Investor Securities Arbitration--
Problems Exist, but it's Still the Least Costly, Most Expedient Way of Resolving Disputes for the Majority of Investors

By

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Accusations have been made that arbitration has turned into a protracted and costly process, rife with unfairness and delaying tactics; and consequently, it is no longer the efficient, inexpensive solution for resolving disputes that it once held itself up as being. Arbitration, it is claimed, has more and more become like litigation, burdened by motions, challenges, and time delays; at the same time being undermined by "creeping legalism," "judicialization," and/or "incremental formalism." [1.]

All types of arbitration are under attack, but perhaps none more than securities arbitration, a specialized type of arbitration with its own sets of rules and administered by its own industry. Securities arbitration is conducted differently than other forms of arbitration, not only with respect to selecting arbitrators and conducting hearings, but as regards the entire self-regulated, self-managed process. This may be why securities arbitration has become somewhat the lead whipping post. Indeed, says Lou Whiteman in his In-House council article, "Arbitration's Fall From Grace," "The backlash against arbitration has its roots in the securities industry, which turned to mandatory arbitration as a quick and easy way to deal with dissatisfied customers who believed they were given unsound or biased advice by their brokers." [2.]

One of the goals of any arbitration provision is to give the parties the means and method, or road-map, to a swift and final conclusion of their dispute without the inconvenience and expense of litigating the matter in court. No one is questioning that the goals for arbitration are not noble ones for investors, brokers and the courts alike. But if arbitration of every kind is turning into litigation, beset with the same kinds of issues, then an aggrieved party giving up the benefits of litigation—namely having one's day in court, becomes a more significant problem.

Now, in 2006, with the increased litigiousness of the practitioners and the process, it may be that many of the advantages of arbitration have been lost and a better way of resolving disputes should be sought. And it could well be there is a better way. It could also be that despite the backlash, securities arbitration is still the best means of handling investors' disputes. If the thousands of securities claims that arise each year are to have a forum, and are to be heard in a timely manner by reasoning individuals, arbitration—with perhaps a few changes-- may still be the all-ways-least-cost solution that avoids an otherwise even longer, more expensive process.

This paper will examine some of the relevant history of securities arbitration, reasons for the backlash against it, opinions on all sides of the issues, and proposals that might improve the process of resolving securities disputes.

OVERVIEW and BACKGROUND

Each year, millions of transactions involving stocks, bonds, annuities and mutual funds take place. Though business in the securities industry is, for the most part, conducted fairly, efficiently, and in a manner that satisfies everyone involved, problems do arise. Satisfied investors notwithstanding, disagreements develop over many securities transactions, which must be addressed in one way or another. It is important these disputes get dealt with in a fair, efficient manner in order to maintain faith in the markets, [3.] and to allow the continued flow of commerce. The method most chosen, and that which is currently mandated by most investor contracts, as well as by statute and case law, is arbitration.

In Securities Arbitration, one of the parties is usually a brokerage/ securities firm or investment counselor operating within the rules of one or another of the self-regulatory organizations, known as SROs. Under federal law, every securities firm is required to be a member of one of these SROs, of which the National Association of Securities Dealers (NASD) is the largest. Over the past twenty-five years, the NASD has seen its membership and resultant power grow substantially to become the industry’s 5000 pound gorilla. According to the NASD website, the organization oversees the activities of more than 5,100 brokerage firms, approximately 115,940 branch offices and more than 657,800 registered securities representatives. It is also responsible for 90% of the claims filed.[4.]

Most, but by no means all the broker/dealer firms that are members of one or another of the SROs, require investors using their firm’s services to sign contracts containing provisions for arbitration in the event a dispute arises. This requirement to arbitrate is clearly a limitation on the choice the parties (mostly investors) have regarding where they can air their grievances along the dispute resolution continuum from mediation to litigation.

Be that as it may, and notwithstanding any arbitration claim, investors do not give up their right to file complaints with the NASD's disciplinary arm and the SEC which oversees all SROs. Such complaints will sometimes result in civil or criminal proceedings that produce damages awards, if investigators find that brokers broke the law or committed fraud. The trouble is, such cases take years to resolve. One of the goals of arbitration in the securities setting was to speed up the process. Some aggrieved investors will file complaints using all three options available.

Composite figures for the NASD and other SROs reflect significant growth in case filings during the past two decades. The tremendous growth of the investor base combined with the bear market of the early years of the new millennium, added momentum to the long-term trend. Though figures for arbitration filings appear to be down since a high in 2003 of 8,945, the number of individual cases filed in "normal" non-crash years is still up as compared with the market decline of late 2000. Cases filed in 1999 was 5,608 while in 2005, the first year after the "correction" in which arguably was over, was 6,074. [5.]

Consistently, regardless of year, roughly half of investor-broker disputes make it all the way to an arbitration hearing. The remaining settle – either through negotiated settlement between the parties' attorneys or through mediation. [6.] Though this percentage is almost exactly the same as for cases destined for a court of law, the sped-up timeline for arbitration also speeds up the settlement process.

Of those disputes that go all the way to hearing, a panel of arbitrators—one “nonpublic” or “industry” arbitrator, and two “public” arbitrators hear the case, resulting in about three out of five claimants getting at least some cash for their trouble. Claimants’ attorneys point out, however, that the amount recovered can be as little as a dollar (figures aren’t published), and the amount of recovery is on a downward turn. [7] This claim is backed by the statistics. According to recent Nasdaq figures through April of 2006, in the years 2000,2001 and 2002, overall claimants were awarded between 50-60% of the amount they were seeking. After 2002, investors awards have continued a steady downward move to a total award figure of 42% in 2005.

In the early days of investor disputes, the court system, in general, was not as bogged down in litigation as it is now, which allowed disgruntled investors to have their day in court with the taxpayers bearing the burden of paying the judges and running the courthouses. But as the number of disputes has grown, not just securities claims, the courts have looked for alternative solutions. There has been a public policy toward moving the handling of disputes into the private arena where those involved in the dispute are the same parties covering the costs of resolving it.[8] This, again, is particularly true for certain types of disputes that share some commonality – employment, labor and securities law, for example. Arbitration provisions inserted into certain types of contracts, therefore, were given great weight.

Indeed, with the Supreme Court decision in *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987), the court held that claims under RICO and the Securities and Exchange Act of 1934 are subject to broad enforceability of arbitration provisions in investor contracts, and that case has been applied repeatedly: *DeKuyper v. A.G. Edwards & Sons, Inc.* USDC (Conn) Civ. No. N-85-529 (1987); *Nilsen v. Prudential-Bache Securities*, 761 F.Supp. 279, SDNY (1991), the latter of which held that even if the exclusion clause in an arbitration agreement is ambiguous, federal policy requires courts to construe arbitration clauses as broadly as possible in favor of arbitration and to construe purported exclusions as narrowly as possible.)

The result is that it is extremely difficult for anyone, but most usually the disgruntled investor, to get out of seeking redress of his grievances through anything other than arbitration. And since, in securities arbitration, that means grievances are heard in front arbitrators selected and managed by one or another of the SROs, it is all-important, that the parties involved trust the process to be "fair and efficient" as it goes about settling disputes. But there is a growing amount of controversy that they *do not,* and that the process *does not.*

From all sides, for different reasons, the arbitration of securities disputes has suffered attacks on the process, the self-regulatory nature of the process, the training of arbitrators, the selection of arbitrators, the behavior of arbitrators and counsel, the rules, the lack of adherence to the rules, and more. In 2006, with most investor-broker disputes handled through arbitration, and a growing dissatisfaction with the process in some quarters, can the process be improved? Should it be scrapped? Should it be made optional to the parties? Or are there "tweaks" that can be made to address some of the concerns without scrapping the process outright and creating unintended consequences elsewhere?

DISCUSSION
A. The SROs and the Threat to Fairness

Under U.S. securities laws that have been in place for over 70 years-- namely the Securities and Exchange Act of 1933 as amended in 1934, again in 1940 and recently by Sarbanes-Oxley in 2002-- securities professionals are required to become members of one of several self-regulating organizations (SROs) in the securities industry. And, as indicated above, most, but by no means all broker/dealers, have investment contracts dictating that, in the event of a dispute, said dispute shall be settled through arbitration.

The Securities and Exchange Commission (SEC) oversees the practices and policies of all SRO arbitration programs, conducting audits and passing on any changes that are made to arbitration procedures.[9] The Security Industries Conference on Arbitration (SICA), established thirty years ago by order of the SEC, provides a forum for a debate on policy and procedural issues among members of SROs, the securities industry and representatives from the investing public. SICA produced the original Uniform Code of Arbitration which is still the model (and minimum standard) for all current SRO arbitration procedures. The SEC continues to review and revise provisions of the Code and offer guidance regarding parallel SRO rules. The GAO also conducts regular reviews such as a recent study on the payment of arbitration awards by brokerage firms and the NASD, itself has an advisory body representing different constituencies, and responds to complaints and suggestions.[10]

The majority of brokers and investment firms belong to the NASD (the largest, most powerful of the SROs)[11], which directs dissatisfied customers to submit to binding arbitration at the hands of a panel of arbitrators who will hear the case and write their award.[12] From the outset, there's an issue as to the fairness of the process, then, because the panel of arbitrators is, for all intents and purposes, selected by the NASD and the rules are set and applied by the NASD.[13.] Though a list of potential arbitrators is given to both sides and both sides can strike the names from the lists, every arbitrator on the list is supplied by NASD. Further, if all names are stricken, then NASD appoints a panel of arbitrators and the only way they can be removed from the panel is for cause, which may be difficult for a claimant to show.

Drawing an analogy from law enforcement and the military, it's a bit like having a police department's internal affairs division investigating the malfeasance of its own police officers—something mockingly referred to as a "bluewash;" or a military tribunal looking into charges that military personnel committed acts of torture at Guantanamo, say. These types of self-regulatory mechanisms are inherently suspect to the outside observer. Self-regulatory bodies simply don't have the incentive to police themselves if their decisions won't be reviewed.

It is incumbent on these types of tribunals, therefore, to go out of their way to avoid the appearance of bias. Obviously this is tough when it appears biased from the get-go. But it's necessary to make the effort because when *actual evidence* of bias occurs, then people begin not to trust the process. It's as if the whole process becomes tainted because of a couple of bad occurrences, and thus, we're confronted with the backlash factor.

The problem is further compounded when a party believes there is wrongdoing and the means of review fails miserably. A recent New York Times article about the securities industry provides the kind of example that would give anyone about to launch into securities arbitration a sense of dis-ease.[14.] In a case that still has yet to be heard involving the East Islip (New York) Volunteer Firemen's Benevolent Association, the association (or claimants') attorney, Stuart D. Meissner, rejected the entire list of potential arbitrators, so was confronted with the NASD arbitrators assigned to the case. Mr. Meissner challenged the assignment of all those assigned, and all but one withdrew but only *after* Mr. Meissner challenged them. The fifth became the panel's chairman after the NASD rejected Mr. Meissner's challenge. Mr. Meissner continued to investigate the new chairman, Robert Cockren, a lawyer at Sonnenschein Nath & Rosenthal, and found that Mr. Cockren's firm took in more than the permissible amount of revenue from the securities industry in the prior two years and also found that a client of the firm was the parent company of a firm being sued in the case. When confronted by all the evidence, Mr. Cockren withdrew. [15] The trouble going forward is that NASD wasn't doing the investigating and denied the challenge --

wrongly, as it turns out. If Mr. Meissner had not been investigating on his clients' behalf, the conflicts of interest would not have been uncovered. When evidence like this surfaces, the whole system suffers. At the very least it slows down and becomes litigious because claimants and their attorneys can't trust the SRO to properly self regulate.

In response, Linda Fienberg, president of NASD Dispute Resolution says, "We believe that our rules are adhered to." [16]She says the Arbitrator's Manual at the NASD website gives potential arbitrators the parameters for ethical behavior and the organization publishes frequent articles on urging arbitrators to disclose--indicating that the appearance of bias can be just as harmful as an actual conflict. Arbitrators must sign oaths stating that they have no personal interest in the case before they agree to hear it. And this duty to disclose continues if a conflict of interest arises during the course of the hearing. The trouble is, the NASD relies heavily on arbitrators themselves to make proper disclosures. Karen Kupersmith, director of arbitration at the NYSE, said that the exchange also relies on arbitrators to be candid and come forth with potential conflicts. [17] This doesn't always happen, clearly. Mr. Cockren in the East Islip case was not forthcoming with his very real conflicts of interest, but worse, it seems only when there's evidence of glaring bias, as in Mr. Cockren's case, will the SRO, at least the NASD, dismiss an arbitrator.

Arbitrators have also learned how to fool the self-regulatory system. Some tend to give little weight to chinks in their histories that others might think could bias them as potential arbitrators in a given case. Some don't believe (often rightly) that claimants' attorneys will do the exhaustive research required to uncover evidence of potential bias. Some arbitrators honestly believe they can be completely fair—and perhaps some can be, but the laws of human nature, to some extent, point to a good many of them being unable to view themselves honestly, or at least as others do. Indeed, after Mr. Cockren's dismissal, confronted with the evidence that his law firm and he were deeply entwined with the respondent firm, he said "I fully complied with the NASD rules and regulations and nothing that either I or my firm did was improper." He said he withdrew because, "it wasn't worth my time or energy to deal with the attacks going on."[18] Giving him the benefit of the doubt here, he is *at best* suffering a disconnect from reality. Or perhaps he simply hadn't read the NASD rules regarding disclosure and the appearance of bias. But if the NASD rules are to be adhered to, then NASD and the other SRO's need to do the "due diligence" to route out the biased arbitrators who don't disclose, even if it means bringing the costs of securities arbitration more in line with outside arbitrations performed by AAA and the like.[19] It *is* possible for the SROs to clean up their policing mechanisms, just as the LAPD has become better at policing its own.[20]

B. The Selection of Arbitrators

If NASD is not going to police its arbitrators' potential conflicts of interest, then perhaps SICA can foster change in the way arbitrators are selected. If knowledgeable, unbiased arbitrators are selected from the outset also making it more difficult for "bad" arbitrators to get through the system, then there would be less need for vigilant self-policing. NASD and the other SROs could also change the requirement that one of the three arbitrators sitting on the panel be a "non-public" or industry arbitrator, since the two public arbitrators are often found to have some ties to the securities industry. This idea has considerable backing and will be discussed below.

There have been complaints, from some quarters, that arbitrator training is insufficient to inform those sitting on a panel of the relevant law and necessary tools to assess risk (often vital when assessing whether or not an investor understood a broker's action/recommendation). It's worth acknowledging this because without knowing what is really needed to make a determination, the arbitrators do not know what to look for, nor what to ask for, and they must make a determination on the basis of the information provided by the attorneys, not necessarily on any law or statistical analysis.[21] Richard Skora even maintains that the NASD "effectively discourages use of the law in the arbitration decision-making process."[22] That's a problem because arbitration is, after all, a legal process and law is or *should be* relevant to a determination. Skora goes onto say the NASD's policies, in this regard, have had several negative consequences. Parties cannot anticipate how arbitrators might rule because the arbitrators seem to follow their own rules most of the time, disregarding law and doing inadequate work as fact finders. Facing this type of tribunal, therefore, provides little possibility for "risk assessment" on the merits of an arbitration claim. There need to be guidelines so that parties have some idea what their risks are in not settling arbitration cases. Securities firms that have hundred-of-billions of dollars in assets and defend themselves against hundreds of claims understand these risks and can afford to take them. But the individual with few assets who pursues arbitration perhaps once in his lifetime may not understand these risks.

"If arbitrators are not proficient in the law and legal reasoning, then they are not qualified to decide disputes. The failure of arbitrators to follow the law means that individuals forced to agree to mandatory NASD arbitration are not only signing away their rights to a court trial, they are unknowingly signing away their rights to protection under the law. This is causing great harm to individuals who assume the securities firms will follow the law or if they do not, that the NASD will force them to follow the law."[23]

Even worse, the uncertainty favors the securities firms in another way. The firms' counsels apparently expect that arbitrators may rule on something other than the law because their counsels often flood a single proceeding with multiple cases involving multiple versions of events that would be deemed nonsense in court. This denies a fair arbitration to the individual who cannot afford to put on multiple cases but it still drives up the cost to the individual who is paying for his counsel and the proceeding.

Another negative consequence is that without the knowledge of the law, even arbitrators who think they are applying the law may in fact not be. Without that knowledge, rendering a fair and just arbitration decision becomes a farce and the NASD's guidelines are "effectively, no guidelines and an excuse to foster and enable incompetence."[24] Many arbitrators cannot even read and understand the law let alone discern whether or not it is applicable. They do not understand precedence, motions, and arguments or when a certain legal standard has been satisfied. They do not know how to calculate damages and hide their incompetence by not giving written explanations of their decisions. In at least one instance where they did give a written explanation it evidenced a “manifest disregard of the governing law.” The arbitrators are not well-versed in relevant law or risk and if they make a mistake in judgment regarding either of these things, these are not reasons to appeal an arbitration award.[25]

Mr. Skora and others have suggested that having arbitrators provide written explanation for the decisions they make would increase the acuity and conscientiousness, not to mention the law and fact-finding, with which they use to make their decisions.

Currently, arbitrators are selected using the Neutral List Selection System (NLSS) a computerized system that has been in place since November 1998. The NASD staff presumably does not have the discretion to make selections. Though NLSS has been called "random," it is, in reality, rotational. The computer is supposed to pick the next person on the arbitrator rolls who is a willing arbitrator for that geographic location and (if warranted) with a particular expertise. One problem arises with how potential arbitrators reveal their expertise. In the Arbitrator Registration Package is a one-page form asking the arbitrator to check categories indicating his/her expertise in various securities-related fields. If parties indicate that they seek arbitrators with specific expertise/experience, then the NLSS will presumably use this expertise/experience information.

But as Douglas J. Schulz wrote in his article “The New NASD Arbitrator Selection Process,”[26] “…my inquiries indicate that the NASD has no process in place to ensure that anyone who indicates he or she has a particular expertise/ experience, in fact, has it.” So, the more boxes one checks, the more likely one is to rotate to the top of the NLSS rotational list. Those who see this new process as an excellent opportunity to sit on more arbitration panels will “likely be liberal with their check marks.” Mr. Schulz proposes therefore, that practitioners keep in mind, when requesting that arbitrators have a particular expertise, they can also ask how many of the people in a particular geographical region have that expertise.[27] This is yet another item the NASD could do a better job of verifying before allowing names of arbitrators, who are, in fact, not qualified in certain areas, into the computer rotation.

Judith Norris, the head of the Los Angeles branch of NASD believes that the NASD’s arbitrator selection system is fair, but she does agree there are some business savvy arbitrators that need weeding out.[28]

The “non-public” or industry arbitrator is a another big source of consternation for some in the field. When the system was set up, it was believed investors could get a fair hearing even though one of the arbitrators hearing the case was a “non-public,” or industry arbitrator, informed about the securities business. The time expense of getting an ill-informed jury up to speed on the facts of the case, could be avoided entirely and the two “public” arbitrators would ensure that the investors’ rights would be looked after and that the industry arbitrator would not carry the day. Or so the theory went. As it turns out, there are issues with respect to the fairness of the "public" arbitrators, too, some of which have already been touched upon (computer selection, training, self-regulation).

The non-public arbitrator is the one member of the panel that the majority of investors' attorneys would like to see done away with. Indeed, there is considerable effort being expended by the Public Investors Arbitration Bar Association, PIABA,a 700 member organization made up of public investors advocates to remove the requirement of having an industry arbitrator on the panel. Current PIABA president, Robert Banks wants to see the rule changed.[29] He thinks the SEC should seek comment letters on the subject but that most investors' advocates don't want the industry arbitrator.

Investor's advocate, Robert Uhl of Aidikoff, Uhl & Bakhtiari, agrees that there's no need for the non-public arbitrator. "It isn't rocket science," he says, indicating arbitrators are able to figure out the relevant facts to make a determination without having an industry arbitrator. "Though most of the public arbitrators are OK, the industry arbitrator does damage to claimants' (his clients') cases." [30]

There has been some effort from the industry to assess the fairness of the arbitrator selection and disclosure process. In 2002, the SEC sponsored an investigative study by Professor Michael Perino regarding the operation of arbitrator disclosure requirements. He found that the most comprehensive study of investor outcomes was the GAO's 1992 report, *Securities Arbitration: How Investors Fare,* Rep. No. GAO/GGD-92–74 (May 1992), which examined results in arbitration over an 18-month period between 1989 and 1990. He concluded there was “no evidence of a systemic pro-industry bias,” but said that more investigation is needed.[31] Interestingly, he failed to quote in his report the GAO finding that “procedures showed that arbitration forums lacked internal controls to provide a reasonable level of assurance regarding either the independence of the arbitrators or their competence in arbitrating disputes.” [32] Clearly the study he sites is over 16 years old and needs updating. The most recent bear market has come and gone and over that same period, awards have been reduced.[33] The point is, there seems no doubt that people are looking at the data and choosing to believe that which they think is important, indeed, Les Greenberg provides evidence in his letter to Jonathan Katz, secretary of the SEC that Dr. Perino “was not an impartial evaluator,” and was providing the “results that would assist the SEC.”[34]

It’s disconcerting to say the least to be confronted with so much controversy regarding the subject of securities arbitration. The challenge of making the process fair and equitable to all seems almost insurmountable. That said….

C. Can We Build a Better Mousetrap? Interested Parties Weigh In

In interviews conducted with both investors’ attorneys and attorneys making the majority of their living defending against the claims of investors for their securities industry clients, both sides, in general, say arbitration is the best way to handle disputes. That said, there are those attorneys on both sides that don’t like the way certain aspects of the arbitration rules play out in practice. A few of the areas most cited for their failure to serve the interests of the parties will be examined.

Even though various groups and individuals have "issues" with the way securities arbitration is conducted, few want to get rid of it entirely. In fact, only one person working in the securities industry wanted to return to litigation or the SEC to resolve investors disputes.

"With arbitration, you get quicker results," said Francis G.X. Pileggi, a Wilmington lawyer who represents investors."[35] "It's much more effective to file for arbitration instead of complaining to the SEC, because you never know how long it will take the SEC to get around to investigating it."

"When you get the SEC complaint forms, they're pretty clear they're investigating for their own purposes, not to help the investor. It's sort of the same way at NASD on *their* enforcement side," said another investors' attorney, Steven Berkley, who practices in Chicago. Instead, by going to arbitration, "investors have a chance of actually seeing something,"[36] and seeing it sooner than later with less expense."

Robert Uhl, an investors' advocate believes arbitration allows him to take on more clients with a lower dollar amount in dispute. This helps the claimants *and* him, he says, because otherwise he wouldn't have the time to have as many clients. He would need to be at court more, filing motions and taking depositions and "jumping through all the hoops" attorneys have to jump through when they litigate as opposed to arbitrate. He concedes there are motions filed and depositions taken in arbitration as well, but it's more the rare occurrence than the norm. Mr. Uhl says litigating a $200,000 case is not cost effective. He is able to take on the $100,000 cases, claims that he says he "couldn't afford to take on," if he were to litigate them. [37] He thinks the abuses of the process are rare and the only issue he has with it is the idea of the non-public arbitrator. He agrees with the majority of the PIABA constituency that believes most of the public arbitrators are repeat players and there's enough business savvy already. The need for someone who is industry, just to keep the public arbitrators informed, is archaic at best, he says, and biased. He concedes that the current system does make him more money so he does have a vested interest in keeping arbitration as a the means of resolving securities disputes.

And what of the claims beneath $100,000? Mr. Uhl wouldn't take them, and yet they make up a sizeable portion of complaints filed. "Most of the disputes that are presented in the investor-broker arena are cases under $50,000, where going to court may be impractical and cost-prohibitive."

As Michael Perino, the author of an SEC sponsored study in 2002 reported, "judicial encouragement of securities arbitration is founded in part on the perceived benefits of the alternative for both industry members and customers, including reduced costs and speedier results."[38] It would seem however, that arbitration still doesn't help those whose claims don't warrant the time of an investors' attorney. It's simply not worth their while. So these investors must figure out, on their own, whether to file a claim and if the arbitrators are fair—which as we've seen above, is often difficult to do.

On the other side of the aisle is defense attorney, Michael Abbot. "I'm a big fan of the arbitration process and I wouldn't change a thing," he says. "Both sides get a fair shake and I *lose* half the time."(*emphasis added*)[39] He goes on to concede that there is some bias in the "arbitrator pool," but that he is aware of only one case where an arbitrator unduly influenced the outcome of a case. In that event, he says, the parties never give up their right to move to vacate the award, which he's done only a "few" times. After practicing securities law for 30 years in Los Angeles, he has had motions to vacate granted in 1-2% of his cases. He had no comment on the decline of award amounts but, unresponsively, said that punitive damages were available and are given half the time.

Les Greenberg has represented individual investors and more than twenty securities brokerage firms before arbitration panels in several forums and in various state and federal courts. Mr. Greenberg, currently an attorney living and practicing securities and real estate law in Los Angeles, believes the way securities arbitration is managed is flawed in many regards and needs an overhaul. And Mr. Greenberg knows the process. He has served as the Associate General Counsel and/or Compliance Director of a New York Stock Exchange (NYSE) Member Firm, as a securities arbitrator for the National Association of Securities Dealers (NASD) for 28 years, and for the NYSE as a business dispute arbitrator for the Los Angeles Superior Court. He has also served as a securities arbitrator for the American Arbitration Association and has written extensively to improve the securities arbitration process. Most recently he has been involved in the submission of formal comments to the Securities and Exchange Commission, e.g. Petition for Rulemaking (SEC File No. 4-502) (severe problems with NASD arbitration and questionable SEC oversight). He says securities arbitration is *prima facie* flawed because a process controlled and managed by the industry it seeks to police is never going to be as "neutral" as one managed by an outside body.[40]

Mr. Greenberg believes the best way to handle securities arbitration, which he concedes is the most cost effective means to resolve investor/broker disputes, is to take it away from the industry regulators, the SROs. He says an alternative would be to place the determination of each arbitrable dispute in the hands of one SEC Administrative Law Judge trained for the purpose but following rules for arbitration. He says this would be expedient, that the SEC already maintains offices in several major cities in which to conduct proceedings and does not have any evident bias attached to it. He says this should also satisfy both investors' and defense counsel because the SEC judge would be trained and have some relevant business acumen with which to make a speedy informed decision.[41.]

Robert Banks, the head of PIABA, says the whole process should be at the investors' option.[42] This might help the larger claimants with awards by juries if they chose to litigate, but those with the $25,000-$200,000 claims would still have a tough time even finding an attorney to help them with arbitration. Gary Weiss, author of "Wall Street Versus America: The Rampant Greed and Dishonesty That Imperil Your Investments," agrees with Mr. Banks, saying "the main problem with arbitration is that investors don't have a choice. They sign a brokerage account form and they give up their right to sue in court. I think that should be voluntary." Mr. Weiss, like Mr. Banks thinks that if investors want to go to arbitration, they should have the ability to do so. Or if they want to agree in advance to arbitration, they can have that ability to agree in advance to go into arbitration. “I think it should be up to the investor. I don't think it should be imposed upon the investor.”

Mr. Weiss also sees a problem with the way securities arbitration is conducted. “It’s different from ordinary arbitration. It's different from the American Arbitration Association's version of arbitration. It's different from the type of arbitration that you have, the binding arbitration that you can very frequently use in resolving court cases. There's nothing wrong with that [kind of arbitration]. It's voluntary. You can voluntarily go into it. But the problem is that the securities industry's version of arbitration is different from AAA arbitration. Certainly anecdotally, and in my own research, I found that it does tend to be biased against the investor.”[43]

Potential Fix – The Pilot Program

In response to some of the complaints, SICA began a voluntary pilot program in 2000 within the forums of NASD and NYSE in which a challenge was issued to the securities industry - let a significant number of cases go to arbitration forums not affiliated with the securities industry, such as J•A•M•S (JAMS) or the American Arbitration Association (AAA), and have those organizations administer the arbitrations.

Several of the country’s largest brokerage firms took part in the two year program. There seems to, once again, be problems with the program and complaints on how it was administered. For example, a firm cannot elect which of the cases it will permit to go into the program; only a public customer can do that. And a firm got to decide which cases were eligible for the non SRO forums.[44]

About a 100 cases went to arbitration with either JAMS or AAA. Though statistics on what the results of the pilot program actually were are hard to come by, Michael Perino observes, “the two-year SICA-sponsored pilot project aimed at encouraging investors and their counsel to choose outside arbitration produced hardly any positive response.[45]

Les Greenberg and others have pointed out that the pilot program is very costly ($500 per arbitrator per hour vs. a $200 honorarium for an NASD arbitrator for the session) and was also beset with other inequities.[46] Other pilot programs are being tried as well. In August of 2005, the NASD began a pilot program in its western and southeast regions aimed at speeding up the discovery process, one of the most time-consuming phases of arbitration. The NASD has also been working to expand the rolls of arbitrators over the past several years — last year alone, it approved over 1,200 new arbitrators, and these individuals are far more competent than past arbitrators, says David Robbins, who chairs the NASD neutral roster committee that approves new arbitrators. “Arbitrator competence is the single most important issue facing securities arbitration,” says Robbins. “And these new arbitrators have led lives of achievement.”[47]

CONCLUSION

There is substantial evidence that mediation and other ADR approaches can result in enhanced satisfaction, reduced dispute resolution costs, shorter disposition times, improved compliance with a settlement, and other benefits in some contexts.

That said, there are clearly problems that need to be addressed. But there doesn't seem to be the drive nor the consensus building efforts required to agree on what changes should be made. Indeed, author, Gary Weiss says, "I assume the industry likes it because the industry fights like the devil whenever efforts are made to change the arbitration system."[48]

Obviously the process is only as good as those individuals engaged in it, and there is still much to learn—and decide—about the role of ADR in the public justice system. Confronted with increasingly daunting litigation costs and perceived great risks, most investors could not afford litigation and most investors' attorneys can't afford to take them on as clients.

In recent years, mediation has become a more and more popular alternative to dispute resolution, and it has been suggested that perhaps there is a greater use for it in the securities industry. [49]

As arbitration has taken on more and more of the features of court litigation, its' positive features—speedy and cheap—have been reduced dramatically. Mediation might prove a good solution, but if mediation were the main technique of resolving securities disputes, it could also become more like litigation, robbing it of the benefits that have encouraged its growth.[50] As a private forum becomes more and more like litigation, it may or may not be preferable to court trial.[51]

It's vital, though, that if there is to be any improvement in how the process is viewed by all who use it, that there needs to be open access to as much information as possible. Richard Ryder, the Editor of the periodical, *Securities Arbitration Commentator*, explains the importance of making data on arbitration of investor-broker disputes broadly available to the public if perceptions are to change for the better.

> My years in the securities industry have taught me that sunshine is the best antiseptic. . . .It relieves distrust, empowers those who are sympathetic, and it steals thunder from your detractors… In consumer arbitration, [confidentiality] is anathema. The process can be private, so long as there is the opportunity for evaluation… Over the years, SAC has provided statistical information garnered from Public Awards to the GAO, the media, and other agencies that have allowed those evaluators to accept what they have been told by supporters of the process—because they have been able to independently verify the information with quantitative data.. . [T]he availability of Public Awards has permitted us to survey such aspects of the arbitration process as the frequency of arbitrator service, the prevalence of attorney fee awards, the dynamics of defamation and discrimination cases, employment awards in general, how forum fees are assessed among the parties, how customers fare in arbitration, outcomes in online trading cases, the results for pro se claimants, the use by arbitrators of punitive damages, their willingness to impose other sanctions, details about raiding cases, situs as a factor in outcomes, the top 100 broker/dealers in arbitration, and numerous other mini-surveys. The Awards must supply reliable and substantive information, because they are the raw material with which outsiders must work.[52]

More disputes are heard through arbitration than would ever see the light of day if litigation were the only outlet in which to resolve them. Most cases would be too costly to bring to trial—not just for the investor/claimant but for the investors' attorneys as well. With arbitration, even those cases involving less than $25,000 have an outlet in which to seek some sort of restitution, which would be unaffordable if it didn't exist. Mediation is an attractive alternative for those claimants without the financial deep pockets to pursue litigation or even arbitration. If mediation were the chosen ADR method of choice, though, safeguards would need to be put in place so that it wouldn't become a mini medarb-itigation as well. Though my personal belief is that arbitration could work, it could definitely be more "fair." Arbitrators need to be more closely screened and monitored for abuses; The means of monitoring need to be more actively followed and the unsavory characters dispensed with; Giving claimants a right to choose their forum. These are but a few of the suggestions those in the securities industry have proposed. Some steps have been taken to improve the system but as it and its practitioners evolve, it too needs to be an ongoing work-in-progress.

The End

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1. Gerald F. Phillips, *"Is Creeping Legalism Infecting Arbiration?"* 37 Disp. Resol. J. 37 (2003).

2. Lou Whiteman, *"Arbitration's Fall From Grace,"* Law.com In-House Counsel, GC South, July 13, 2006.

3. NPR story, "Marketplace" July 20, 2006.

4. NASD website, www.NASD.com, July 2006.

5. *Id.*

6. Phone interview with attorney Robert Uhl, July 19. 2006

7. Statistics published at multiple sites including www.NASDAQ.com, www.NASD.com.

8 Thomas Stipanowich, Arbitration Class Lecture, Straus Institute, July 12, 2006

9 www.SEC.gov

10 Thomas Stipanowich, *"ADR and the Vanishing Trial,"* Journal of Empirical Legal Studies, Vol. 1, Issue 3, 843-912, November 2004.

11 NASD members include 5100 brokerage firms, 168,120 branch offices and more than 659,200 registered securities representatives. *Information obtained from www.NASD.com, page updated 7/5/06.*

[12] Because NASD is the largest of the SROs handling 90% of cases, discussion of SROs in general may exclude the smaller of these organizations. *Only if* there is a specific distinction between NASD and NYSE, for example, will that be discussed.
[13] See NASD Rules: 10202. Composition of Panels, 10104. Composition and Appointment of Panels, 10308. Selection of Arbitrators.
[14] Gretchen Morgenson, *"Is This Game Already Over?"* New York Times, Sunday, June 18, 2006.
[15] *Id*.
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] NASD pays its arbitrators an honorarium of $200/session. This is compared to $500/hour for AAA arbitrators.
[20] Constance L. Rice, *"This is not your grandpa's LAPD,"* Los Angeles Times, Sunday, July 16, 2006
[21] See *in general* Richard Skora's letter to SEC Secretary Jonathan G. Katz in response to File Number 4-502. See SEC petition responses at www.SEC.gov. Mr. Skora has worked in the field of credit risk management since 1992. He has developed many fundamental products and models that have advanced portfolio risk management and contributed to the transparency of the credit derivatives market. He traded various exotic credit derivatives including default swaps, default options, and basket swaps. Skora is chairman of the Global Association of Risk Professional's committee on supervision and regulation. Previously, Skora held academic positions at The Institute for Advanced Study in Princeton and Columbia University in New York. He received a B.S. in mathematics from The University of Illinois in Champaign-Urbana and a Ph.D. in mathematics from The University of Texas in Austin.
[22] "Requirements When Using Predispute Arbitration Agreements With Customers… The arbitrators' award is not required to include … legal reasoning …" [NASD Rule 3110(f)]
[23] Skora, *supra*, note 21.
[24] *Id.*
[25] *Id*.
[26] Douglas J. Schulz, *"The New NASD Arbitrator Selection Process-NLSS,"* Securities Arbitration Commentator, 2000.
[27] *Id*.
[28] Phone interview with Ms. Norris, July 20, 2006.
[29] Phone interview with Mr. Banks, July 20, 2006.
[30] Phone interview with Mr. Uhl, July 19, 2006.
[31] Stipanowich, *supra*, note 10, at 204-6.
[32] General Accounting Office, "*Securities Arbitration: How Investors Fare*," Rep. No. GAO/GGD-92–74 (May 1992) at 6, citing SICA, Final Report, Securities Industry Conference on Arbitration Pilot Program for Non- SRO Sponsored Arbitration Alternative (2002).) Also available at www.SEC.gov.

[33] www.NASDAQ.com, through April 2006.
[34] Les Greenberg letter to Jonathan Katz dated July 31, 2005, in response to SEC petition 4-506 available at www.SEC.gov, or Mr. Greenberg's website: www. LGEsquire.com.
[35] Joseph N. DiStefano, *"Aggrieved investors turning to arbitration; Brokers, customers try to work out settlement,"* The Monterey County Herald, March 25, 2003
[36] *Id.*
[37] Uhl, *supra*.
[38] Stipanowich, *supra*, note 10.
[39] Phone interview with Michael Abbott, July 19, 2006.
[40] Phone interview with Les Greenberg, July 19, 2006.
[41] Greenberg, letter to Katz, *supra* note 34.
[42] Banks interview, *supra*.
[43] David Geracioti, *"Headquarters, we Have a Problem,"* Registered Representative, June 1, 2006.
[44] Stephen G. Sneeringer, *"Securities Arbitration Pilot Program,"* www.NASD.com.
[45] GAO, *supra* note 32.
[46] Greenberg, letter to Katz, *supra* note 34.
[47] Kristen French and Ann Therese Palmer, "*The Argument Over Arbitration*," Registered Representative, May 1, 2006.
[48] Geracioti, *supra* note 43.
[49] French and Palmer, *supra* note 47.
[50] Stipanowich, *supra* note 10.
[51] *Id.*
[52] Email from Richard Ryder to Thomas Stipanowich, *supra* note 10, at 908.