

Submitted online at SEC.gov

September 30, 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: SR-FINRA-2020-027

Dear Secretary Countryman:

We are writing in response to SR-FINRA-2020-027, which FINRA describes as a “[p]roposed rule change to temporarily amend FINRA Rules 1015, 9261, 9524, and 9830 to permit OHO and NAC hearings under those rules to be conducted by video conference” (hereinafter referred to as the “Rule Change”). This Rule Change is especially problematic and improper as it pertains to Rules 9261 and 9524 involving disciplinary and NAC proceedings because it removes a long-established right to in person hearings and fails to consider or apply factors relevant to applicable statutory obligations.

A. FINRA Improperly Designated the Rule Change as Immediately Effective.

FINRA claims that the rule change should be effective upon filing pursuant to “Section 19(b)(3) of the Act and paragraph f(6) of Rule 19b-4 thereunder” (17 CFR 240.19b(f)(6)). *See* Notice of Filing at 21. However, the SEC Release that adopted the relevant amendments to Rule 19b-4 makes it clear that FINRA’s Rule Change does not qualify for immediate effectiveness. The SEC Release states: “for policy reasons, a proposed rule change that would reduce public representation in the administration of the affairs of an SRO or that would *amend the procedures*

for arbitration or disciplinary proceedings would not be a proper candidate to become effective under Section 19(b)(3)(A). See Securities Exchange Act Release No. 43-35123 (December 20, 1994) (emphasis added), available at <https://www.sec.gov/rules/final/19b4.txt>. The Rule Change amends procedural Rule 9261 for disciplinary proceedings and is thus not a proper candidate to become immediately effective under Section 19(b)(3).

B. The Rule Change Violates the Statutory Requirement for FINRA to Provide Fair Disciplinary Proceedings.

The current Rule 9261 provides: “[i]f a hearing is held, a Party **shall be entitled to be heard in person**, by counsel, or by the Party’s representative.” FINRA Rule 9261(b) (emphasis added). FINRA’s Rule Change reverses this rule, taking away a party’s right to be heard in person and providing FINRA with the unilateral discretion to order a party to submit to virtual hearings. FINRA’s attempt to characterize such a monumental change in the rights guaranteed to those facing FINRA disciplinary proceedings as “non-controversial” is misplaced and elevates FINRA’s clearing its docket over ensuring that respondents, whose reputations and livelihoods often hang in the balance, receive a fair disciplinary process.

While FINRA may be comfortable placing expedience over fairness, the Commission has the responsibility to ensure that FINRA “provide[s] a fair procedure for the disciplining of members and persons associated with members.” 15 USC § 78o-3(b)(8). Moreover, the Commission retains the authority to “abrogate, add to, and delete from ... the rules of a self-regulatory organization ... as the Commission deems necessary or appropriate to *insure the fair administration of the self-regulatory organization...*” 15 USC § 78s(c) (emphasis added). The Commission has acknowledged these “statutory obligations to ensure fairness and integrity” in

disciplinary proceedings and that “a fundamental principle governing all SRO disciplinary proceedings is fairness.” *In re: Jeffrey Hayden*, 2000 SEC LEXIS 946, 54 S.E.C. 651. The revocation of respondents’ right to in person hearings will result in unfair and unworkable disciplinary proceedings.

Many disciplinary proceedings that reach the hearing stage involve complex issues and high stakes. The respondents often face charges that can result in significant sanctions and a temporary or permanent bar from FINRA. Thus, individuals and firms are facing the possibility of having a significant sanction against them, or, worse yet, being expelled from their profession. Disciplinary proceedings that reach the hearing stage often involve hearings lasting several days to several weeks, dozens of witnesses, a hearing officer and two extended panel members, multiple parties and attorneys, expert witnesses, and hundreds of exhibits. Attempting to conduct large disciplinary proceedings on a virtual medium, especially when there is no available body of evidence showing that these proceedings can be conducted effectively and fairly in a virtual environment, is simply too great of a risk to take with individuals’ livelihoods on the line. Take just one example: exhibits – especially exhibits necessary for expert testimony (which often involve voluminous amounts of complicated data). Asking a witness to pour over and explain these massive exhibits via Zoom on a laptop screen (with multiple parties, attorneys, and panel members all trying to fit on the screen), while juggling questions from panel members and objections from the other side (with everyone’s voices cutting out when more than one person speaks) would present an unworkable situation.

Not only is there a concern with the ability to conduct the proceeding itself, there is the added concern with the ability to make a clear record for appeal purposes. The foundation for an

appeal is the record from the underlying proceeding and, here again, there is no track-record showing that Zoom hearings result in a clear, reliable record sufficient for appeal purposes. It is difficult for a court reporter to make an accurate record of trial proceedings when everyone is in the same courtroom; there is no telling how much more difficult the task becomes when questions, answers, objections, and rulings on objections are all coming from different computers while the reporter in real time is trying to discern who is saying what—assuming everything that is being said can be heard at all.

FINRA states that it is providing fair process because it uses a “high-quality, secure and user-friendly video conferencing service” (via FINRA’s Zoom platform). *See* Notice of Filing at 14. These are vague and ultimately empty reassurances in the face of the reality of virtual hearings. Anyone who has participated in a virtual conference (especially in a professional environment) involving multiple participants has experienced issues, including but not limited to bad connections and sound, lagging, and individuals being “dropped” from the conference and/or unable to log on. Indeed, all of these issues have arisen in Zoom conferences that we have participated in. While Zoom may be a viable alternative for conducting some business under the current circumstances caused by COVID-19, there can be no argument that Zoom is fool-proof or that it is even close to as effective as an in-person hearing.

Indeed, Courts routinely recognize that the value of in person testimony cannot be replaced by other means. As recognized by the Ninth Circuit:

Underlying both the constitutional principles and the rules of evidence is a preference for live testimony. Live testimony gives the jury (or other trier of fact) the opportunity to observe the demeanor of the witness while testifying. William Blackstone long ago recognized this virtue of the right to confrontation, stressing that through live testimony, “and this [procedure] only, the persons who are to

decide upon the evidence have an opportunity of observing the quality, age, education, understanding, behavior, and inclinations of the witness.”

United States v. Yida, 498 F.3d 945, 950 (9th Cir. 2007) (quoting 3 William Blackstone, *Commentaries on the Laws of England* 373-74 (1768)).

The importance of in person testimony is especially heightened in proceedings involving witness credibility. *See id.* FINRA disciplinary proceedings include charges that depend heavily on the credibility of witnesses, including, for example, willful manipulation or fraudulent activity under Section 10(b) of the Exchange Act. It is vital that a hearing panel be provided with the opportunity to observe the witnesses—including both the accused and the accusers—in person and evaluate their credibility.

While the cases noting the need for live testimony are often comparing live testimony with transcripts, the reasoning and principles still apply to virtual hearings. As noted by courts, the advantages of in person testimony include the ability to observe “**body language, eye contact** and other indicia from which jurors can draw, based on their own experience, to infer the reasons for the witness’s evasiveness or pugnaciousness.” *Brooks v. United States*, 39 A.3d 873, 885 (D.C. 2012) (emphasis added). A trier of fact cannot evaluate a witness’s body language if the trier of fact can only see the witness’s head. Nor can a trier of fact evaluate whether a witness is making eye contact if the witness and examiner are both looking at a screen rather than each other.

In addition to allowing the trier of fact to judge the credibility of a witness, live testimony “allows counsel to adjust examination to other evidence and to the [trier of fact’s] apparent reactions as the witness testifies.” *United States v. Burden*, 443 U.S. App. D.C. 142, 152, 934

F.3d 675, 685 (2019). In a live hearing, counsel is easily able to direct his or her attention back and forth between the witness being examined and hearing panel. The reality of a virtual conference is that viewing options consist of: 1) a “grid-view” where the many people in attendance are displayed in small squares (resulting in very limited view of reactions and mannerisms), or 2) a “speaker-view” where the person who is speaking is displayed in a larger image on the screen and the other attendees are displayed on very small screens (or potentially not displayed at all if there are more than 4 or 5 attendees). In the virtual environment, it is difficult, if not impossible, for counsel to pay attention to the witness and multiple panel members in different locations on (and potentially off) the screen all while keeping up the running examination dialogue and adjusting the line of questioning dependent on the panel’s reaction. Add to that the voluminous and often complex exhibits to put up on the screen and objections from counsel, and even the most “high-quality” and “user-friendly” virtual platform is still a logistical and strategic nightmare.

FINRA claims it “has experience conducting numerous hearings and oral arguments using video conferencing.” *See* Notice of Filing at 6. Yet, as disclosed in FINRA’s footnote, those hearings are all arbitrations, not disciplinary proceedings. Moreover, FINRA does not disclose the length or nature of “43” arbitration cases it has conducted via Zoom. It is doubtful that many (if any) of those proceedings were multi-week hearings or involved the highly complex issues and number of attendees often present in disciplinary proceedings.

Notably, issues are already arising from FINRA’s use of Zoom to conduct hearings. The award in one of the first cases to make use of Zoom in March (shortly after the beginning of the COVID Pandemic in the U.S.) was challenged in part on the basis that multiple issues were

caused by the use of Zoom to conduct the final day of the hearing. *See Wunderlich Securities Inc. et al. v. Dominick & Dickerman LLC et al.*, Case No. 1:20-cv-03507, filed in U.S. District Court for the Southern District of New York.

Making the Rule Change “temporary” does not resolve any concerns. Indeed, it highlights the arbitrary and problematic nature of the new rule. It is fundamentally unfair to allow one individual a more effective means to defend themselves than another individual solely based on timing and whether a virus (that has nothing to do with the facts or circumstances of a case) is active when the case is ready to be heard.

C. The Rule Change Fails to Address Relevant Considerations

If the Commission deems it appropriate to give presiding officials the discretion to remove the previously granted right to in person hearings, *at a minimum*, the officials should be directed to consider the facts relevant to the case and FINRA’s *statutory obligations*, rather than the fluctuating status of a disease. According to FINRA’s Notice of Filing, in determining whether to order parties to participate in a virtual hearing, the presiding official is directed to consider virus trends, state and local COVID-19 orders, and exposure risks to participants. *See* Notice of Filing at 13. While these COVID-19 concerns are certainly valid considerations for cancelling or postponing in-person hearings, they should not be the sole consideration in determining whether to force a party to participate in a virtual hearing.

Given that FINRA is required by statute to provide a fair proceeding, that should be a primary factor considered by the presiding official in determining whether to hold the hearing. Even FINRA’s own Arbitrator Resource Guide for Virtual Hearings provides the following guidance: “The Panel must postpone the virtual hearing until further notice if the Panel believes

the virtual hearing will result in unfairness to any party.” *See* FINRA Arbitrator Resource Guide, available at <https://www.finra.org/arbitration-mediation/case-guidance-resources/arbitrator-resource-guide-virtual-hearings#fairness>. Although this guide is for FINRA arbitrations rather than disciplinary proceedings, a fair hearing is even more important when individuals are facing expulsion from their profession. Yet FINRA’s Rule Change provides no direction to hearing officers to consider whether a virtual hearing will result in unfairness. At a minimum, the presiding officer should be directed to consider the facts and circumstances of each case, such as, but not limited to, the complexity and anticipated length of the proceeding, the number of witnesses and parties, the amount of evidence and exhibits, the seriousness and effect of the potential sanctions that could be levied against the respondents, and whether the case is likely to turn on determinations of credibility, in order to determine whether a virtual hearing would be a feasible and fair alternative.

FINRA’s other statutory obligations should also play into the analysis. FINRA claims the Rule Change is necessary due to the “backlog” of cases that will compromise FINRA’s ability to fulfill its statutory obligations to protect investors and maintain fair and orderly markets. While this might be true in certain instances, in many cases, the FINRA investigation and litigation process results in hearings many years after the action at issue and firms or individuals have frequently taken corrective action. Thus, in many cases that comprise FINRA’s “backlog,” an additional temporary delay would do little to thwart FINRA’s statutory obligation to protect investors, yet much to further FINRA’s statutory obligation to provide fair proceedings to its members. At a minimum, the presiding official should be directed to consider whether

there is a significant ongoing risk to the investing public or the fair and orderly market as one of the factors in evaluating the need to mandate a virtual hearing.

We appreciate the Commission's consideration of our comments and concerns.

Sincerely,

MICHAEL BEST & FRIEDRICH LLP

/s/ Richard F. Ensor

/s/ Evan S. Strassberg