SECURITIES ARBITRATION COMMENTATOR

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The Dark Side of Technology in the Hearing Room: Electronic Eavesdropping and Surreptitious Recording

Introduction

Technology has found its way into securities arbitration procedures in manifold ways in the early aughts. FINRA Dispute Resolution itself, as the dominant forum in securities arbitration, has moved from tape recording to digital recording of the hearings. Arbitrators' schedules, profiles and notes are now kept on FINRA's MATRICS system and FINRA will move someday soon from online claim filing, which has been available for the past decade, to the filing of all pleadings online.

Lawyers representing clients have been even more innovative, using electronic devices and techniques to display information, to make the complex readily understandable, and to summarize evidentiary data for panels. Videoconferencing of remote witnesses has become acceptable and a preferable substitute for telephonic testimony. We heard recently about a long and complex case in which the lawyers cooperated to place all exhibits in electronic format and to distribute iPads to each Panel member with the exhibits loaded and catalogued for recall at a sweep-and-punch of the arbitral finger.

Experts have become proficient in the use of PowerPoint, Excel, Access and other data management and display software to produce graphs, charts, videos and other graphic aids for use during their presentations. While they may still be presented on paper in many instances, these tables and graphs have been electronically produced and have now become an indispensable and interwoven aspect of today's arbitration process. Testifying experts no longer just "crunch" the numbers; they produce color graphics that manipulate, re-sort, condense and enlarge the data presented, sliced and diced to suit alternate damage theories, and displayed to arbitrators with moving elements, pop-ups, overlays and pivot tables.

While it has not yet come to securities arbitration (to our knowledge), entire cases are now being conducted online – with direct and cross-examination of witnesses, opening and closing statements, and the introduction of documentary and testamentary evidence presented by the parties to virtually present factfinders and decisionmakers. Those who attended the AAA's recent program – "ADR & Emerging Technologies" – heard about these and other innovative uses of technology and electronic devices in the furtherance of more efficient and effective dispute resolution. The program – about which we report further on pages 7-8 of this edition – was fittingly presented in a Webinar format with electronic poll-taking of the attendees for the Q&A segments. Perhaps the most interesting poll result was that 100% of those responding said they would serve as a neutral, or file a case or represent a party, if the ADR provider required that they use a secure, Web-based system for their case.

Just as the wonderful world of the Internet spawned email hacking, spear phishing, and malware, though, the use of electronic devices in the hearing

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room has revealed its potential dark side in securities arbitration. We had not taken the potential prospects for confidentiality breaches, gamesmanship and unfair practices into account until the August 2012 Securities Experts' Roundtable (SER) Conference in Washington DC. There, in extemporaneous reports from audience members, testifying experts recounted hearing experiences in which participants had utilized electronic devices to "open" live hearings to outsiders. In each of the cases they related, the devices were used surreptitiously, without disclosure to, and without prior approval from, the panel or the user's adversary.

Numbering approximately 100 members today, SER experts have been meeting and exchanging experiences and practices for a score of years. As a group, these peripatetic entrepreneurs witness and participate in more arbitration hearings and a wider variety of cases than any group of lawyers on either side of the "aisle." Moreover, their expected role as objective onlookers and knowledgeable professionals affords them a birds-eye view of the process and a host of observational experiences. Even these sophisticated observers were alarmed by the possibilities for mischief and partisan practices represented by the accounts presented.

Now, we hasten to add that the related experiences were several, not numerous, and, when we checked back at this year's SER Conference in Boston, we heard no further tales of "electronic eavesdropping" or "surreptitious recording" of the proceedings. That was not very surprising, as much had occurred in the interim to assure that arbitrators were alerted to these possibilities and that parties were warned about unauthorized recordings and sensitized to long-standing policies and party expectations of privacy when utilizing arbitration.

To be sure, the parties control the process and jointly they may re-shape it as they see fit. Even unilateral disclosures during the proceedings of the filing of a claim or a party's objections to jurisdiction or to arbitrators' actions are viewed as fair play in today's arbitration world. So, too, if arbitrators inadvertently tape-record their private remarks to each other and the parties, who own the record, later transcribe those remarks, disclosure is not untoward. We recall the case of Morgan Keegan v. Grant, No. 10-56166 (9th Cir. 2012),in which a party challenge to the ultimate Award was based upon alleged prejudicial misconduct and arbitrator bias, evidenced in part by accidental recordings of recess sessions in which at least one of the arbitrators referred to the investment product in dispute as "crap." The assault on the Award was unsuccessful, but there was no question that the otherwise private remarks were subject to disclosure.

Still, there are unquestionably limits. To record conversations, whether on telephone or in person, without the knowledge of those being recorded, certainly brings into issue state and federal privacy laws. Telecommunications and eavesdropping laws come into play as

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well. In some states, it violates the law to record a conversation unless the other side knows about it. In other states, surreptitious recording is permitted as long as one party (it can be the person making the recording) knows about it. These laws would certainly apply in the instance of telephonic hearings. Similar restrictions would be called into play, we would think, in a video or Internet-based hearing.

Are not intellectual property rights also at issue? If performers in stage productions are able to reserve the commercial privacy of their performances by banning recording equipment, might not experts, testifying for pay and reliant upon preserving integrity and reputation for the continued value of their services, have some say in whether they are recorded or exposed by video or audio transmission to a larger, unseen, even unlimited, audience? Should not arbitrators -- in much the same position really -- and with the added imprimatur that they must control and guide the proceedings, be informed of developments and electronic intrusions that can change the dynamics of the proceedings and, indeed, the case?

Schaff Letter

Concerned that FINRA Arbitrators and, even perhaps, the forum were unaware of the practices represented by the accounts of the three expert attendees at the SER Conference, SER's Board authorized the Roundtable's then-President Jeffery E. Schaff, to communicate with FINRA, to describe the experiences of its members and to recommend remedial action.

In a letter dated September 28, 2012, Mr. Schaff, an Illinois-based investment and fiduciary expert and Principal of Ardor Fiduciary Services, wrote to Linda D. Fienberg, President of FINRA Dispute Resolution, reciting the particulars of the experts' accounts and advising FINRA of instances where hearing participants used smartphones or laptop computers in the course of FINRA proceedings in ways that suggested they were recording or transmitting "audio and/or video of an arbitration hearing … without the knowledge or consent of arbitration panels."

The three instances described by Mr. Schaff in the letter to FINRA maintained that:

- "Immediately prior to cross-examination, opposing counsel aimed the outward-facing camera built into his laptop directly at the expert about to testify, giving the expert the distinct impression that he was being 'filmed.'

- "Immediately prior to an expert's testimony, retaining counsel noticed the associate of opposing counsel pushing buttons on his cell phone and then arranging the cell phone on the tabletop. Retaining counsel broached the subject with the panel's Chairman, who asked if the phone was on. Once challenged, opposing counsel admitted that it was on and that other attorneys at his law firm were listening in. The Chairman then directed that the phone be turned off and that no further transmissions be made.

- "Opposing counsel hired a court reporter who was found broadcasting live transmissions of the recorded testimony to opposing counsel's law firm."

Well, these may be troublesome, but they were not instances of nefarious or dangerous practices. They did not equate to spear-phishing, credit card fraud or infiltrating people's e-mail-boxes to steal their address books. In the early days of the Internet, before the WorldWide Web, self-promotion, solicitation and advertising were frowned upon and the practice of "spamming" first arose to punish those who defied the established privacy conventions by unleashing overwhelming traffic in their direction. These described practices were more of that latter nature. They were done surreptitiously, not openly, but they were tactical practices at base -- efforts to intimidate, perhaps, or just to bolster brainpower on the advocate's side of the table.

Mr. Schaff did not state otherwise; it was the potential for abuse that drew SER's concern. His letter made the point that using electronic devices without arbitral knowledge or party agreement created the potential for recording and publication of a private, consensual process. It could allow future witnesses a glimpse at earlier testimony and it permitted individuals outside the hearing room a "virtual presence" at the proceeding. He recommended to FINRA, on behalf of SER, that it consider amending the hearing script to incorporate guidance to hearing participants and to develop policies on recording and potential eavesdropping that could be communicated to arbitrators (and mediators) through training and FINRA's publications.

FINRA-DR's Reaction

FINRA responded to the SER initiative in a letter written by FINRA-DR Senior Vice President Ken Andrichik on November 9, 2012. In the letter, he thanks SER and agrees that FINRA Arbitrators should be "prepared to handle issues related to any unauthorized recording of hearings." Initially, he promised, staff guidance would take the form of an article on the subject in The Neutral Corner, FINRA Dispute Resolution's quarterly newsletter for roster neutrals. Mr. Andrichik acknowledged that early warning allowed preventive action and that FINRA appreciated SER's "raising the issue" of possible abuses.

That article in The Neutral Corner did appear in early 2013. In the first edition of the new year, FINRA included in its "Arbitrator Tip" column a treatment on "surreptitious recording" of arbitration hearings. The article warned arbitrators that "parties may be surreptitiously recording arbitration proceedings – by audio and/or video – without the knowledge or consent of the arbitrators and all parties." The Tip states further that arbitrators who see a hearing participant "attempting to make an audio or video recording of the hearing using an individual electronic device (e.g.

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smartphone, computer, tablet, etc.) – other than taking notes -- …should advise the party that no such recording should be made absent the agreement of all participants."

FINRA also advised in that column that arbitrators should address the issue of "surreptitious recording" at the opening of the hearing by announcing that "the digital recording (or stenographic record) will be the official record of the hearing" and that parties "should refrain from making any audio or video record of the proceedings" without agreement in advance of all concerned. FINRA only addressed the "surreptitious recording" issue in the TNC column and not the prospect of "virtual" participants through electronic eavesdropping. In fact, its advice to tackle the issue at the hearing's outset appeared to suggest that no amendment to the hearing script was contemplated to ensure such a warning.

Whatever occurred in the interim – or, perhaps, it was just part of a continuum of measures -- the staff did amend the hearing script later in the first half of 2013 and, in doing so, stated its concerns somewhat more broadly in the new instruction. There now exists in the prefatory remarks section of the Arbitrator's Hearing Script (Para. O) a sentence which states: "The digital recording (or stenographic record) will be the official record of the hearing, and parties and counsel should refrain from making audio or video recordings or transmissions of the proceedings unless otherwise agreed by all parties and the arbitrator." (Emphasis supplied)

By covering "transmissions" in the listing of unauthorized practices, the Hearing Script warns hearing participants – both parties and counsel – that they are forbidden from using electronic devices to "surreptitiously" transmit audio or video data to parties outside the hearing room. This additional step now addresses the remainder of the concerns raised in the Schaff Letter. Unless they have prior approval, hearing participants are not allowed to "film" an expert offering testimony; lawyers cannot secretly seek assistance and counsel from other lawyers, paralegals, experts or others not in the hearing room; and the court reporter, retained by counsel to keep a digital record of the proceedings, cannot secretly and contemporaneously transmit the record to outsiders.

The SER might also have alerted other SRO arbitration forums or it could be that the potential for surreptitious recording or electronic eavesdropping drew discussion with other forums, perhaps at a meeting of the Securities Industry Conference on Arbitration. However it received the alert on this subject, in August 2013, the National Futures Association cautioned in its arbitrator newsletter, *The NFA Arbitrator Update*, "Be on the Lookout!" NFA staff reported that "other forums" have warned arbitrators about the use of "surreptitious recordings." Moreover, the Update continued, "it appears technology may have been used to stream a live hearing to people outside the hearing room." Arbitrators were advised to caution parties engaging in the "inappropriate use of technology" that they must refrain. NFA also amended its hearing script to be sure that chairpersons advise parties on proper practice.

Steve Martin & Tweeting Jurors

Such is the current status of events and developments in the securities arbitration arena. What FINRA and NFA have done may be enough to curb infractions, but real threats to participant privacy, intellectual property, document confidentiality, reputational integrity, and control of proceedings are easy to imagine. It may be that those who seek permission for the above activities could justify them to the Panel and, for some activities, receive permission to proceed. For instance, involving other lawyers at the home office could, with conditions and appropriate assurances, be acceptable. Lawyers, once told what they cannot do, generally conduct themselves professionally and obey the rules; the integrity of the process depends upon that.

There are others, though -- those who have a stake in the proceeding, friends who think they are helping parties, participants with an axe to grind -- who may go further. Against these possibilities, current safeguards erected by the SRO forums will only protect, if fortified by watchful vigilance. Even then, it seems almost inevitable that we will some day find segments of a FINRA arbitration proceeding on YouTube. Some state regulators and the media for years have declared themselves willing and eager to attend an arbitration hearing, if only the arbitrators and all parties would agree. Will it happen first at FINRA that a hearing participant electronically transmits the ongoing arbitral doings to an online press? Will a disgruntled arbitrator pipe the Panel's deliberations to the outside world? This is very different than a hearing participant conveying information about the proceedings by phone during a break, as it eliminates hearsay and accuracy issues; it is as different as one who records the play and another who writes a review afterwards.

The impact of the Internet and electronic devices are being felt in court as well. According to Internet folklore and a Mondaq.com article written (9/19/12) by the Cozen, O'Connor law firm, actor-comedian Steve Martin, pretending to be on jury duty, tweeted to 380,000 fans a "Report from Jury Duty," lightly dissing other jurors and adding that the "defendant looks like a murderer. GUILTY. Waiting for opening remarks." In that same article, the author, Hayes Hunt, reported that the Federal Judicial Conference had recently issued new jury instructions to address increasing concerns about the use of social media in the courtroom. "[Y]ou may not communicate with anyone about the case … on Twitter, through any blog or website, including Facebook, Google+, MySpace, LinkedIn, or YouTube," judges are instructed to say – and to admonish further: "I expect you will inform me as soon as you become aware of another juror's violation of these instructions."

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In an October 2012 story, the Associated Press (see stlouis.CBSlocal.com, 10/31/12) reported that a Kansas juror could face felony charges for posting information about the case on a newspaper's WebSite while in the midst of jury deliberations. Another juror found a defendant's criminal record on the Internet and displayed it to a fellow juror ("Judges Fear Social Media…, The Columbus Dispatch, 9/10/12). In USA v. Lawson, No. 10-04831 (2012), the Fourth Circuit overturned a felony conviction, because a juror performed legal research on Wikipedia and brought a print-out copy of the Wikipedia page into the jury room. Even unrelated cell phone texting can lead to a mistrial, if the juror continuously disregards the judge's orders to stop and the activity potentially distracts the juror from hearing critical evidence ([Arkansas] Supreme Court Overturns Death Penalty…, www.arktimes.com, 12/8/11).

Stories abound about the ways in which social media can disrupt the course of justice and courtroom proceedings (see, e.g., Social Media and the Right to a Fair Trial, www.salinecounty.org, and Jurors' Tweets Upend Trials, by Steve Eder, Wall St. Journal, 3/5/12). Certainly, arbitrators can be expected to conduct themselves more professionally than these jurors and forum training, plus the warnings arbitrators are expected to make to parties and counsel, will raise the consciousness of neutrals. These instances of recording and transmissions through the use of electronic devices – whether by parties, arbitrators or counsel -- are not simply a threat to decorum; they represent potentially far greater threats, including vacatur, the appearance of unfairness, and outright injustice.

The Kinkade Matter

Let's conclude with an example somewhat closer to home. In our Securities Litigation Alert, SLA 2013-13, we summarized the Opinion of the Sixth Circuit in Thomas Kinkade & Co. v. White, No. 10-1634 (2013), in which the Court vacated an AAA Award for evident partiality of the party-neutral Arbitrator in a tripartite arbitration proceeding. The underlying arbitration was not a securities dispute, but the Arbitrator in question was both a securities arbitration practitioner and served as a FINRA neutral. Moreover, the primary reason motivating the Court to overturn the AAA Award relates to two assignments the Arbitrator's law firm accepted during the pendency of the Kinkade arbitration that related to securities arbitration.

The first assignment concerned the retention by the White's party arbitrator, Mayer Morganroth, of an expert from Arbitrator Kowalsky's firm. Then, two months later, one of the parties, David White, retained Arbitrator Kowalsky's firm to represent him in an unrelated NASD Arbitration. Both retentions occurred during the course of the arbitation. They were fully and contemporaneously disclosed to the parties, but it was too much for the Sixth Circuit (and the reviewing District Court). The nine-page Opinion offers a great read. At one point, the Court huffs: "The arbitration itself was a model of how not to conduct one. The least of its blemishes was that it dragged on for [seven] years…."

What follows this "sigh" of exasperation, however, explains Kinkade's relevance to this article. The Court relates, that, "[i]n January 2006, Kinkade's counsel discovered that the Whites' counsel, Joseph Ejbeh of 'the Yatooma firm' in Michigan, had been surreptitiously sending a live feed of the hearing transcripts to a hotel room miles away. There, a disgruntled former Kinkade employee, Terry Sheppard, would review the transcripts in real-time and send proposed cross-examination questions to Ejbeh via instant messages. This scheme went on for more than a year." After this electronic eavesdropping came to light, the law firm remained on the case, but Mr. Ejbeh was replaced by new counsel, the Court observes.

Looking to the Future

As technological change continues its inexorable march forward, we must be even more vigilant about secret recording of hearings. As more and more hearings are conducted online, the prospect of such recordings or transmissions becomes more daunting. For example, one can only react in horror to the possibility in a high-profile case, that an online videoconference will be secretly streamed live to the media or posted on YouTube. As discussed below, it behooves the dispute resolution fora to plan now for the online hearing of the future.

And the future might not be so far off. At the recent AAA webinar on ADR and technology (see separate sidebar article), eight percent of the participants responding felt that, in the future, in-person hearings will not be needed and 36% said it would depend on the size of the case. Sixty percent of those responding agreed with the statement "By the end of 2018, cloud-based ADR will overtake 'Brick-and-Mortar' arbitration case filings." While this is good news for Arbitration Resolution Services, which has a completely cloud-based dispute resolution system, it also underscores the need for it and other ADR providers to address the surreptitious recording and transmission issue before it becomes a major problem.

Conclusion: a More Proactive Approach

There is no denying the many ways in which technology, the Internet, and the use of electronic devices has transformed and overall improved the manner in which securities arbitrations are conducted. Moreover, the continuation of such trends are a foregone conclusion; technology will only re-shape our judicial and dispute resolution processes even more as time proceeds and leaps in progress occur. At the same time, the possibilities for mishaps and deliberate misbehavior multiply with the ability to infiltrate the four walls of the hearing room with the very same devices that we all carry with us, rely upon for personal and business use, and utilize in our presentations to panels.

The antics of Steve Martin and thoughtless juror actions are laughed at or easily

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dismissed, but for securities arbitration – always under scrutiny and mistrusted by media and the "laity" – the prospects of scandal, embarrassment, and serious consequences are multiplied by SRO arbitration's sensitive position as an "industry-run," "back-room" operation, in which arbitrators are entrusted with great powers and protected by the insulating doctrines of immunity and finality.

We can wait for ADR providers, the courts, and arbitrators to slowly shape the rules and law in this area, but this will be a slow, inefficient process. If the recent past is any indication, technology will continue to change at an accelerating pace, thus increasing the risk of surreptitious recording or information transmission. We suggest that a more proactive approach makes more sense. FINRA's change in the Hearing Script is a good first step, but we think more work remains to be done.

Here are a few proposals:

• Further Toughen the Hearing Script: FINRA's recent change in the Hearing Script and commitment to train arbitrators is responsive to concerns about clandestine recordings, but it can go further. First, it is addressed only to parties and counsel. It should apply to witnesses as well. Second, it is too polite. The phrase "should refrain" seems a bit permissive; "will not" contains no ambiguity. Third, we propose that arbitrators pause and ask each participant to affirmatively agree not to secretly record or transmit the proceedings. The script should also warn the participants of the consequences of violations.

• Express Confidentiality Concepts in the Rules: FINRA rules should spell out the confidential nature of the proceedings (they currently do not), specifically bar illicit recording and transmission, and define participants' obligations, as well as the arbitrators', to maintain confidentiality and privacy of the proceedings. However those obligations might differ, from witness to party and counsel to neutral, they should be established in the rules or through published guidance. The rule should also make violations sanctionable, including claim and evidence preclusion.

Models already exist. For instance, in the AAA's rules, an explicit requirement exists that the arbitrators maintain the privacy of the hearings.[1] In fact, AAA extends that obligation to itself.[2] Extending the privacy obligation to the parties is not as radical as it seems; the AAA's Commercial Mediation Rules for years have had a rule requiring that, in addition to the mediator, the parties must "maintain the confidentiality" of the proceeding.[3]

• Put It in the Code of Ethics: Most ADR providers require arbitrators to adhere to the Code of Ethics for Arbitrators in Commercial Disputes[4] ("Code of Ethics"). For example, the FINRA arbitrator application[5] has this language right before the signature line:

> I also agree to serve as an arbitrator in accordance with established FINRA procedures, the FINRA Code of Arbitration Procedure, and the provisions of the ABA/AAA Code of Ethics for Arbitrators in Commercial Disputes.

Canon VI(B) of the Code of Ethics states:

> The arbitrator should keep confidential all matters relating to the arbitration proceedings and decision…"

It would be appropriate to amend the Code of Ethics to add to this section language obligating the arbitrator to enforce this aspect of the Code. For example, Canon VI(B) might instead read:

> The arbitrator should keep confidential all matters relating to the arbitration proceedings and decision, and should take reasonable measures to ensure that arbitration participants maintain the confidentiality of the arbitration process."

The commentary accompanying this change should address specifically unauthorized recording and transmission of hearings.

• Set an Example: One of the least argued grounds for attacking an arbitration Award under the FAA is "undue means."[6] Specifically, FAA section 10(a)(1) provides that an arbitration Award can be vacated "where the Award was procured by corruption, fraud, or undue means." A losing party in an arbitration, who can demonstrate a perceptual nexus between the loss and the hearing having been secretly recorded or transmitted has an arguable basis to successfully challenge the Award, because it was procured by undue means. When that happens – and the Kinkade facts provide an excellent example of how it might – the courts will have a wonderful opportunity to set an example.

We can accept that an electronically-enabled calamity is inevitable and unpreventable or we can exert training, vigilance, oversight and a generally more proactive approach to ensure that securities arbitration does not fall prey to such a public event.

Footnotes

1.See Commercial Arbitration Rules and Mediation Procedures Rule M-25, available at http://www.adr.org
2.Id.
3.See Commercial Arbitration Rules and Mediation Procedures Rule M-10.
4.See http://www.americanbar.org/content/dam/aba/migrated/dispute/commercial_disputes.authcheckdam.pdf <visited 11/10/2013>.
5.See page 31, available at http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbtors/documents/arbmed/p017271.pdf <visited11/10/2013>.
6.See 9 U.S.C. sec. 10(a)(1), available at http://www.law.cornell.edu/uscode/text/9/10 <visited 11/10/2012>
7. SAC received valuable editorial assistance from George H. Friedman in the preparation of this article. Mr. Friedman is a former FINRA Director of Arbitration and a member of SAC's Editorial Board.