UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15974

In the Matter of

NATURAL BLUE RESOURCES, INC.
JAMES E. COHEN, and
JOSEPH A. CORAZZI,

Respondents.

DEFENDANT'S MEMORANDUM OF LAW IN SUPPORT OF MOTION IN LIMINE TO EXCLUDE CERTAIN OF THE DIRECT TESTIMONY OF ROBERT M. DAINES

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Pursuant to Rule 321 of the Rules of Practice of the United States Securities and Exchange Commission, Respondent James Cohen submits this memorandum in support of his motion to exclude certain of the direct testimony of the Division's expert witness, Robert M. Daines, on the grounds that this testimony constitutes impermissible legal conclusions and is otherwise irrelevant.

PRELIMINARY STATEMENT

Key portions of the testimony offered by the Division's purported expert, Prof. Daines, do not measure up to the requirements set by the landmark decision of Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579 (1993), and related cases. Much of Prof. Daines's testimony is unobjectionable: his recitation of his lengthy c.v., his description of his published works, and even his overview of general corporate governance concepts. However, Prof. Daines verges into forbidden territory by drawing legal conclusions concerning the facts of this matter. Clear precedent bars expert witnesses from reaching legal conclusions in their testimony, and the Court has no cause to permit Prof. Daines to breach this standard.

The law concerning appropriate subjects for the testimony of a corporate governance expert is straightforward: "experts are restricted to explaining general corporate governance concepts, such as setting forth the respective roles of a corporation's directors and officers ... [but] courts specifically preclude the expert from offering either legal conclusions or opinions that apply corporate governance concepts to the case's specific facts." United States v. Brooks, 2010 U.S. Dist. LEXIS 2277, *11-12 (E.D.N.Y. Jan. 11, 2010). Yet Prof. Daines repeatedly violates these tenets to reach legal conclusions that the law reserves for the Court. For example, in this matter, the parties dispute whether or not Mr. Cohen should have been considered a *de facto* director of Natural Blue Resources, Inc. Prof. Daines testifies directly that "a person that

[engaged in the alleged activities] would be fulfilling the economic function of a corporate officer or director." (No. 41.) Such testimony encroaches on the Court's role, and Respondent respectfully requests that the Court exclude it.

Prof. Daines also gives testimony that is not relevant to this matter and that should be excluded for that reason. Prof. Daines offers testimony on the factors that he would "consider in evaluating whether an individual was behaving in a manner akin to a Chief Executive Officer or other officer of a public company" or a "corporate board member." (Nos. 32-33.) Given that the standard for whether an individual should be considered a director for disclosure in a public filing is set forth in Rule 3b-7 of the Exchange Act—as the SEC has acknowledged—Prof. Daines's testimony that ignores Rule 3b-7 and sets forth different considerations would only distract from the crucial issues and should be excluded on that basis.

STATEMENT OF FACTS

I. Procedural Background

On December 5, 2014, the Court entered a scheduling order that required the parties to file any expert reports by January 7, 2015.

On January 7, the Division filed a Designation of Prof. Daines as an expert witness. The Designation described Prof. Daines's professional background and curriculum vitae, listed his publications and the cases in which he had previously offered testimony, and provided an overview of the topics of his expected testimony in this matter. However, the Designation was not an expert report authored by Prof. Daines.

On January 13, 2015, the Court entered an Order addressing various pre-hearing filings. As it related to expert testimony, the Court found that

> [t]he Division has filed information concerning a proposed expert witness, not an expert report. If it wishes to present expert testimony, it must file an expert report

– the expert's direct evidence – by January 26, 2015, and make its expert available for cross-examination.

January 13, 2015 Order at 2 n.2 (emphasis added).

On January 26, 2015, the Division filed—instead of an expert report—the Direct Testimony of Prof. Daines, described below.

II. Description of Prof. Daines's Direct Testimony

The Direct Testimony of Prof. Daines filed by the Division takes the form of sixteen pages of questions and answers, with forty-eight questions and answers overall, accompanied by a signed declaration by Prof. Daines attesting to the truth of the submission.

Question and Answer Nos. 1-16 and 20 retread much of the same ground covered by the Division's January 17, 2015 submission. Prof. Daines describes his occupation and professional affiliations (Nos. 4, 14-15), the cases in which he previously served as an expert (No. 5), his educational and professional background (Nos. 6-12), and his research and published works (Nos. 16, 20).

Question and Answer Nos. 17-18 describe Prof. Daines's affiliation with the outside consulting firm Compass Lexecon, which Prof. Daines states "assisted" him in his work on this matter.

Question and Answer Nos. 21-38 and 48 offer Prof. Daines's opinions on general corporate governance principles.

Question and Answer Nos. 39-47 offer Prof. Daines's opinions about the Division's allegations, though Prof. Daines acknowledges that he has not, in fact, "investigated whether . . . Respondents engaged in [the] activities" that the Division has alleged (No. 40). Yet, in this portion of his testimony, Prof. Daines offers conclusions as to the legal consequences of the Division's allegations. Thus, he:

- testifies that he is "aware of [the Division's] allegations" that "Respondents James Cohen and Joseph Corazzi exercised direct and indirect control over Natural Blue Resources, Inc." (No. 39);

- testifies that has not, in fact, "investigated whether . . . Respondents engaged in [the] activities" that the Division has alleged (No. 40);

- states that "a person that [engaged in the alleged activities] would be fulfilling the economic function of a corporate officer or director" (No. 41).

Prof. Daines also addresses supposedly hypothetical questions that provide a thin veneer over the Division's allegations – which he admits he has not investigated. Thus, Prof. Daines:

- offers testimony regarding "certain 'core' functions of officers and directors of a public company that would be unusual to outsource to business consultants" (No. 44);

- offers testimony regarding whether business consultants may "retain greater authority over a company's strategy, decision making and management than the company's own senior executives" (No. 45);

- offers testimony as to whether he has "ever observed a situation where outside consultants must give their approval before major firm decisions can be made by corporate management" (No. 46);

- offers testimony as to whether he has "ever encountered scenarios where major transactions were identified, negotiated, and substantially completed before involvement by any senior executive" (No. 47).

To date, the Division has not filed an expert report of Prof. Daines or any other expert.

DISCUSSION

Trial courts occupy a key gatekeeping role with respect to expert testimony: under settled caselaw, including Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993), and Kumho Tire Co., Ltd. v. Carmichael, 526 U.S. 137 (1999), courts may only admit expert testimony if it proves sufficiently reliable.[1] *See also* Fed. R. Evid. 702. Moreover, expert testimony "must be carefully circumscribed to assure that the expert does not usurp either the

[1] SEC Rule of Practice 320 broadly provides that a "hearing officer . . . shall exclude all evidence that is irrelevant, immaterial or unduly repetitious."

role of the trial judge as to the applicable law or the role of the jury in applying that law to the facts before it." United States v. Bilzerian, 926 F.2d 1285, 1294 (2d Cir. 1991) (citing United States v. Scop, 846 F.2d 135, 139-40 (2d Cir. 1988); Marx & Co. v. Diners' Club, Inc., 550 F.2d 505, 510-11 (2d Cir. 1977)).

A. Prof. Daines Draws Impermissible Legal Conclusions that Should Be Excluded

Under the above standard, legal conclusions are clearly out-of-bounds: "although an expert may opine on an issue of fact within the jury's province, he may not give testimony stating ultimate legal conclusions based on those facts," as stating a legal conclusion encroaches on the roles of judge and jury. Bilzerian, 926 F. 2d at 1294 (emphasis added). Accordingly, courts do not hesitate to exclude expert testimony that goes so far as to reach legal conclusions. *See* United States v. Brooks, 2010 U.S. Dist. LEXIS 2277, *11-14 (E.D.N.Y. Jan. 11, 2010); Floyd v. Hefner, 556 F. Supp. 2d 617, 640 (S.D. Tex. 2008); Pereira v. Cogan, 281 B.R. 194, 198 (S.D.N.Y. 2002).

Experts that seek to offer opinions regarding corporate governance precepts must abide by these same standards, and limit their testimony to general concepts, or courts will deem their testimony inadmissible. The Brooks court summarized the state of the law:

> Experts are restricted to explaining general corporate governance concepts, such as setting forth the respective roles of a corporation's directors and officers, the nature of an officer's fiduciary duties to the corporation, or the concept of parent-subsidiary corporate separateness. And, overwhelmingly, courts specifically preclude the expert from offering either legal conclusions or opinions that apply corporate governance concepts to the case's specific facts. Thus, although a corporate governance expert can explain what a CEO does, and what a fiduciary duty is, the expert cannot opine as to whether a specific CEO's acts breached any fiduciary duty.

Brooks, 2010 U.S. Dist. LEXIS 2277, at *11-12 (emphasis added). Accordingly, the court in Brooks held that the law professor the Government sought to qualify as an expert was not

permitted to testify regarding the conduct of the defendants or the legal import of that conduct. *Id.* at 14. Similarly, in Floyd v. Hefner, the court held that a corporate governance expert could "testify as to the standards of conduct applicable to directors in general," but could not testify "as to whether the Defendants' conduct comported" with the applicable standards. 556 F. Supp. 2d at 640. And the Pereira court too struck a number of statements made by a corporate governance expert that the court found to be "ultimate legal conclusions," including statements in which the expert evaluated whether a corporate board or the defendant had properly exercised fundamental responsibilities in "manag[ing] the business affairs of the company." 281 B.R. at 197-199.

Evaluating Prof. Daines's testimony against this standard, Question and Answer Nos. 39-47 should be stricken because through they draw impermissible legal conclusions. Prof. Daines directly states in this series of answers that "a person that [engaged in the alleged activities] would be fulfilling the economic function of a corporate officer or director." (No. 41). Through this portion of his testimony, Prof. Daines "appl[ies] corporate governance concepts to the case's specific facts"—the exact type of improper legal conclusion that courts routinely exclude. Brooks, 2010 U.S. Dist. LEXIS 2277, at *11-12.

Nor does it save Prof. Daines's testimony that he admits that he has not actually investigated the Division's allegations. (No. 40). To the contrary, Prof. Daines's testimony nonetheless amounts to a series of unacceptable legal conclusions as he describes the legal consequences of engaging in various types of behaviors: whether taking certain actions "would be fulfilling the economic function of a corporate officer or director" (No. 41); whether "certain 'core' functions of officers and directors of a public company . . . would be unusual to outsource to business consultants" (No. 44); or whether business consultants may "retain greater authority over a company's strategy, decision making and management than the company's own senior

executives" (No. 45), retain rights of "approval before major firm decisions can be made by corporate management" (No. 46), or "identif[y], negotiate[], and substantially complete[] . . . [major transactions] . . . before involvement by any senior executive" (No. 47). Even though Prof. Daines couches these legal conclusions as responses to thinly disguised putative hypothetical scenarios, they remain legal conclusions and must be excluded for that reason.

With respect to the portions of his proposed testimony that address whether the witness has "ever" encountered particular circumstances, Question and Answer Nos. 46-47, those statements should be stricken also because they lack any adequate basis or value to the factfinder. Whether this witness has*personally* "ever" seen those scenarios has no probative value, particularly in the absence of evidence that he has actually studied or surveyed some significant percentage of microcap or start-up businesses. Nor does it have any legal relevance, since those circumstances are, even according to the witness, plainly not impermissible and instead only unusual or unfamiliar to him. Those practices would, if anything, fall into the category of those that are either desirable or not – an issue that is not present in this case or properly considered by this witness.

B. Prof. Daines Gives Irrelevant Testimony that Should Be Excluded

Prof. Daines also gives testimony that is not relevant to this matter. In his response to Question Nos. 32 and 33, Prof. Daines describes the factors that he would "consider in evaluating whether an individual was behaving in a manner akin to a Chief Executive Officer or other officer of a public company" or a "corporate board member." (Nos. 32-33.) That testimony would be relevant only if such behavior – "akin to" an officer or director – were in any way germane to the issue of whether Respondent James Cohen is liable for allegedly false filings of Natural Blue Resources, Inc.. But it is not. The SEC has properly identified the standard that

applies to a disclosure in a public filing, and the law that applies to an interpretation of that provision.

On the issue of whether an individual should be disclosed as an officer in a public filing, the applicable standard is set forth in Rule 3b-7 of the Exchange Act, which defines "executive officer" as any "officer who performs a policy making function or any other person who performs similar policy making functions." 17 C.F.R. § 240.3b-7.

The decision in SEC v. Prince demonstrates that, in applying that provision, the courts should focus on who has the authority to make company policy. 942 F. Supp. 2d 108, 132 (D.D.C. 2013). In Prince, for example, the fact that the defendant served as an "influential" advisor, as the director of the Mergers and Acquisitions program, and as the supervisor of the Contracts Department, did not alter the court's conclusion that "the ultimate decision" on significant issues remained with the Chief Executive Officer, and that the defendant did not therefore qualify as an officer. Id. at 136.

Here, the purported expert *does not* acknowledge or apply Rule 3b-7 or the standard that it sets. He focuses and sheds some light on the notion of "akin-ness" but fails to illuminate the only relevant question: whether Mr. Cohen had the authority to make company policy. His assertions, while possibly relevant in proceedings involving the liability of directors or officers, would serve in this action only to distract from that salient issue and should be excluded.

CONCLUSION

Accordingly, Respondent respectfully requests that the Court exclude Question and Answer Nos. 32-33 and 39-47 of Prof. Daines's testimony.

Dated: February 3, 2015

Respectfully Submitted,

/s/

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