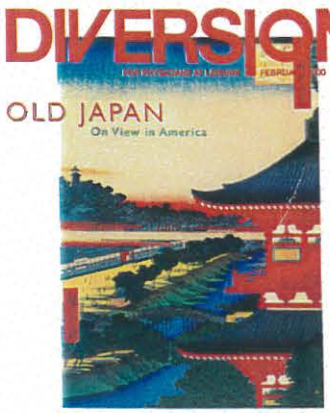

WANT TO SUE YOUR BROKER?

Sorry, you can't—but you can go to securities arbitration • by Howard A. Baker

Ever feel like punching out your broker? Or, more realistically, suing him? Well, you'd better stop and take a deep breath, because that's simply not going to happen. After all, just because your portfolio hasn't kept up with the overall market doesn't mean you have a valid claim for damages. Investing in the stock market is not risk-free, and investors should understand that.

But what if you do have a valid grievance? Perhaps you're wondering how some of those near-worthless stocks in your portfolio ever got there. You told the broker you wanted income, so why did he put you into a bunch of start-up highfliers?

Or maybe you're angry about those in-and-out trades. With all those commission charges, it looks as if only the broker made money. Aren't brokerage firms supposed to supervise their salespeople? And aren't there know-your-customer rules that should have required your broker to understand your needs, investment objectives, and financial condition?

Maybe you've tried to talk to your broker about those inappropriate buys or that in-and-out trading—and now he or she refuses to return your phone calls. What to do? Forget about a civil law suit. Instead, you're about to enter the world of securities arbitration.

Your first step is to find the right lawyer—and that probably doesn't mean the one who handled your son's automobile accident. You need an attorney who specializes in securities law; if your *(continued on page 55)*

(from page 52) family lawyer has difficulty referring you to one, call your county or state bar association. Your new attorney will help you decide if your case looks winnable in arbitration.

Why arbitration rather than civil litigation? The answer lies in an agreement you signed when you opened your brokerage account. There, tucked away in the fine print, lies a provision in which you consented to submit any dispute with your broker to arbitration, generally under the rules of the New York Stock Exchange (NYSE) or the National Association of Securities Dealers (NASD), the two primary self-regulatory organizations (SROs).

Arbitration has long been a favored way to handle all sorts of commercial disputes because it is faster and cheaper than court litigation. Within the securities industry, too, arbitration is nothing new.

In 1987, the U.S. Supreme Court made a ruling that upheld the arbitration provisions in new-account agreements. That decision, coupled with the increasing number of Main Street investors, has caused securities arbitration claims to swell to 6,000 cases annually. (Some 85% of these cases are under the oversight of the NASD.)

Can small investors receive impartial treatment in an industry-run process? Simply put, yes: A 1992 study by the Government Accounting Office found no evidence that industry-sponsored securities arbitration forums were biased against customers. And to help ensure this lack of bias, all rules and procedures of SRO arbitration programs are subject to direct oversight by the Securities and Exchange Commission (SEC).

If you make a claim of less than $10,000 against a brokerage firm under NYSE arbitration rules (or less than $25,000 against a firm under NASD rules), your dispute will be handled by a single "public" arbitrator. Disputes involving sums over these amounts are heard by two public arbitrators plus one "industry" arbitrator.

The distinction between public and industry arbitrators boils down to whether the arbitrator has an ongoing connection with the securities industry. Note that it's not just lawyers who serve as arbitrators; members of other professions can apply to the NYSE or NASD for certification, too. Once an applicant is approved, he or she is required to undergo special training.

James V. Gargan, a former commodity exchange general counsel who now represents securities and commodities investors in arbitration cases, serves as a public arbitrator from time to time. He says he and his clients benefit from the experience. "As a practitioner, serving as an arbitrator gives me an opportunity to get into an arbitrator's mind-set."

In the past, an investor could always learn the professional and business background of any potential arbitrator, but new rules give both sides even more power in that area. Today, if you are bringing your broker to arbitration, you have the right to veto the appointment of any arbitrator whose record you don't like. In disputes large enough to merit a panel of three arbitrators, you can even take an active role in selecting the panel chairman.

Overall, investor win rates in SRO arbitration cases stand at about 62%, although, of course, awards are not always handed down for the full amount of the damages claimed. Interestingly, win rates for investors whose cases require three-arbitrator panels are a little higher than the average.

Smaller claims, as mentioned, are decided by a single arbitrator, and they do not get an actual hearing unless the parties request one. Instead, these cases are resolved on the basis of paper pleadings and supporting documents. The slightly lower win rate for customers with these smaller claims may be attributable to the fact that the amounts involved make it hard to retain a lawyer, so lay customers find themselves facing off against experienced brokerage firm attorneys.

How can it be, then, that investors win about 60% of the time? For one thing, the NASD and NYSE offer substantial assistance (see box).

What's more, acting as your own counsel at a hearing before an arbitration panel sometimes has its advantages. Jenice L. Malecki, a New York City securities attorney who serves as a public arbitrator, recalls a recent case: "In watching the customer represent himself, it became obvious he didn't have any idea about the trades he had made and really had no understanding of securities industry terminology. The arbitrators became sympathetic to his claim and found he was not suitable for those trades."

To help investors get a better shot at putting forth their strongest arbitration case, the schools of law and management at SUNY at Buffalo have opened a securities arbitration clinic. The clinic only assists investors with claims that are $25,000 or less, and the investors must live in the Buffalo area, but universities in other areas have

similar programs. The Buffalo clinic receives 15% of any successful award, considerably less than the 30% to 40% cut usually asked by private lawyers.

Professor Joseph Ogden, co-director of the clinic, stresses that education, such as sponsorship of investment seminars and free portfolio evaluation, is an important part of the program. But all too often these efforts come too late, so Ogden says he'll include a chapter on "horror stories" in his next financial text to help warn investors against overreaching brokers.

Arbitration rules allow investors to request that cases be decided at a location reasonably close to where they reside. Thus, the NASD conducts hearings in about 50 cities across the country.

While cases may be settled voluntarily at any time prior to the rendering of an award, most cases that go on to hearings are resolved within one or two half-day sessions. Parties at these hearings make opening and closing statements and present sworn evidence through witnesses, qualified experts, and documents. Anyone giving testimony at a hearing is subject to cross-examination by the opposing party. The arbitrators sit as judge and jury, and they can ask clarifying questions. Arbitration is binding.

While the formal rules of evidence need not be followed as closely in securities arbitration cases as in court proceedings, some observers say that arbitration has lost a bit of its long-standing advantages over civil litigation. For example, the NASD's prehearing "discovery" rules prescribe that the parties exchange some of the very documents that in past years may have been withheld.

What does this mean for you, the investor? It means that while brokerages must now furnish account and trade information, among other internal documents, you may now be required to disclose portions of your federal income tax returns.

David E. Robbins, a New York City securities attorney and former arbitration director of the American Stock Exchange, defends the changes in prehearing discovery rules. He feels the codification of which documents are required helps streamline the process. Says Robbins, "This should permit cases to come to hearing more quickly and preserve the lower costs for which arbitration was intended."

Although decisions must reflect the majority vote of the arbitrators, the panel does not have to explain why or how it reached its findings. Awards are final and binding, and can be appealed in court only on very limited grounds. "It would be ideal if arbitrators gave 'reasoned decisions' to explain their awards," notes Brian M. Greenman, a former brokerage compliance officer who now represents small investors in New York City.

That said, evaluations submitted to SROs indicate that parties to securities arbitration proceedings are generally pleased with their overall experience. Nonetheless, in response to concerns that the arbitration process, at times, can be overly adversarial, costly, and time consuming, another dispute resolution process—mediation—is developing a cadre of followers.

In mediation, parties undertake an informal voluntary process under the guidance of an impartial mediator whose role is to try to forge a settlement. Here, there is no winner or loser, and the mediator has no power to decide the dispute. Instead, the emphasis is on finding a solution to which both the investor and the broker can voluntarily agree.

The NASD has formulated mediation rules approved by the SEC for parties who want to resolve their issues this way. Early results indicate a fairly high percentage of cases—perhaps as much as 80%—can be settled in this forum.

So, happily, you don't have to go to extremes when a dispute arises. Take your broker to arbitration, or maybe mediation, instead. ■

Howard A. Baker is a former arbitration director of the American Stock Exchange and now heads his own legal and consulting firm.

GETTING STARTED

To research the background and conduct of any brokerage firm that's a member of the National Association of Security Dealers, call 800/289-9999. You can also learn more about your broker, your rights, and where to file a complaint (there are 11 district offices around the country) by visiting *www.nasdr.com* or calling 301/590-6500.

The New York Stock Exchange's Web site (*www.nyse.com*) offers similar services to investors; you can call the NYSE at 212/656-3000. —H.B.