



## DISPUTE RESOLUTION SECTION

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“Disputes arise across a broad spectrum of relationships and substantive areas of the law. Alternatives to litigation may best serve client needs for resolving many of these disputes. The NYSBA Dispute Resolution Section has prepared a series of White Papers to set forth some of the special advantages of mediation and arbitration in the various contexts in which disputes commonly arise.”

*Edna Sussman, Chair, NYSBA Dispute Resolution Section*

*David Singer, Chair, White Paper Subcommittee*

### THE BENEFITS OF MEDIATION AND ARBITRATION FOR DISPUTE RESOLUTION IN SECURITIES LAW

By Irene Warshauer\*

*"Traditional litigation is a mistake that must be corrected... For some disputes trials will be the only means, but for many claims trial by adversarial contest must in time go the way of the ancient trial by battle... Our system is too costly, too painful, too destructive, too inefficient for really civilized people." Chief Justice Warren E. Burger of the U.S. Supreme Court*

Any litigator will attest that litigation has become a lengthy and expensive proposition. It is a stressful process that destroys relationships. As some disputes will inevitably arise, lawyers seeking to best serve their clients must consider other forms of dispute resolution which can avoid much of the delay, expense and disruption of traditional litigation. Mediation and arbitration, both of which are responsive to party needs in a way that is not possible in a court proceeding, are two of the most frequently utilized forms of dispute resolution. They have particular applicability in the field of securities law. Securities arbitrators are knowledgeable in the field. Discovery is limited in arbitration and sanction very rare. Securities mediation can quickly resolve the dispute, reduce customer anger and provide for a nonmonetary component.

Mediation and arbitration are no longer *alternate* dispute resolution mechanisms. but have become common in the resolution of commercial and non-commercial disputes between and among business entities and/or individuals. Mediation and arbitration are routinely incorporated into contracts as the method of choice for resolving disputes that may arise in the future. They are also routinely used after problems arise and the parties are seeking an appropriate means to resolve their disputes. We review the benefits of mediation and arbitration generally and how they can serve to improve your client's experience in resolving disputes in the field of securities and lead to a better outcome.

## I. Mediation

*“Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser -- in fees, and expenses, and waste of time.” Abraham Lincoln*

Mediation is the process in which parties engage a neutral third person to work with them to facilitate the resolution of a dispute. The growth of mediation over the past fifteen years has been exponential, a tribute to the success of the process. User satisfaction is high as parties retain control and tailor their own solution in a less confrontational setting that preserves relationships and results in a win/win instead of a win/lose. While not every case can be settled, an effort to mediate is appropriate in virtually any subject matter and any area of the law. The advantages of mediation include the following:

1. ***Mediation Works.*** Statistics have shown that mediation is a highly effective mechanism for resolving disputes. The rate of success through mediation is very high. For example, the mediation office of the U.S. District Court for the Southern District of New York reports that over 90% of its cases settle in mediation. Most cases in mediation settle long before the traditional “courthouse steps” at a significant saving of cost and time for the parties.

2. ***Control by the Parties.*** Each dispute is unique, and the parties have the opportunity to design their own unique approach and structure for each mediation. They can select a mediator of their choice who has the experience and knowledge they require, and, with the help of the experienced mediator, plan how the mediation should proceed and decide what approaches make sense during the mediation itself.

3. ***The Mediator plays a crucial role.*** The mediator’s goal is to help the parties settle their differences in a manner that meets their needs, and is preferable to the litigation alternative. An experienced mediator can serve as a sounding board, help identify and frame the relevant interests and issues of the parties, help the parties test their case and quantify the risk/reward of pursuing the matter, if asked provide a helpful and objective analysis of the merits to each of the parties, foster and even suggest creative solutions, and identify and assist in solving impediments to settlement. This is often accomplished by meeting with parties separately, as well as in a group, so that participants can speak with total candor during the mediation process. The mediator can also provide the persistence that is often necessary to help parties reach a resolution.

4. ***Opportunity to Listen and be Heard.*** Parties to a mediation have the opportunity to air their views and positions directly, in the presence of their adversaries. The process can thus provide a catharsis for the parties that can engender a willingness to resolve differences between them. Moreover, since they are heard in the presence of a neutral authority figure, the parties often feel that they have had “their day in court.”

5. ***Mediation Helps In Complicated Cases.*** When the facts and/or legal issues are particularly complicated, it can be difficult to sort them out through direct negotiations, or during trial. In mediation, in contrast, there is an opportunity to break down the facts and issues into smaller components, enabling the parties to separate the matters that they agree upon and those that they do not yet agree upon. The mediator can be indispensable to this process by separating, organizing, simplifying and addressing relevant issues.

6. ***Mediation Can Save An Existing Relationship.*** The litigation process can be very stressful, time consuming, costly and often personally painful. At the end of litigation, the parties are often unable to continue or restart any relationship. In contrast, in mediation disputes -- such as those between an employer and employee or partners in a business -- can be resolved in manner that saves a business or personal relationship that, ultimately, the parties would prefer to save.

7. ***Expeditious Resolution.*** The mediation can take place at any time. Since mediation can be conducted at the earliest stages of a dispute, the parties avoid the potentially enormous distraction from and disruption of one's business and the upset in one's personal life that commonly results from protracted litigation.

8. ***Reduced Cost.*** By resolving disputes earlier rather than later the parties can save tremendous sums in attorney's fees, court costs and related expenses.

9. ***Lessens the Emotional Burden.*** Since mediation can be conducted sooner, more quickly, less expensively and in a less adversarial manner, there typically is much less of an emotional burden on the individuals involved than proceeding in a burdensome and stressful trial. Furthermore, proceeding through trial may involve publicly reliving a particularly unpleasant experience or exposing an unfavorable business action which gave rise to the dispute. This is avoided in mediation.

10. ***Confidential Process and Result.*** Mediation is conducted in private -- only the mediator, the parties and their representatives participate. The mediator is generally bound not to divulge any information disclosed in the mediation. Confidentiality agreements are often entered into to reinforce the confidentiality of the mediation. Moreover, the parties may agree to keep their dispute and the nature of the settlement confidential when the matter is resolved.

11. ***Avoiding the Uncertainty of a Litigated Outcome.*** Resolution during mediation avoids the inherently uncertain outcome of litigation and enables the parties to control the outcome. Recent studies have confirmed the wisdom of mediated solutions as the predictive abilities of parties and their counsel are unclear at best. Attorney advocates may suffer from "advocacy bias" -- they come to believe in and overvalue the strength of their client's case.

In an analysis of 2,054 cases that went to trial from 2002 to 2005, plaintiffs realized smaller recoveries than the settlement offered in 61% of cases. While defendants made the wrong decision by proceeding to trial far less often -- in 24% of cases -- they suffered a greater cost -- an average of \$1.1 million -- when they did make the wrong decision.<sup>1</sup>

A mediator without any stake in the outcome or advocacy bias can be an effective "agent of reality" in helping the parties be realistic as to their likely litigation or arbitration alternative."

12. ***There are no "winners" or "losers."*** In mediation, the mediator has no authority to make or impose any determination on the parties. Any resolution through mediation is solely voluntary and at the discretion of the parties.

13. ***Parties Retain Their Options.*** Since resolution during mediation is completely voluntary, the option to proceed thereafter to trial or arbitration is not lost in the event the mediation is not successful in resolving all matters.

14. ***The pro se litigant.*** Mediation can be very helpful when a party does not have an attorney and is therefore representing him/herself *pro se*. Court litigation can be very difficult for the *pro se* litigant who is unable to navigate the complexities of the court process and trial. With the downturn in the economy, studies showed that fewer parties are represented by counsel and that lack of representation negatively impacted the *pro se* litigant's case.<sup>2</sup> Dealing with a *pro se* litigant in court can also create difficult challenges for the party that is represented by counsel. However, in mediation, the parties can more easily participate in the process and benefit from the involvement of an experienced mediator.

## **II. Arbitration**

***"Choice- the opportunity to tailor procedures to business goals and priorities- is the fundamental advantage of arbitration over litigation."***<sup>3</sup>

Arbitration is the process in which parties engage a neutral arbitrator or panel of three arbitrators to conduct an evidentiary hearing and render an award in connection with a dispute that has arisen between them. As arbitration is a matter of agreement between the parties, either pre-dispute in a contract as is generally the case, or post-

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<sup>1</sup> Randall Kiser, *Beyond Right and Wrong: The Power of Effective Decision Making for Attorneys and Clients*, (Springer Science + Business Media LLC New York publ.) (2010)

<sup>2</sup> Report on the Survey of Judges on the Impact of the Economic Downturn on Representation in the Courts (Preliminary), ABA Coalition for Justice, July 12, 2010, available at <http://new.abanet.org/JusticeCenter/PublicDocuments/CoalitionforJusticeSurveyReport.pdf>

<sup>3</sup> Thomas J. Stipanowich, *Arbitration and Choice: Taking Charge of the "New Litigation."* 7 De Paul Bus. & Comm. L.J. 3 (2009), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1372291](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1372291)

dispute when a difference arises, the process can be tailored to meet the needs of the parties. With the ability to design the process and the best practices that have developed, arbitration offers many advantages including the following:

1. ***Speed and Efficiency.*** Arbitration can be a far more expedited process than court litigation. Arbitrations can be commenced and concluded within months, and often in less than a year. Leading dispute resolution providers report that the median time from the filing of the demand to the award was 8 months in domestic cases and 12 month in international cases compared to a median length for civil jury trials in the U.S. District Court for the Southern District of New York of 28.4 months and through appeals in the Second Circuit many months longer.<sup>4</sup>

2. ***Less Expensive.*** The arbitration process can result in substantial savings of attorney's fees, court costs and related expenses because the arbitration process generally does not include time consuming and expensive discovery that is common in courts in the United States (such as taking multiple depositions and very extensive e-discovery). Time consuming and expensive motion practice is also much less common.

3. ***More Control and Flexibility.*** In cases where arbitration is required by contract, the parties can prescribe various preferences to suit their needs, such as the number of arbitrators hearing the case, the location of the arbitration and scope of discovery. Once the arbitration is commenced, a party seeking a more streamlined and less expensive process will be better able to achieve that goal than in court where the applicable procedural and evidentiary rules govern. The parties will also have input in scheduling the hearing at a time that is convenient.

4. ***Qualified Neutral Decision Makers.*** The parties can select arbitrators with expertise and experience in the relevant subject matter or that meet other criteria that they desire. Arbitration avoids a trial where the subject matter may not be within the knowledge or experience of the judge or jury.

5. ***Arbitration is a Private Process.*** Arbitrations are conducted in private. Only the arbitrators, the parties, counsel and witnesses attend the arbitration. Confidentiality of the arbitration proceedings, including sensitive testimony and documents, can be agreed to by the parties. In contrast, court proceedings are generally open to the public. In the generally less adversarial context of a private arbitration, ongoing relationships suffer less damage.

6. ***Arbitration provides Finality.*** In court proceedings, parties have the right to appeal the decision of a judge or the verdict of a jury. In contrast, the grounds for court review of an arbitration award are very limited. The award of an arbitrator is final and binding on the parties.

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<sup>4</sup> *Judicial Business of the United States Courts 2009* Table C-5, available at <http://www.uscourts.gov/Viewer.aspx?doc=/uscourts/Statistics/FederalJudicialCaseloadStatistics/2009/tables/C05Mar09.pdf>

7. *Special considerations for international arbitrations.* Party selection of arbitrators ensures that a neutral decision maker rather than the home court of one party decides the case, and allows the parties to select an arbitrator with cross cultural expertise and understanding of the different relevant legal traditions. Of crucial importance also is the enforceability of arbitration awards under the New York Convention, in contrast to the much more difficult enforcement of court judgments across borders.

### **III. Arbitration of Securities Disputes**

Most disputes arising from securities transactions are arbitrated pursuant to the rules of the Financial Industry Regulatory Authority (“FINRA”). Agreements between customers and broker-dealers have a standard arbitration clause requiring arbitration under those rules. All registered representatives, investment advisors and their broker-dealer employers’ are required to sign a “Uniform Application for Securities Industry Registration or Transfer” (Form U-4) which contains an arbitration provision. Disputes between broker-dealers who are FINRA members are also arbitrated pursuant to FINRA rules.

Traditionally, customer disputes were held before a panel of three arbitrators comprised of two public arbitrators and one industry arbitrator. Public arbitrators are defined as persons who do not work in the securities industry or receive 10% or more of their professional income from securities business.<sup>5</sup> In 2008, FINRA started a voluntary two-year Public Arbitrator Pilot Program allowing investors in cases involving only a firm, to have a panel consisting of three public arbitrators, instead of two public arbitrators and one non-public arbitrator.<sup>6</sup> At the end of the two years, FINRA submitted a rule filing to the SEC requesting approval of a rule amendment to allow customers with the option to choose an all public arbitration panel in all cases (involving firms or individual brokers). 75 Fed. Reg. 69,481 (Nov. 12, 2010). The rule proposal is pending comment and approval.

In the interim the pilot program has been extended for another year. The composition of all other disputes will remain unaffected by the proposed rule filing. Disputes between two broker-dealers are resolved with solely industry arbitrators.<sup>7</sup> In disputes between a registered representative and his broker-dealer employer, if the panel has only one arbitrator, she will be a public arbitrator. A three-member panel will have

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<sup>5</sup> FINRA *Regulatory Notice*, published on May 9, 2008.

<sup>6</sup> <http://www.finra.org/ArbitrationMediation/Parties/ArbitrationProcess/NoticesToParties/P116995>

<sup>7</sup> FINRA Rule 13402.

two public arbitrators and one industry arbitrator with a public arbitrator serving as chair.<sup>8</sup>

The FINRA arbitration process follows rules which are readily available online (<http://www.finra.org/ArbitrationMediation/Rules/CodeOfArbitrationProcedure/>). Arbitration pursuant to FINRA rules is an efficient process for resolving disputes. The rules include a discovery guide of the types of documents that must be produced, including lists of documents which must be produced (1) by the customer and (2) by the broker-dealer and registered representative in various types of claims. Most FINRA arbitrations are heard within a year to a year-and-a-half of filing the statement of claim, and awards are issued shortly after the hearings. In 2010, the average resolution time for FINRA arbitrations was within 12 ½ months. For arbitrations that concluded with a hearing, the 2010 turnaround time was 15.1 months.<sup>9</sup>

Arbitration is very useful for disputes in all areas of securities law. Arbitration offers the advantage of arbitrators who are knowledgeable about securities law, as opposed to judges who are likely to be generalists. The parties may also have more detailed information about the backgrounds and securities industry experience of potential arbitrators. As with all other arbitrations, records of proceedings in securities cases are confidential, thus avoiding publication of private business practices and trade secrets. Discovery is also much more limited and discovery sanctions, while permitted, are rarely used. The arbitration process is usually less expensive than litigation as there is much less motion practice, so even though the parties pay a small honorarium for FINRA arbitrators, the total costs can be significantly lower.

#### **IV. Securities Mediation**

Mediation is an effective means of resolving securities disputes. It can be used in all types of securities disputes, including those between a customer and a broker-dealer, an employee and a firm, and between broker-dealers. In mediation the parties and counsel meet with a mediator, explain their positions and discuss common interests in a joint session and may break into private caucuses to discuss the issues and settlement possibilities separately with the mediator. The mediator can work with each side to identify and address its needs and can be helpful in reestablishing working relations between the parties. The mediator can work with the parties to reach a resolution that works for both sides and lessen antagonism through the use of venting, reframing and other mediation techniques.

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<sup>8</sup> Id.

<sup>9</sup> <http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/>

FINRA has a voluntary mediation program, with mediators drawn from a panel of experienced mediators. During the Initial Pre-hearing Conference of a FINRA arbitration, the parties' representatives are advised of the mediation process, in which a mediator facilitates negotiations between disputing parties. They are advised that the mediator's role is to help the parties find a mutually acceptable solution to the dispute.<sup>10</sup>

Securities mediation has the advantage of permitting resolutions beyond simply monetary payments. Customers and registered representatives have the opportunity to present their claim directly to the broker-dealer or registered representative, and sometimes to executives of the broker-dealer. Many of the customers who bring a claim have lost money in the market and are angry. Mediation permits the customer to explain what he or she experienced and why it is improper. This process can often enable the claimant to gain perspective and move on with his or her life. Confidential statements made during the mediation may also result in changes to the broker-dealer's business mode of dealing with and communicating with customers.

Mediation can also provide for resolutions that are not obtainable in arbitration. Examples of such agreements include: a year's free subscription to a broker-dealer's publications, establishment of a new process for handling customer complaints, an apology from the registered representative or the broker-dealer, and expungement of the claim from the registered representative's record.<sup>11</sup>

For example, A registered representative's parents had been killed in a plane crash and she was raised by her aunt and uncle. She invested for them and one of the investments went sour. They cut her out of her grandfather's estate, filed a FINRA arbitration and then agreed to mediate. At the mediation they were in the same room for the first time in over a year. Each side presented their position. The registered representative said that she thought she was giving them a great opportunity by putting them in the IPO and never intended to hurt them. The aunt was very pleased to see her "daughter." After several confidential caucuses, the matter resolved with a payment of money. The mediation also resulted in a family reconciliation, something impossible in an arbitration or lawsuit. While most mediations in this context do not generally involve relatives as this one did, the benefits of mediation are applicable to all mediations.

FINRA mediation occurs in a separate but parallel process with any filed arbitration and does not slow down the arbitration process if the mediation is unsuccessful. An overwhelming majority of FINRA mediations result in resolution. At

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<sup>10</sup> FINRA Initial Pre-hearing Conference Arbitrator Script.

<sup>11</sup> Such consent does not alter the full expungement process required by FINRA rules, including court approval.

FINRA 83% of the cases that go to mediation settle in mediation.<sup>12</sup> For the year 2010, FINRA mediations took an average of 95 days from start to finish.<sup>13</sup>

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<sup>12</sup> <http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/>

<sup>13</sup> Id.