Stockbroker losses bring no trials, lots of tribulations

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Every year, millions of investors lose money.

Many times, it's our own stupidity or a lousy year on Wall Street that gets us into trouble. But other times, somebody else is to blame. If that somebody is a stockbroker, you could get swept up in a process that would make the Mad Hatter's tea party look sane.

You see, a consumer can sue a car dealer, a doctor, an investment adviser, a beautician and any other professional you can imagine, but a consumer can't sue his or her stockbroker. The U.S. Supreme Court made sure of this in 1988 when it ruled that brokerage documents, in which investors waive their rights to sue in court, were legally valid.

If a stockbroker loses your life savings because of incompetence or unethical behavior, you might be able to recover some of your cash through a settlement. But if an investor can't reach a settlement with a brokerage firm, the only recourse is to seek restitution through arbitration. The most popular arbitration forum is the NASD, which oversees the NASDAQ stock market and investigates complaints against its member brokerage firms.

The brokerage industry has lauded the arbitration process as a way for investors to obtain justice quickly and cheaply. But critics are less sanguine. Les Greenberg, a longtime securities attorney who previously spearheaded a successful move to improve corporate governance, recently filed a rule-making petition with the U.S. Securities and Exchange Commission, urging it to overhaul the arbitration system.

Greenberg, a lawyer from Culver City who has been an NASD arbitrator since 1976, complains that the NASD doesn't provide arbitrators with legal training, it fails to evaluate the quality of their work and it allows industry participants to unduly influence the rulings.

As evidence that the current system works, the NASD likes to point out that roughly three out of four investors end up winners by either pocketing money through a settlement or later in arbitration. According to the NASD, investors win 55 percent of the arbitration cases. The NASD's definition of victory, however, isn't too tough to meet. It's considered a victory if an investor recoups any cash.

Here's one of the cases that ended up in the win column: A retired nurse turned over her $1.3 million nest egg to a broker who lost more than $900,000 of it. The arbitrators concluded that the retiree deserved restitution, but only awarded her $5,000. At the same time, the arbitrators dinged her $5,600 for the proceeding. I don't think anyone would even dare call this a Pyrrhic victory.

One of the many complaints against the present system is the presence of an industry representative on many arbitration panels. If an investor's claim reaches at least $50,000, the arbitration panel includes three people. Two are classified as public arbitrators and the third works in the industry. Critics, including William Francis Galvin, the secretary of the commonwealth of Massachusetts and its chief securities regulator, question why industry reps should be judging cases at all.

At a congressional hearing earlier this year, Galvin summed up his take on the arrangement: "Would anyone here seriously suggest that in all future disputes between automobile manufacturers and their customers ... (consumers could) only bring their complaints and claims before a panel selected by GM, Ford or Chrysler? I don't think so."

What's equally controversial is the background of so-called public arbitrators. Greenberg and others insist that many of these arbitrators have industry ties that makes investor attempts at retribution even more quixotic. At the same congressional hearing, Linda D. Fienberg, president of NASD Dispute Resolution, argued that the NASD had recently tightened the definition of public arbitrator. For instance, she said, the NASD now excludes public arbitrators, including attorneys, accountants and other professionals whose firms have derived 10 percent or more of their annual revenue in the previous two years from clients involved in securities-related activities. That may or may not sound fair, but it will be even harder to check your skepticism at the door when you hear what the NASD did after the state of California insisted that neutral securities arbitrators disclose all conflicts of interests to participants. Rather than comply, the NASD sued.

So much for embracing greater disclosure. The enforcement of California's arbitration standards, which took effect in 2002, essentially would have disqualified many so-called public arbitrators with hidden ties to the securities industry from serving as panelists. What's more, the rules may have blocked the NASD and the New York Stock Exchange, which also conducts arbitration hearings, from choosing any arbitrators because of potential conflicts of interest. Unfortunately, the NASD prevailed in court.

If you'd like to read Greenberg's 24-page petition, along with comments filed by others in the industry, visit the Securities and Exchange Commission's Web site at **www.sec.gov/rules/petitions.shtml**.

Once you read the filings, you may agree with Galvin, who insists that investor arbitration is a joke. "What we have in America today," he insists, "is an industry-sponsored damage containment and control program masquerading as a judicial proceeding."

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