPROPRIATENESS AND SUITABILITY TO THE CUSTOMER AND THE CUSTOMERS' INVESTMENT GOALS**

The expert will ask the claimant the typical broker questions in addition to very detailed questions to determine his sophistication, investment goals, knowledge of risk/reward relationships, investment history, trading strategy, etc. The expert will then research all investments: S&P ratings, prospectus, sales literature, articles, books, and talk to brokers and investment advisors along with using his personal knowledge of these investments. He will then form an opinion as to how these investments fit into the claimant's investment and financial goals.

**G. REPORT ON ACTUAL DAMAGES AND LOST OPPORTUNITIES**

By working with the attorney and client, the expert will help determine not only what actual losses are but even more importantly, which losses are caused by violations and how these losses occurred. There are also the damages caused by the client having to file suit, which include litigation costs, attorney's fees and expert witness fees. Lastly the expert will produce documents which will show what might have happened if the account was left alone, traded properly, followed other indices or put into money market funds.

**H. ASSISTANCE WITH DISCOVERY**

To the novice its absolutely necessary. Experts know what to ask for, what is available and how to fight for it.

**I. BE A FINDER OF ADDITIONAL FACTS & INFORMATION**

An expert can be used to do more than merely give his expert opinion based on the facts provided him. Allow your expert to conduct interviews as to what other experts, brokers, and managers in the securities industry think about a particular product or topic. The expert has sources, contacts, reference materials and more. How is this brokerage office thought of on the street? What is the broker in question's background? Has he had any previous problems? Answers to questions such as these may provide good evidence to sway the arbitrators.

**J. ASSIST ATTORNEY IN ARBITRATION CONCERNING THE TESTIMONY AND EVIDENCE**

Most litigation attorneys will agree, you can't have too much help in the courtroom. The expert not only listens to testimony being given and peruses documents submitted as evidence, but he is that extra ear for contradictions, etc. Since much of the testimony and documents may be heard and seen for the first time, you need someone there who fully understands it. The expert will catch items you may not. Lastly, his presence will intimidate the other side from trying to get away with things that it thinks no one will understand due to its complicated investment nature.

**K. TESTIMONY OF FINDINGS AND INTERPRETATIONS OF LAWS AND NORMS**

Your expert is your key witness through which you will introduce much of your case. He will retell the client's story but hitting only the key points, dates, infractions etc. He will also give his opinion as to what may or should have been happening at the brokerage firm during the relevant time.

### **3. HOW TO SELECT AN EXPERT**

#### **A. EXPERIENCE IN TRADING IS KEY**

A quote from Peterson & McCarthy's "Arbitration Strategy and Technique" is that, "If an expert is utilized, arbitrators tend to be more impressed by persons who have practical experience as opposed to merely academic or testimonial expertise."

#### **B. EXPERIENCE IN TRADING THE EXACT INVESTMENTS**

It is not absolutely necessary that your expert have this experience, but it can be extremely helpful, both in assisting the attorney and in building credibility with the arbitration panel.

#### **C. NOT OUT OF THE BROKERAGE BUSINESS TOO LONG**

A lot has changed in the past ten years - types of products, marketing, strategies, policies, equipment, etc. If the expert is from the brokerage field, a trader is more valuable than a compliance person, unless "lack of supervision" is the claim.

#### **D. EMPLOYMENT AT THE BROKERAGE FIRM IN QUESTION**

This can be a great asset, but if he has worked only for one firm it can be a drawback. It is necessary to ensure that no current conflicts exist and familiarize yourself with your expert's status while at the brokerage firm and his reason for leaving.



**E. ABILITY TO GO BEYOND SOURCE DOCUMENTS**

Most of the time you will need additional information. Make sure the expert has the resources, contacts and abilities to search out this additional information. What inside information can he find on the brokerage firm, broker in question or customer, if the expert is used by a brokerage firm?

**F. WIDE RANGE OF SERVICES**

Find an expert who can analyze the case, quote the laws and norms, do the accounting, aid in preparation, conduct research and investigation, and assist and testify in arbitration.

**5. ATTACHMENTS: TYPICAL DOCUMENTS PRODUCED BY EXPERT**

Be sure to discuss with your expert the contents of all documents he intends to prepare before they are prepared, bearing in mind that they may be produced to the other side. A smart opposing attorney is going to ask to see all documents prepared by your expert, including notes on scratch paper and including documents that are not given to the attorney. A good expert will only prepare favorable documents and will alert you to negative findings VERBALLY.

**A. THE REPORT ITSELF**

The report should be in a narrative form and should contain the expert's findings of fact and opinions as to violations of regulations, laws, norms and industry standards.

**B. CHRONOLOGY OF EVENTS**

A chronological list of key dates, trades, transfers of money, account status, conversations and correspondence.

**C. SCHEDULE OF PURCHASES AND SALES**

A list of all trades, # of shares, buy and sell dates, price per share, total cost of commissions, etc. The formats vary, however, the schedule should be prepared both chronologically and alphabetically.

**D. MONTHLY & QUARTERLY SUMMARY OF ACCOUNT**

An extremely helpful list showing the account status comparatively and cumulatively.

**E. SCHEDULE OF CASH DEPOSITS AND WITHDRAWALS**

**F. SCHEDULE OF INCOME, DIVIDENDS, AND MARGIN INTEREST**

**G. TRADE ANALYSIS**

This document displays the average number of losing trades versus winning trades, including the average number of days each trade was held, etc. Your expert will need to interpret the importance of the numbers for the panel. Thee trade analysis can be most useful in impeaching the broker.

#### **H. COST AND TURNOVER ANALYSIS**

The cost and turnover analysis measures the cost incurred in the trading of securities and how often the account is turned over using the Looper formula, which compares the total amount of purchases with the average net equity.

#### **I. COMMISSION ANALYSIS**

Depending of the number of trades and the time span of the trading this document can be very crucial. The analysis compares the total commissions of the account to the average equity, total dollars invested, and losses in the account. It also has a comparison by trade and to the broker in question's other commissions generated in other accounts.

#### **J. TRANSACTIONS VS PHONE LOGS**

This document compares phone calls between the broker and the client in relation to all trades made in the account. Phone logs can be critical in all cases claiming unauthorized and discretionary trading. They, of course, are only useful in cases where long distance communication is involved.

#### **K. CHARTS**

Charts of individual stocks and commodities, the Dow Jones, the bond market, interest rates, etc. Key prices and dates should be marked and the entire chart enlarged to assist in presentation.

**L. THE S&P AND SUITABILITY ANALYSIS (no example supplied)**

Using the S&P and various rating agencies, your expert can prepare a document which reflects his opinion of the suitability of each investment made in the account and how it relates to the needs, goals and guidelines of the client.

**M. INDIVIDUAL STOCK STRATEGIES (no example supplied)**

Your expert can demonstrate the methodology behind trades, the supposed rationale for trades and the risks and rewards involved. This document is especially useful in complex arbitrage, option and commodity trading.

**N. SUMMARY OF DAMAGES**

This document reflects only monetary damages.

**O. OPPORTUNITY LOSSES**

Opportunity losses are established in several ways. First, your expert can show what would have happened if the money had been placed in a money market fund or an indexed stock fund or portfolio. Secondly, your expert can take the actual portfolio or a similar portfolio and demonstrate what the results would have been A) if no trades at all were made, or B) if disputed trades are rescinded.

## 6. SEQUESTRATION OF AN EXPERT WITNESS

- A. Your opposition will attempt to exclude your expert witness from the arbitration hearing, except for when he is testifying. Arguments against sequestration are:
1. That the expert witness is an aid to the attorney,
  2. That since much of the testimony and documents will be seen and heard for the first time in the arbitration hearing, it is essential for your expert to be present,
  3. That your case will be adversely effected if the expert is excluded, and
  4. That your expert can wear two hats - one to give expert opinion and the other, to give factual testimony about investigation and research in the industry.
- B. RELY ON GOLBERG'S ARTICLE IN APRIL 1989 SECURITIES ARBITRATION COMMENTATOR

## 7. EXPERTS' ROLE IN DISCOVERY

"FORCED ARBITRATION - PERFECT JUSTICE? DISCOVERY IN ARBITRATION"

BY DOUGLAS J. SCHULZ & TRACY PRIDE STONEMAN; REPRINTED WITH PERMISSION FROM SECURITIES ARBITRATION COMMENTATOR

This article focuses on the problems with discovery in arbitration and the SRO's efforts to address those problems. We polled 50 or so securities attorneys and arbitrators to assess people's thoughts about how discovery in arbitration worked. Almost all defense attorneys said it worked fine. Almost all claimants attorneys said words to the effect that discovery in arbitration was an abomination. The article addresses problems with the system, offers suggestions to improve the system and gives advice to attorneys working within the system.

The securities expert can be useful in several ways. Often, claimants attorneys use the discovery process as a fishing expedition to obtain virtually every category of document conceivable in an effort to build their case on what they find. This approach can be counterproductive in that it results in the opposing side responding with blanket objections. One of the defense attorneys in our poll stated, "It is my job to object to every request for production and force the other side to overcome my objections." Furthermore, the approach gains no sympathy with the arbitrations panel.

One suggestion is to use your expert to enable you to tailor your discovery requests to only those documents that are, in your expert's opinion, necessary to the presentment of your claim. Once again, your expert should know what documents are available from the brokerage firm and in what format.

Another suggestion is to have your expert articulate the reasons why the information requested is relevant and state those reasons in your discovery request. Doing so will go a long way to prevent objections from the opposing side and will better your case in front of the arbitrators at a preliminary hearing.

## **8. CONCLUSION**

Your securities expert witness can make or break your case. Hopefully, this article will assist you in selecting a securities expert and in utilizing him to your fullest advantage. You and your client will reap the benefits.