UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-v-

No. 06 Civ. 6483 (LTS)(RLE)

FREDERICK O'MEALLY,

Defendant.

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MEMORANDUM ORDER

The United States Securities and Exchange Commission ("SEC") brought this action against Frederick O'Meally ("O'Meally" or "Defendant") for securities fraud under section 17(a) of the Securities Act of 1933, 17 U.S.C. § 77q(a), section 10(b) of the Securities Exchange Act of 1934, 17 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, alleging that Defendant employed deceptive schemes to conceal from mutual fund companies the fact that he was engaging in "market timing" practices, thereby defrauding both the mutual fund companies and the funds' shareholders. The Court has jurisdiction of this case pursuant to 17 U.S.C. §§ 77q and 78j, as well as 28 U.S.C. § 1331.

At the close of evidence at trial, Defendant moved the Court for judgment as a matter of law pursuant to Rule 50 of the Federal Rules of Civil Procedure, insofar as Defendant was accused of negligent conduct. The Court reserved decision on the motion. The jury found Defendant liable for negligently violating section 17(a)(2) or (3) of the 1933 Securities Act with regard to six mutual fund companies and not liable on all other claims.

Defendant seeks a judgment of non-liability on the negligence claim on the grounds that the SEC failed to establish the requisite standard of care because the SEC failed to proffer expert testimony regarding the appropriate standard under the circumstances and because the documentary and lay testimonial evidence regarding the standard of care was inadequate to support a determination that Defendant breached an applicable standard of care. The Court has considered carefully the parties' submissions and, for the following reasons, Defendant's motion is denied.

Background

Defendant was employed by Prudential Securities ("Prudential") from 1994 to September 2003. At Prudential, he began executing market-timing trades in mutual funds for various Prudential clients. Market timing involves the frequent purchase, sale or exchange of mutual fund shares in order to take advantage of market inefficiencies in the pricing of mutual fund shares. Although not illegal, market timing is discouraged or prohibited by many funds because it disadvantages those shareholders who make long-term investments in the funds.

At trial, the SEC proffered hundreds of letters and emails sent to Prudential from dozens of mutual fund companies seeking to stop O'Meally's market timing in their funds. (Exhs. 101-189.) Some of the letters were addressed to O'Meally directly or members of his team. Others were addressed to supervisors at Prudential. Al Vayda was the manager of Prudential's mutual fund operations department at the time O'Meally was engaged in market timing. (Tr. 693-94.) Vayda testified that 60 or 70 mutual fund companies contacted Prudential seeking to stop or limit market timing in their funds and that, when Prudential received such correspondence, Vayda's office would forward copies of the correspondence to the broker to whom it applied, including to O'Meally. (Tr. 717-18.) Jessica Oldham, who worked as a supervisor on Prudential's mutual fund exchange desk, also testified that she forwarded copies of such letters to brokers. (Tr. 848-49.)

At trial, O'Meally testified that, pursuant to Prudential's internal policy, he was required to follow any restrictions that fund companies, in their letters to Prudential, placed on the frequency of trading in their funds. (Tr. 1735.) O'Meally also testified that, contrary to the testimony of Vayda and Oldham, copies of mutual fund letters restricting market timing were not forwarded to brokers. (Tr. 1706.) Instead, according to O'Meally's testimony, an individual working in Prudential's operations or compliance department would "interpret" the fund companies' letters and then send a memorandum to the brokers communicating the fund companies' instructions. (Id.)

O'Meally expressed skepticism that fund companies actually intended to restrict market timing in their funds, despite the express statements in the fund companies' letters and emails. On direct examination, O'Meally was asked, "[I]f the fund company said we don't want this client anymore [because the client engaged in market timing], do you really think [the company] didn't care if the client kept trading [in that company's funds but] using different accounts?" O'Meally responded, "Depends on . . . the fund family . . . . They said a lot of things they did not mean." (Tr. 1715-16.) The SEC's counsel then asked:

> And if a fund company said we don't want Mr. O'Meally trading with us any longer, and the fund company identified five of your [account or brokerage] numbers but not the other 41 that were used, do you think the fund company really didn't care that people kept trading [using] those other 41 numbers?

(Tr. 1716.) O'Meally responded, "I know in some circumstances they did not care." (Id.) Of the 60 fund companies as to which the SEC proffered evidence of instructions to refrain from market timing, O'Meally named only one that had mistakenly sent him a block letter after the company had given him permission to market time in its funds. (Id.) The jury did not find O'Meally liable in connection with transactions involving that fund company.

The SEC proffered evidence that O'Meally continued to engage in market timing transactions of particular mutual funds after O'Meally was instructed to cease his marketing timing of those particular funds. No expert testimony was presented at trial regarding the appropriate standard of care for a broker engaged in mutual fund trading.

Discussion

A motion for judgment as a matter of law made pursuant to Rule 50 of the Federal Rules of Civil Procedure "may only be granted if there exists such a complete absence of evidence supporting the verdict that the jury's findings could only have been the result of sheer surmise and conjecture, or the evidence in favor of the movant is so overwhelming that reasonable and fair minded persons could not arrive at a verdict against [him]." Brady v. Wal-Mart Stores, Inc., 531 F.3d 127, 133 (2d Cir. 2008) (citations and some internal punctuation omitted). In reviewing such a motion, this Court "may not weigh the credibility of witnesses or otherwise consider the weight of the evidence" and "must give deference to all credibility determinations and reasonable inferences of the jury." Id.

The Absence of Expert Testimony

A violation of section 17(a)(2) or (a)(3) of the Securities Act of 1933 may be established by showing that the defendant did not exercise reasonable care under the circumstances. See S.E.C. v. Shanahan, 646 F.3d 536, 545-46 (8th Cir. 2011); see also S.E.C. v. Dain Rauscher, Inc., 254 F.3d 852, 856 (9th Cir. 2001); S.E.C. v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997). Whether a defendant exercised reasonable care is typically a jury determination. See S.E.C. v. Fitzgerald, 135 F. Supp. 2d 992, 1020 (N.D. Cal. 2001) (explaining, in the context of section 17(a)(2) and (3) claims, that "[n]egligence is typically a jury determination based on an objective standard").

A jury is capable of determining what constitutes reasonable care under the circumstances, without expert testimony, when a claim involves questions of fact within the jury's common experience in human affairs. See S.E.C. v. Shanahan, 646 F.3d at 546; see also Merlin Biomed Asset Mgm't v. Wolf Block Schoor & Solis-Cohen, 798 N.Y.S.2d 711, 2004 WL 2495778 (N.Y. Sup. Ct. 2004) (explaining that expert testimony is unnecessary to support a malpractice claim "where a juror's ordinary experience would provide sufficient basis for judging the adequacy of the professional service"). For negligence claims involving questions of a specialized and technical nature, however, expert testimony may be necessary to aid the jury in determining the appropriate standard of care. See S.E.C. v. Badian, 06 Civ. 2621, 2010 WL 4840063, *3 (S.D.N.Y. Nov. 19, 2010) (citing Nobile v. Shwartz, 265 F. Supp. 2d 282, 288 (S.D.N.Y. 2003)).

Here, the claims against O'Meally involve technical tasks, which are governed by a standard of care that is likely beyond the jury's common experience, as well as straightforward, everyday tasks that are well within a jury's common experience. Brokering market timing transactions, for instance, is specialized and technical work. It requires specialized knowledge regarding the pricing of mutual funds, the applicable legal and regulatory requirements and the computing requirements for executing a large volume of trades quickly. By contrast, the claims against O'Meally also involve everyday tasks, such as receiving communications from a supervisor at work and heeding the basic instructions contained in those communications. At trial, two Prudential supervisors testified that Prudential received letters from fund companies seeking to stop certain brokers at Prudential from trading in their funds. The supervisors testified that they forwarded these letters to the appropriate broker, such as O'Meally, via facsimile or email. At trial, O'Meally testified that he never received these letters. He also testified that, when he learned that certain fund companies had sent letters seeking to block his trades, he did not believe that the fund companies actually intended to block his trades, despite the unequivocal statements contained in the fund companies' letters. In other words, a supervisor sent O'Meally dozens of emails with instructions to stop doing a particular task—specifically, market timing in particular funds—but he continued to do that task, either because he did not read the emails or simply did not heed them. O'Meally's receipt and comprehension of that basic instruction to stop market timing is antecedent to, and separate from, the technical aspects of executing market timing trades. Whether a person is negligent in failing to read or heed basic instructions communicated through a supervisor at that person's place of employment is well within the common experience of most jurors.

The jury's verdict holding O'Meally liable for violations of section 17(a)(2) or (a)(3) might be premised on a finding that O'Meally acted negligently with regard to either the specialized and technical aspects of his job or the common task of reading and heeding emails from a supervisor. However, neither the Court nor the parties knows which particular aspect of O'Meally's behavior the jury found to be negligent, as the verdict form did not ask the jury to specify its findings in this regard. On the instant motion, the Court is required to "give deference to all . . . reasonable inferences of the jury" and may only grant Defendant's motion if "the jury's findings could only have been the result of sheer surmise and conjecture." Brady v. Wal-Mart Stores Inc., 531 F.3d at 133 (emphasis added). Because the jury's verdict could have been based on a finding that O'Meally was negligent in reading and heeding emails from a supervisor, and because such an activity is within the jury's common experience, O'Meally's argument that the jury required expert testimony to establish the appropriate standard of care is unavailing.

In his brief, O'Meally suggests that expert testimony is required to establish a standard of care even for common, everyday tasks where, as here, the everyday tasks occurred within the context of a specialized and technical profession. In determining whether expert testimony is necessary, the court must consider the nature of the particular task, in context, and whether the task falls within a jury's common experience. Context alone is not dispositive. See Merlin Biomed Asset Mgm't v. Wolf Block Schoor & Solis-Cohen, 798 N.Y.S.2d 711, 2004 WL 2495778 at *7 ("[E]xpert testimony is needed to support a malpractice claim" unless "a juror's ordinary experience would provide sufficient basis for judging the adequacy of the professional service.") Accordingly, the fact that O'Meally worked in a specialized and technical field did not necessitate expert testimony in this case.

The Sufficiency of the Evidence

O'Meally argues that, even if expert testimony was not required to establish the standard of care, the SEC failed to establish negligence as a matter of law because the SEC offered "no . . . evidence to allow the jury to determine whether Mr. O'Meally breached the requisite standard of care." (Def.'s Mem. in Supp. p. 11.) O'Meally is mistaken. The jury had, in addition to its own common experience in human affairs, a variety of evidence from which to find that O'Meally failed to observe the requisite standard of care. The evidence presented at trial included (i) O'Meally's own testimony that, pursuant to Prudential's policy, he was obligated to follow scrupulously any instructions contained in letters from fund companies regarding market timing and excessive trading, (ii) the testimony of individuals from eight different mutual fund companies regarding those companies' limitations on excessive trading and the companies' communications with brokers to enforce those limitations, (iii) the rules contained within different funds' prospectuses regarding excessive trading, (iv) hundreds of pages of letters and emails from fund companies seeking to stop or limit O'Meally's market timing, and (v) the testimony of supervisors at Prudential regarding Prudential's efforts to block market timing. Based on this evidence, the jury had an adequate basis for its finding that O'Meally failed to observe the requisite standard of care by failing to read and heed instructions from mutual fund companies forwarded to him by one or more supervisors at Prudential.

The jury saw a substantial amount of evidence regarding market timing restrictions and the expectations (shared by Prudential, the mutual fund companies and O'Meally himself) that those restrictions would be observed. However, Defendant contends that, even if expert testimony was not required, the SEC failed to establish the appropriate standard of care because the evidence was ambiguous and, at times, inconsistent. A motion for judgment as a matter of law may only be granted when there is a complete absence of evidence supporting the verdict or the evidence is overwhelmingly in favor of the movant. Brady v. Wal-Mart Stores, Inc., 531 F.3d at 133. O'Meally has not demonstrated either a complete absence of evidence or overwhelming evidence in his favor, such as to warrant judgment as a matter of law. Thus, his motion will be denied.

Conclusion

For the foregoing reasons, Defendant's motion for judgment as a matter of law is denied. The jury verdict stands. The parties are directed to consult with each other and to submit to the Court by **June 4, 2012**, a proposed briefing schedule on the civil penalty issue. This Memorandum Order resolves docket entry number 196.

SO ORDERED.

Dated: New York, New York
May 30, 2012

LAURA TAYLOR SWAIN
United States District Judge