Confidentiality and Use of the Attorney Client Privilege in Arbitration Proceedings

by Jenice L. Malecki, Esq., June 2010[1]

Confidentiality is important. There is private and trade secret information on both sides of any arbitration that should not be utilized outside of the arbitration and should be used only in the arbitration. It would be hard to dispute this proposition.

Confidentiality agreements and orders are mandated for information which is "subject to abuse if widely disseminated." McLaughlin v. G.D. Searle, Inc., 38 A.D.2d 810, 811, 328 N.Y.S.2d 899, 900 (1st Dep't 1972). Moreover, to assert a document is confidential, the party has to prove that it had undertaken legal steps and incurred expense "to guard the secrecy of the information at issue." Dibble v. Penn State Geisinger Clinic, Inc., 806 A.2d 866, 871, 2002 PA Super 156, *P15 (Pa Super Ct 2002).

However, protective orders should be limited to trade or business secrets and are required to be specific. Bristol, Litynski, Wojcik, P.C. v. Queensbury, 166 A.D.2d 772, 773-74, 562 N.Y.S.2d 976, 977-78 (3d Dep't 1990). As an example, the court in Mann ex rel. Akst v. Cooper Tire Co., 33 A.D.3d 24, 36-37, 816 N.Y.S.2d 45, 56 (1st Dep't 2006) found that the following were not trade or business secrets and therefore not the proper subject of a protective order or promise of confidentiality:

> the job descriptions of identified personnel; pleadings and bills of particulars for similar litigation; customer complaints; . . . Further, "confidential" material shall not include (a) advertising materials, (b) materials that on their face

[1] Reference is made to Philippa Duncan, New York Law School intern, who assisted with the researching of this article.

> show that they have been published to the general public, or (c) documents that have been submitted to any governmental entity without request for confidential treatment. [The] confidentiality agreement is unacceptable as to form. . . . As presently written, the protective order also appears to prevent the actual plaintiffs (the clients, as opposed to their lawyers) from seeing confidential material unless they happen to be deponents. . .

Id.

Confidentiality was meant to be a shield, but can be used as a sword, unnecessarily burdening parties and increasing the costs of arbitration. In many cases, confidentiality in arbitration has become expansive and oppressive, as well as carries with it potential perils for the average investor and practitioner. Firms have increasingly sought to designate as confidential documents which were never confidential in the first place. Moreover, provisions requiring the return of all designated confidential information at the conclusion of a matter, unchallenged, can cause problems for a practitioner, both in the next case, where documents were not legitimately confidential and could help in the representation of another individual, as well as where return could violate the practitioner's malpractice policy, as a lawyer is often required to maintain a file for a certain number of years in order to address possible complaints.

1. FINRA GUIDELINES ON CONFIDENTIALITY IN DISCOVERY AND SETTLEMENT
    a. Discovery

NASD Notice to Members 99-90, the FINRA discovery guideline, discusses confidentiality in Section B, mentioning only these principles:

a. The parties can stipulate or arbitrators can issue an order; and
b. Arbitrators cannot issue an order or use a confidentiality agreement to require parties to produce documents otherwise subject to an established privilege.

In arbitration, parties and arbitrators are often concerned with "getting it done" and avoiding issues that seem to be innocuous. The problem is that sometimes seemingly innocuous confidentiality stipulations and orders can harm an investor and a practitioner

To date, the focus of FINRA's rules and notices has principally been on confidentiality provisions that impede future FINRA or other regulatory or governmental investigations. It makes sense that investigations are FINRA's primary concern, as it can directly see the effects of overbroad confidentiality in its investigations.

Arbitrators are educated through "The Neutral Corner," a series of articles produced by FINRA to provide guidance on a variety of topics related to the arbitration process. An April 2004 mailing on confidentiality advises arbitrators of the following:

a. FINRA and staff have an ethical obligation to keep confidential information obtained in arbitration
b. The parties are generally free to disclose details of their own proceeding.
c. The preference is for mutually agreeable confidentiality agreements for discovery purposes.
d. Because confidentiality orders can adversely affect the parties (both by limiting parties' ability to pursue/defend against a claim and FINRA's ability to investigate claims, confidentiality orders should

only be granted after a serious and case-by-case consideration of the issues).

e. The party seeking the order has the burden of establishing that the documents in question legitimately require confidential treatment

f. Questions to ask in the determination of whether an order is warranted:

1. Is the information so personal that disclosure would constitute an unwarranted invasion of personal privacy (e.g., an individual's social security number, tax return, or medical information)?
2. Is there a real threat of injury attendant to disclosure of the information?
3. Is the information proprietary containing confidential business plans and procedures or a trade secret?
4. Are there essential competing interests at stake that require confidential treatment of certain portions of the proceedings?
5. Is the information already public (e.g., has it previously been published or produced without confidentiality) or is it already in the public domain?
6. Would an excessively broad confidentiality order be against the public interest in disclosure?
7. Are there first amendment or other issues which might be raised by excessive restrictions on the ability of parties to comment freely upon matters in which they are involved?
8. Would an unduly extensive confidentiality order impair the ability of counsel to represent other clients?

9. Preference for "least restrictive manner" approach to questions of confidentiality.
10. Rarely should all discovery be deemed confidential.[2]

While the Neutral Corner asks arbitrators to consider all the right questions, it still becomes a battle to avoid abusive confidentiality and often rules are not stringently enforced by arbitrators, looking to "get it done." This battle should be unnecessary, but it can become an abusive tactic.

The problem becomes highlighted that in arbitrations where the same product is involved in different cases, a "product case." Attorneys become restricted from discussing documents that are not actually confidential and multiple arbitrations with the same product wind up having different documents produced, there being documents missing from one case to another, because these is no way to police productions behind unnecessary and over-reaching "gag" agreements and orders.

Moreover, FINRA does not address the issue of confidentiality outside of the regulatory inquiry requirements when it comes to an issue controlled in settlement. Since the arbitrators have no role in the drafting of a settlement agreement, abuses in this area remain rampant.

b. Settlements

The notices and rules that apply to settlements underscore only that overly broad confidentiality provisions impede the self-regulating nature of the industry, but fail to address other perils to investors and their counsel caused by over-reaching use of confidentiality.

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[2] See, Neutral Corner, "Arbitrators and Orders of Confidentiality." April 2004. Jointly written by members of the Neutral Roster Subcommittee of the National Arbitration and Mediation Committee (NAMC), a committee of the NASD Dispute Resolution Board.

Notice to Members (June 2004) Guidance on Settlement Agreements[3] indicates:

> a. The use of confidentiality provisions in settlement agreements with customers or persons that impede, or have the potential to impede, NASD investigations and the prosecution of NASD enforcement actions violates NASD Rule 2110 (now rule 2010) which states,
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> " [A] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.

This Notice was written to address continued use of confidentiality provisions which restrict the customer or other person from disclosing the settlement terms and underlying facts of a dispute from FINRA or other regulators.

In practice, brokerage firms, ever concerned with reputation, have increasingly required customers to indicate in settlement documents that they "will not discuss or disclose (or cause or allow to be disclosed) the facts underlying the claims raised or any document exchanged." The breadth of this paragraph is rarely discussed when negotiations on the settlement numbers are occurring, but come later as a surprise when t feels too late to go back to the table, after the typically "material" settlement provisions are negotiated.

In essence, this expansive paragraph often means that a customer cannot fully discuss what happened with their account at a prior broker-dealer. Thus, the client's next broker-dealer may not

[3] See also, Notice to Members (1996): 95-87 Confidentiality Clauses in Settlement Agreements.

properly investigate the client's investment history, as required by "know your customer" and suitability rules which require a registered person to properly inquire about all information about a client, including the client's "investment history."

While FINRA Rule 2010[4] is broadly written, it has not been invoked to protect a former client from revealing information about their investment history to a new broker. Moreover, after feeling betrayed by a prior broker and having litigated against the broker and firm, the client is then forced to sign a broad confidentiality agreement. One would expect that the client, particularly an unsophisticated one, would not want to do anything to wind up in litigation again and consequently would be reticent to discuss anything having to do with the prior broker-dealer. The chilling effect is an enormous hurdle to the success of the investor's next dealer-broker relationship, particularly because the client cannot talk about the problems and possible miscommunications that arose in the prior relationship. The client may even be prohibited from revealing statements from the prior broker and thus what "went wrong" in the previous relationship remains a secret.

The United States Securities and Exchange Commission's ("SEC") Rules of Practice and Rules of Fair Funds and Disgorgement Plans, Rule 190 "Confidential Treatment of Information in Certain Filings" allows a party to apply for confidential treatment of documents pertaining to an SEC hearing. Pursuant to Rule 322 "Evidence: Confidential Information, Protective Orders," a party may move for a protective order limiting disclosure to other parties or to public. The motion can only be granted upon a finding that the harm resulting from disclosure outweighs the benefit of disclosure. While the rules do not address confidentiality as it

[4] See, FINRA Rule 2110 (formerly Rule 2010) which states, "[A] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."

relates to settlement, the rules allow a party required to pay a disgorgement to seek a protective order against disclosure of the information submitted to the public or to any parties other than the Division of Enforcement.

The SEC and FINRA are similar in that both are concerned with future/ongoing investigation/regulation and both indicate a preference for party settlement, but neither regulator addresses the actual harm to investors that a "gag" agreement or order may have in dealing with other securities professionals in practical day-to-day transacting within the industry.

At a minimum, counsel should insure that clients are only restricted in confidentiality clauses to the settlement terms and legitimately confidential documents. Moreover, counsel should either have an agreement to keep and archive the documents, or get the contact information and storage details of where the returned documents can be located if needed.

c. The Uniform Arbitration Act and the Court's View

The Uniform Arbitration Act, Section 17, addresses confidentiality in discovery:

> (e) An arbitrator may issue a protective order to prevent the disclosure of privileged information, confidential information, trade secrets, and other information protected from disclosure to the extent a court could if the controversy were the subject of a civil action in this State.

The Uniform Arbitration Act invokes state law, specifically courts have considered more closely substantive challenges to pre-award rulings of arbitrators on grounds of privilege or confidentiality.

Resort to the courts may help curb these unnecessary abuses. In World Commerce Corp. v. Minerals & Chem. Philipp Corp., 15 A.D.2d 432, 224 N.Y.S.2d 763 (1st Dep't 1962), the court held that it and not the arbitrator decides whether documents of a non-party to arbitration are protected as confidential. Similarly, in DiMania v. New York State Dept. of Mental Hygiene, 87 Misc. 2d 736, 386 N.Y.S.2d 590 (N.Y. 1976), the court overruled the decision of an arbitrator regarding the client's privilege of confidentiality.

2. Attorney-Client and Work-Product Privileges Also Suffer From Abusive Use

The same issue also arises with the attorney-client privilege issue, particularly where there is an attempt to shield attorney-client and work-product documents because a document may have been sent to an attorney.

To assert an attorney-client privilege, one must clearly and with purposeful intent, seek legal advice from a lawyer specifically designated for that purpose. Rossi v. Blue Cross & Blue Shield, 73 N.Y.2d 588, 542 N.Y.S.2d 508 (N.Y. 1989). An ordinary business document also does not become privileged by sending it to an attorney. Governale v. Airborne Express, Inc., 1997 U.S. Dist. LEXIS 7562, at *21–22 (E.D.N.Y. 1997).

"A corporation cannot be permitted to insulate its files from discovery simply by sending a 'cc' to in-house counsel." United States Postal Service v. Phelps Dodge Refining Corp., 852 F. Supp. 156, 164, 1994 U.S. Dist. LEXIS 6383, *20 (E.D.N.Y. 1994). Even legal advice may not be privileged if it is merely incidental to business advice. United States v. International Business Machines Corp., 66 F.R.D. 206, 212-213, 1974 U.S. Dist. LEXIS 6431, *16-18 (S.D.N.Y. 1974) (Supplemented by United States v. International Business Machines Corp., 71 F.R.D. 376, 378, 1976 U.S. Dist. LEXIS 15092, *4 (S.D.N.Y. 1976).

The fact that the attorney was not the primary recipient of a document suggests two reasons for believing that the document is

not privileged. First, documents circulated to non-legal personnel are more likely to concern business rather than legal matters, which indicates that the attorney is not acting in a legal capacity. Baxter Travenol Laboratories, Inc. v. Abbott Laboratories, 1987 U.S. Dist. LEXIS 10300, at *13 (N.D. Ill. 1987)("where a document is prepared for simultaneous review by legal and non-legal personnel and legal and business advice is requested, it is not primarily legal in nature and is not privileged"). Second, the more a document is circulated to non-legal personnel, the harder it is to conclude that the document was intended to be confidential. See, e.g., Id. at *14 ("some documents may be unprivileged if they were circulated primarily among non-attorneys and to a large number of such personnel").

Courts have considered more closely substantive challenges to pre-award rulings of arbitrators on grounds of privilege or confidentiality. In Hull Municipal Lighting Plant v. Massachusetts Municipal Wholesale Electric Co., 414 Mass. 609, 609 N.E.2d 460 (Mass. 1993), the defendant refused to turn over certain documents to the plaintiff, despite an arbitral subpoena requiring such, because the defendant claimed that portions of the documents contained attorney-client and work-product privileges. After the supervisor of public records decided issues arising under the public records law, the court concluded that because the matters fell under Massachusetts public records law, the question of privilege was within the discretion of the judge and not the arbitrator.

Conclusion

Because of the involvement of important legal rights, practitioners, as well as arbitrators and courts, should review more carefully claims of confidentiality, trade secret, privilege, or other matters protected from disclosure.

Practitioners need to fight back against overbroad confidentiality in both discovery and settlement; doing so, will protect both the client and the practitioner.

FINRA and the SEC should also become more sensitized to the issues and problems overbroad confidentiality will cause an investor in dealing with the industry.

Parties and mediators should not just "get it done" and resort to advising clients that "no one will ever know" if they discuss prohibited topics with a future broker. Clients should not be forced to breach settlement agreements in order to gain access to proper financial services and advice.

Most of all, arbitrators must be vigilant in not allowing one party to demand overbroad confidentiality provisions that do not include truly confidential information, such as trade secrets, personal tax information, and the like. The same is true with respect to the expansive use of attorney-client and work-product privileges to shield important documents from disclosure. A document is not automatically confidential or privileged just because one party raises the issue. Ultimately, practitioners and arbitrators have an obligation to ensure that nondisclosure and overly broad confidentiality provisions do not adversely impact the right to a full and fair hearing on the substantive issues of the matter.