YOUR MONEY

Taking a Broker to Arbitration

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Your Money

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If you have a problem with your investment broker and you cannot resolve the dispute on your own, you probably won't get your day in court. But you will be heard, most likely in a conference room somewhere, before a panel of arbitrators.

The moment people open a brokerage or investment account, they most likely — and perhaps inadvertently — waive their right to sue. The fine print of most customer agreements almost always contains a clause that says the customer agree to resolve any future disputes through arbitration, largely through the forum operated by the Financial Industry Regulatory Authority, Wall Street's self-regulatory organization, known as Finra.

The mandatory nature of these agreements — which are increasingly appearing in other consumer financial products as well and have been repeatedly blessed by the Supreme Court — is a frequent complaint of consumer advocates. And if you try to avoid brokers' so-called predispute arbitration clause, you may have little

choice but to stow your savings in a mattress.

While arbitration has its share of benefits — it's much quicker and cheaper than litigation — some securities lawyers who represent investors argue that they would get better results before a jury of their peers. But other legal experts point out that many investors wouldn't have a chance to be heard if it weren't for arbitration; federal securities laws, along with some states' laws, are not always investor-friendly.

"From the investor's perspective, the great advantage of the Finra model is that arbitrators might be able to find a remedy for investors that is not supported by law," said Barbara Black, a professor at the University of Cincinnati College of Law.

But it doesn't always work in investors' favor, according to securities lawyers. And on Thursday, Finra acknowledged that its arbitration process, which has come under recent criticism, could be improved when it announced a 13-member task force to look into improving transparency, impartiality and efficiency.

So how do investors fare in arbitration right now? Last year, about 18 percent of customer cases, or 499 claims, were decided in arbitration. Customers received monetary or nonmonetary damages in 42 percent of those cases. But 77 percent of customer cases — including settlements between the parties and arbitration awards — resulted in some sort of monetary or nonmonetary relief (such as canceling a stock purchase and getting money back).

Investors' lawyers say, however, that even a $1 win would be considered an award so the statistics don't necessarily provide the full story. "It is seldom that you see a home run," even on stronger cases, said Robert Rex, who typically represents retirees in Boca Raton, Fla.

"One of the big deficiencies in the process is the quality of dedication of the arbitrators," Mr. Rex added. "You can have some that are very smart and they try to do the right thing. And then you have people in there who are career arbitrators, and know if they give a big award they won't get on another case" because the brokerages will not choose them to be on their panels.

Finra and some academics contend, however, that the $400 a day arbitrators earn isn't enough of a financial incentive to create a bias.

The leading reason consumers pursue arbitration is because of claims of a breach of fiduciary duty, which is the legal way of saying the broker did not act in a customer's best interest. There were nearly 1,900 of those cases last year, according to Finra, followed by lesser numbers of cases involving claims of negligence and misrepresentation. Problems involving stock investments were the most frequent, followed by mutual funds and variable annuities.

Investors are often surprised at how the process works. Arbitration is considered an "equitable forum," for instance, which means arbitrators don't have to strictly apply the law. "The court applies the law to the facts and makes a decision," said Jonathan Morris, chief legal officer at Dynasty Financial, who has served as an arbitrator. "In arbitration, they might not rule all for one side or another. The investor can be partially right and partially at fault and arbitrators can split the difference."

Depending on the circumstances, the lack of a legal standard can help or hurt your case. Someone like Phil Ashburn, whose case was arbitrated last year, may have done better if his case had been heard by a jury, at least by his lawyer's estimation, because the laws in his home state, California, are more favorable for investors.

Mr. Ashburn, a former phone installation and repair technician, said he pursued his claim after an "adviser" who visited his company offices, and later his kitchen table, urged him to take a company buyout instead of a $1,500-a-month pension. He was 51 at the time, and took the buyout.

The adviser then invested the $355,000 he received into a high-cost variable annuity. Mr. Ashburn needed income right away, so she recommended that he take advantage of a tax rule allowing penalty-free withdrawals before retirement age. He took out about 9 percent of his money each year. "She kept stressing the fact that you are never going to go broke," said Mr. Ashburn, now 63 and working as a part-time dog trainer out of his Pleasanton, Calif., home. "And I believed her. It was my ignorance."

He filed his case in 2009, seven years after he met with the adviser, and went to arbitration early last year. He, along with five of his co-workers, lost, though the opposition had to pay the arbitration fees.

Mr. Ashburn said he didn't feel like he had received a fair hearing because the head arbitrator was hard of hearing, while the two other arbitrators struggled to stay awake. He said he also overheard the head arbitrator in the lobby laughing about the facts of the case.

Legal experts say that most arbitrators are well-intentioned, though Finra's training program needs to be more rigorous. And Finra did recently improve the impartiality of the panels: Until 2011, the panel of arbitrators included one industry arbitrator and two "public" arbitrators, with no industry ties. Consumers can now request an all public panel. Finra also proposed a rule to make it more difficult for people with former industry ties to be listed as public arbitrators.

Still, Melinda Steuer, Mr. Ashburn's lawyer, said that the makeup of a panel played a large role in the outcome of the case. "In a jury system, there are more protections, including the judge, the law and the right to appeal," she said, noting the virtual impossibility of appeals in arbitration. But she also has had cases in which the arbitration rules worked in her clients' favor, she said.

"There is much more room to plead a whole range of alleged violations in a Finra statement of claim," said Linda Fienberg, president of Finra's dispute resolution forum.

Whether investors win or lose, they rarely know arbitrators' reasoning because they don't have to provide any explanation. Investors can request one, but will receive it only if the opposing party also agrees; legal experts say that typically doesn't happen. (Awards, however, are made public on Finra's website.)

"Brokerage firms love the confidentiality," said Andrew Stoltmann, a securities lawyer. "We have these product cases where brokerage firms create these really complicated defective investment products and in arbitration, it's all kept quiet."

The lack of transparency is a frequent complaint. "If the vast majority of the cases are being decided in arbitration, they are deciding the law," said Mercer Bullard, an associate professor at the University of Mississippi School of Law. "The problem you have now is you have so much of the law being decided in secret we don't know what the law is. There is no accountability."

The Securities and Exchange Commission, as part of the financial regulatory law known as Dodd-Frank, was given the authority to adopt regulations to ban, limit or condition mandatory arbitration clauses, but consumer advocates do not expect the S.E.C. to push

forward.

For people who decide to pursue arbitration, legal experts suggest finding a lawyer with significant experience in Finra arbitration. But many lawyers, who typically work on a contingency basis, do not take on claims with less than about $150,000 of losses.

Claims under $50,000 are typically resolved through a simplified arbitration process in which written complaints are submitted and decided by one arbitrator (Finra's website has a list of clinics that offer help for smaller investors). The problem here, legal experts say, is that a lot of these cases turn on credibility, which doesn't necessarily shine through on paper.

The Finra task force might start with figuring out ways to make the process more equitable for these smaller investors, for whom every last dollar counts.

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