A GUIDE TO THE SECURITES ARBITRATION PROCESS FOR THE PUBLIC CUSTOMER©

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You come home after a long day of work and open your mail. You discover a confirmation from your stockbroker confirming a trade that was never discussed with you. Or suppose, that "sure fire" investment just became the latest bankruptcy statistic or worse. Or you discover to your horror that your stock brokerage account has lost 50, 60 70, 80 or 90 percent of its original value. The next day over lunch your friends at work tell you that you should "do something."

In some cases, just complaining to the brokerage firm will get you some results. In most, however, you will have to file the securities law equivalent of a lawsuit -a NASD or NYSE arbitration. The "cases" are less formal than actual lawsuits, but can still be a difficult and scary nightmare for the uninitiated. This guide will attempt to outline what can be expected from the arbitration process.

I --IDENTIFYING THE CLAIM

Most customer claims fall into one of four categories. Some are easy to spot and others require careful expert analysis and an experienced professional approach.

The easiest claim to identify (though not necessarily the easiest to prove) is the unauthorized trading claim. In this case, the customer knows whether he or she has been consulted about and approved of the transaction in question. Absent the grant of discretionary trading authority, a stockbroker is required to get the customers approval before any transaction is executed. NO contact means no approval; thus, no trade.

The second common type of claim is a suitability claim. Under both NASD and New York Stock Exchange rules, a stockbroker must make sure that any recommendation for the purchase or sale of a stock must be consistent with the customer's financial wherewithal, experience and investment goals. These cases require a careful evaluation of the customer's investment history and financial status as well as a careful review of the customer's entire portfolio to determine whether a specific investment should have been recommended. Certain of these claims are fairly obvious. A retiree with no significant resources and a fixed income should not be asked to put thousands of dollars into the latest .com start-up Company.

A third common claim arises when the broker tells an untruth about an investment to a customer, or conveniently forgets to tell the customer something important about the stock. If a customer relies on these misstatements or omissions, then the brokerage firm and the brokers can be held responsible for any losses that occur. These claims typically also involve high-pressure sales tactics where the broker refuses to take no for an answer. This claim is called misrepresentation and encompasses claims where a customer is not told all of the facts that is needed to make an informed investment decision.

The fourth common customer claim occurs when the broker either receives discretionary trading authority from the customer or convinces the customer to follow the broker's trading advice and then uses that control to cause transactions to occur mainly for the purpose of generating commissions for the broker. These "churning" cases involve a relatively large degree of statistical analysis of the customer's account to calculate turnover rate and commission to equity ratios. Expert analysis is almost always needed in these cases.

If you are successful in proving your claim, then you may recover all or a portion of your losses. In addition, many states have specific securities laws and/or deceptive trade practice statutes that will permit customers to recover a multiple of their damages as a deterrent to improper conduct on the part of brokers. Many of these state statutes also provide for the recovery of reasonable attorneys fees.

Once you have determined that something has gone amiss with your account, the next step is to decide whether to hire a lawyer or go " pro se."

II -- HIRING A LAWYER FOR A SECURITIES ARBITRATION

The primary factor that you will need to consider before hiring a lawyer is the amount of your loss. Obviously, if losses are nominal it may not make sense to hire a lawyer. In many cases where small amounts are at issue, the case will be resolved on the submission of the claim on the papers. In these cases, where there is no hearing, hiring a lawyer to do anything more than help you write a letter (called a statement of claim) is most likely unnecessary.

If substantial sums were involved, however, it would make sense to have somebody with you who is not emotionally involved in the case, who is familiar with the process and who knows the laws involved. Although NASD and NYSE rules permit just about anyone to act as an advocate at arbitrations, most states require that advocate to be a lawyer. In most cases, you will want to be represented by an attorney who has extensive experience with arbitration and especially stock exchange arbitrations.

In selecting an attorney take the time to find out if that lawyer specializes in securities arbitrations. As both an advocate and as an arbitrator, I have seen many examples of lawyers who are not experienced with securities arbitrations fail to spot issues that could have altered the outcome of the case. Unlike the more common types of trial practice, there are unique issues and practice considerations that are not like any other type of trial practice.

Once you make the decision to hire a lawyer, then you will need to negotiate the terms of the representation. Legal retainer agreements generally take one of three forms. In the first and most common, the lawyer is simply paid an hourly fee for service rendered. These fees, depend on where the lawyer lives, and the lawyer's level of experience. Generally, they start at between $150 and $200 per hour. If you hire a lawyer from a large metropolitan area and with extensive experience, expect to pay between $300 and $400 per hour. Obviously, at these rates, hiring a lawyer at hourly rates will only make sense if there is a lot of money involved and you are in a position to pay the lawyer on a continuing basis. If you do hire a lawyer on an hourly basis, you will likely be required to post a retainer to secure services.

The second type of retainer arrangement is known as a contingent fee. With a contingent fee, the lawyer makes nothing unless there is a recovery of money for you. If there is a recovery, then the lawyer

will collect a percentage of the moneys you receive. Generally, if you can get a lawyer to accept a contingent fee, you should expect to have to pay at least 33 1/3 percent of any recovery. Further, unless you are required to pay out-of- pocket expenses as you go a long; you should expect the lawyer to deduct those expenses off the top of the recovery before any fees are calculated.

Recently, a third type of retainer arrangement has developed. Under these retainers, the lawyer accepts a reduced hourly rate in exchange for a reduced contingent fee upon recovery. Generally, the reduced hourly rates should represent at least a fifty-percent discount from the lawyer's normal hourly rate.

Another example of this type of retainer requires the payment of a fixed dollar amount which is then subtracted from the contingent fee upon recovery. For example, assume that a lawyer requires a $10,000 fee against a 331/3 % contingency and the case is settled for $100,000. If expenses for the case amounted to $3,700, the lawyers would receive a total of $21,779 from the settlement ($31,779 less the $10,000 that had already been paid) and the client would receive $73,558. Note that the $3,700 in expenses is deducted from the gross amount of the settlement before any fees are calculated. These modified retainers appear to be gaining in popularity.

Regardless of the type of retainer you agree to, you should expect to be required to advance or at least reimburse out of pocket expenses. Typically, you should expect your lawyer to ask you for the amount of the filing fee for the arbitration in advance. Similarly, you should expect to be required to advance or reimburse copying expenses, expert witness fees and expenses, and travel expenses, not to mention a myriad of other types of potential expenses that are too numerous to list.

III --Preparing and filing the Statement of Claim

Once you have decided to pursue a claim either on your own or with the help of an attorney, the next step in the arbitration process is the preparation and filing of the statement of claim. The statement of claim need not be extremely formal but it should simply and succinctly layout the facts that you think give rise to liability on behalf of the broker .

If you have hired a lawyer, your lawyer will ask you to show him or her all of your trading records. If the lawyer suspects that churning may be an issue, she or he will retain the services of an expert witness who will review the trading history of your account and will prepare a report for the attorney to use in the preparation of your case. Many times, the lawyer will ask you to advance the out of pocket costs of this service. If there was a lot of trading, the preparation of this report could run as much as a $2-3000. In even the simplest of cases, these reports are invaluable and should be obtained as early as possible.

In addition to reviewing your trading history, you should expect your lawyer to review your financial background in some detail. It is important that you cooperate with your lawyer during this process. You will naturally feel that your privacy is being invaded somewhat but the questions that your lawyer will ask you are important ones. Among the types of questions you can expect are questions relating to your education, bank accounts, real estate, other brokerage accounts, inheritances, Individual Retirement Accounts, tax returns, loan applications, mortgage applications, what magazines you subscribe to and what television shows you watch regularly. It may seem odd, but you should expect to be asked much of the same information during cross-examination at your hearing. It is important that you be

completely and totally candid with your lawyer. There is nothing to hide, and nothing to be embarrassed about. By being completely candid with your lawyer, you will only help the prosecution of your case. If you are not completely candid with your lawyer, you may be setting yourself up for failure an otherwise potentially successful claim.

Once the lawyer and possibly the expert have interviewed you, your lawyer will probably submit a demand letter to your brokerage firm on your behalf. This letter will briefly set forth the legal and factual basis of your claim. The purpose of this letter is to give the brokerage firm an opportunity to settle with you before a formal claim is filed. Many times, firms will settle with a client who has retained a lawyer even if the firm has refused to settle based upon a complaint letter from the customer.

In the event that the firm still refuses to settle, the next step is the actual filing of the statement of claim. If you are representing yourself, you do not have to worry about the formal rules of pleading. All you need do is provide a short concise statement of what happened, how you feel you were wronged and the amount that you were damaged. If you have hired a lawyer, your lawyer will prepare the statement of claim. You should review it carefully. If there are any statements that are factually incorrect you must correct them at this time. There is nothing more devastating to a claimant's credibility than to have to admit that an allegation in the statement of claim is not true. If there are allegations that you are not sure of, you should discuss them with your lawyer.

Once you and/or your lawyer are satisfied with the claim, it will be filed with the appropriate arbitration forum. In most cases, that will be the NASD Alternate Dispute Resolution forum. If, however, the respondents are member firms of the New York Stock Exchange, then you may decide to file with the New York Stock Exchange. There are several small difference between these forum, two of which are that the NYSE Filing fees are slightly lower than the NASD's and the NYSE can often schedule hearings within 10 to 12 months while the NASD usually takes 12 to 13 months to schedule hearings.[1]

When you file your claim, you will be required to pay a fee. This fee is calculated on the dollar value you are claiming. The NASDADR web site has an easy to use fee calculator at http://www.nasdadr.com/Arb_Calc/Arb_Calc.htm. You will also be required to sign a form called a uniform submission agreement. A copy of this form is annexed to this document. When you send in your claim remember to send in an original copy and three photocopies of the claim.

[1] The forms necessary to file NASD Arbitration are available at www.NASDADR.com.

IV --The pre-hearing and discovery Process [2]

Once you have filed the claim, the NASD or other forum will send you notice that it has received your claim, and will assign you a case number. All future communication with the NASD will require that case number. The NASD will serve the claim for you on the respondents. Once served, the respondents have 45 calendar days to file a response to your claim. The response should not be a general denial but should set forth any factual disputes and describe any defenses that the respondents may have.

Once the answer is served, the discovery process begins. Under the NASD Code of Arbitration Procedure you will generally be required to produce certain documents, and the firm will be required to produce documents to you. In almost every case, you will be required to produce the following documents. For the most part, these are documents that you should provide your lawyer when you retain one.

1) All customer and customer-owned business (including partnership or corporate) federal income tax returns, limited to pages 1 and 2 of Form 1040, Schedules B, D, and E, or the equivalent for any other type of return, for the three years prior to the first transaction at issue in the statement of claim through the date the statement of claim was filed.
2) Financial statements or similar statements of the customer's assets, liabilities and/or net worth for the period(s) covering the three years prior to the first transaction at issue in the statement of claim through the date the statement of claim was filed.
3) Copies of all documents the customer received from the firm/Associated Person(s) and from any entities in which the customer invested through the firm/Associated Person(s), including monthly statements, opening account forms, confirmations, prospectuses, annual and periodic reports, and correspondence.
4) Account statements and confirmations for accounts maintained at securities firms other than the respondent firm for the three years prior to the first transaction at issue in the statement of claim through the date the statement of claim was filed.
5) All agreements, forms, information, or documents relating to the account(s) at issue signed by or provided by the customer to the firm/Associated Person(s).
6) All account analyses and reconciliations prepared by or for the customer relating to the account(s) at issue. A significant exception to this requirement is that analyses prepared by an expert at the request of your lawyer are subject to a privilege known as the attorney's work product privilege. Generally, you lawyer will only be required to produce those analyses that are intended to be introduced at the hearing.
7) All notes, including entries in diaries or calendars, relating to the account(s) at issue.
8) All recordings and notes of telephone calls or conversations about the customer's account(s) at issue that occurred between the Associated Person(s) and the customer (and any person purporting to act on behalf of the customer).
9) All correspondence between the customer (and any person acting on behalf of the customer) and the firm/Associated Person(s) relating to the account(s) at issue. This does not include communications between you and your lawyer. These communications are covered by the attorney-client privilege.

[2] Although NYSE and NASD rules are very similar, this discussion will focus on the NASD Code of Arbitration Procedure.

10) Previously prepared written statements by persons with knowledge of the facts and circumstances related to the account(s) at issue, including those by accountants, tax advisors, financial planners, other Associated Person(s), and any other third party.
11) All prior complaints by or on behalf of the customer involving securities matters and the firm's/Associated Person(s) response(s).
12) Complaints/Statements of Claim and Answers filed in all civil actions involving securities matters and securities arbitration proceedings in which the customer has been a party, and all final decisions and awards entered in these matters.
13) All documents showing action taken by the customer to limit losses in the transaction(s) at issue.

In addition to these documents, you will be required to produce certain types of documents depending on the type of claim that you have. For example, if you are alleging that certain transactions were unauthorized, you will be required to produce your telephone records to demonstrate whether or not you called you broker at or around the time of the allegedly unauthorized trade. The NASD's discovery guide provides lists of documents that are presumed discoverable for each type of potential claim.

You will not be the only person who will have to produce documents. The firm and the broker will also have to produce documents. You and your lawyer should review the production and review any issues that may crop up. For example, in an unauthorized trading case, the firm's phone records may reveal that you had two conversations with the broker in the ten minutes immediately preceding the transaction. If this happens, you will need to be able to explain what happened in those conversations. Rest assured that the broker will claim that the transaction was discussed with you and that you approved.

While the discovery process is starting, the NASD will be trying to assign arbitrators to your case and schedule a pre- hearing conference. The first step will be the generation of arbitrator lists. The NASD will submit a list of arbitrators to you and ask you to strike any arbitrators you are uncomfortable with for any reason and to rank the remaining arbitrators. If you strike the entire list, then the NASD will generate a new list and you will have no opportunity to rank them. If this happens, the only way you will be able to remove an arbitrator would be for "cause."

You and/or your attorney should review these lists carefully. Take the time to request and review recent awards that the arbitrators may have made. Lawyers, who may have access to more information about the arbitrator than you do, will try to review these awards to determine if there are any trends in the way that an arbitrator resolves cases. Your lawyer may even be able to speak with another lawyer who has had a case in front of a specific arbitrator or may have personal knowledge of an arbitrator. Such insight can be invaluable in determining how to rank arbitrators or whether to strike an arbitrator completely.

Once the parties have ranked the arbitrators, the NASD will review the rankings and appoint a panel. Once the panel is chosen, the NASD will ask the parties to agree on a chair. The chair will be responsible for running the hearing. If the parties cannot agree, then the NASD staff will select the chair.

Shortly after the chair is appointed, the NASD will schedule an initial pre-hearing conference. During this conference, which is usually done via a conference call, the hearing dates will be scheduled. Make sure that your attorney is aware of ALL personal plans and commitments that you have. Once hearing dates are set, it is very expensive and time consuming to reschedule. In addition to setting hearing dates, the chair will set discovery deadlines, motion deadlines and deadlines for the submission of briefs regarding legal issues on which the panel may require education, or on issues which the parties may want

to bring to the panel's attention. Finally, the panel will likely set aside a date for a final pre-hearing conference. This conference will be used to resolve any outstanding discovery and scheduling issues prior to the actual hearing.

Twenty days before the hearing, the parties are required to exchange witness and exhibit lists.

V --Preparing for and attending the hearing

Ideally, preparation for the hearing begins before the statement of claim is filed. Your first interview with your lawyer is the beginning of the preparation of your testimony. It is when your lawyer first begins to think of what facts need to be proven and what issues will need to be addressed.

As discovery proceeds, your lawyer will continue discussing things with you on an occasional basis. As issues are identified, your lawyer may ask you to explain certain facts or events from your perspective. Each one of these conversations should be viewed as part of your preparation for the hearing.

If you are representing yourself, your review of the documents which the firm produces and which you produce to the firm, will help you prepare for the presentation of the case. As you review these documents, you should ask yourself how you would use these items to poke holes in your story. As holes are identified, you should think of responses to the obvious questions. As you do this, it is important that you evaluate each tidbit of information, each document, without emotion.

If a lawyer represents you, your lawyer will prepare the case for presentation to the panel. As the hearing approaches, your lawyer will want to spend a significant amount of time with you going through your testimony. These meetings, which may well include a dry run through your testimony, are essential to your presentation of the case. During these meetings, you and your lawyer will decide what exhibits will be presented to the panel and in what order. Your lawyer will decide which witnesses to call and in what order . These meetings may also include a dry run of your cross-examination. During this dry run your lawyer will play devil's advocate and question you as if representing the respondents. Your responses and your behavior during these dry runs are important for several reasons. First, it will alleviate the shock of the actual cross-examination. Second, it will identify areas of inquiry which will need addressing on your direct. Third, it provides your lawyer an opportunity to explain to you certain techniques for handling the different styles of cross-examination.

During the weeks immediately before the hearing, you will also begin preparing your exhibits. If you are representing yourself, you should consider consolidating the documents you want to present to the panel in a set of one or more binders. If a lawyer represents the respondents, you might be able to have that lawyer agree to put all of your exhibits together with the respondent's exhibits in a single binder. Since documents are not going to change during the course of a hearing, there is no reason not to do this. Indeed, arbitration panels, which are often swamped by multiple copies of the same document, tend to appreciate the "joint" submissions. If counsel represents you, do not be surprised if the lawyers agree to a joint exhibit book and agree to share the costs of copying. Believe it or not, in the long run a joint exhibit submission will save you money.

Once the exhibit book has been completed and all the hearing preparations are finished, the hearing will occur. Most arbitrations take place in a conference room setting. The panel will sit at one end of the table, you and your lawyer will sit on one side and the respondents will sit on the other side. The

panel will introduce themselves at the start of the hearing. In most cases no member of the panel will acknowledge you outside of the hearing room. The reason for this is that the panel is not supposed to have any communications with either party in the absence of a representative of the other parties. Indeed, do not be surprised if the panel asks you to leave the room if you are the only person left besides the panel.

When taking your seat at the table, your lawyer should sit closest to the panel. Any expert witness who is appearing with you should sit between your and your lawyer. You must understand that once the hearing starts, communication with your lawyer will only take place during breaks and through the passing of notes. For that reason, you should have with you an ample supply of post-it notes.

The chair of the panel will control the record. Most of the time, the record consists of a tape recording of the proceeding. As the hearing begins, the chair will make sure that everybody is introduced and will ask the panel if any additional disclosures have to be made. Once all preliminaries are dispensed with, the chair will ask the parties to proceed with opening statements. Claimants, who bear the burden of proof, always go first.

The opening statement should be a brief recitation of what you intend to prove. It should summarize the facts and the theories on which you claim you are entitled to an award. You should not go into a detailed discussion of the facts, but you should educate the panel as to what the case is about.

Once opening statements are finished, testimony begins. Unless the panel has already sworn all of the witnesses, each one will be sworn as they take the stand. If you do not have a lawyer, you first task will be to show the panel what happened. A narrative story will suffice and is easier to deliver than asking yourself questions and then answering them. Once you have completed your testimony the other side will be allowed to "cross-examine" you. You should remember that the firm's lawyer has a job to do and although the questioning might be aggressive and may seem personal --it is not. You should not take any of the questions asked of you as a personal attack. What the lawyer is trying to do is damage your credibility. If you do not allow yourself to get caught up in emotions, you can remain focused on your case and the facts. Unless you have made up your story, there will be little that respondent's lawyer can do to directly damage your credibility.

If a lawyer represents you, your lawyer will have decided in what order to call witnesses. When you are called, you should listen carefully to your lawyer's questions and answer them fully. The same holds true on cross-examination with one significant caveat. Most cross-examination questions can be answered with a yes or no answer. If that is the case, you should answer the question yes or no as appropriate. Volunteering information on cross-examination will almost always allow the respondent's counsel a chance to demonstrate conflicting information in your testimony that will then be used to demonstrate that your entire testimony is not credible. Rest assured that during the cross-examination your attorney will be taking notes and will take you through damaging areas on redirect. It is on the redirect that you should explain your cross-examination.

At any time during your testimony, a member of the panel may ask you a question. Answer those questions fully. The panel member has identified an issue that they want to probe and there is nothing to be gained by appearing evasive.

During the testimony of other witnesses, you should pay keen attention to what is being said. Do not be afraid to pass notes to your lawyer and expert, especially with respect to testimony that you believe

is completely false. One word about these notes, do not pass them to your lawyer in the middle of his examination of a witness. Wait for a break or some other good time.

Once your testimony is complete, you or your lawyer will have a chance to call other witnesses who can support your case. If you don't have a lawyer, you will have to question these witnesses. Before you call them, you should outline the areas that you want that witness to cover. Panels will give you significant leeway in questioning witnesses, but their patience can be tested. Try to get your points out quickly but make sure that you cover everything you want.

Once the claimant has completed presenting their case, the respondents will put on their case. You or your lawyer will have to conduct the cross-examination of the respondents' witnesses. The goal of any cross-examination is to discredit the witness by demonstrating inconsistencies in the testimony. Small inconsistencies can add up. Rarely will the smoking gun come out on cross-examination. In most cases, you should be able to demonstrate one or two inconsistencies that you will use in your closing argument.

Once both sides have rested, you may be given the opportunity to present rebuttal testimony. Rebuttal testimony should be limited to addressing' issues raised during the respondent's case. Do not present rebuttal testimony unless that testimony will be compelling and cannot be challenged.

Once all testimony has been concluded, the parties will be given the opportunity to sum up. Again, the claimant will usually go first, then the respondent and then the claimant will be given the last word. Claimant may, however, reserve their entire closing for rebuttal. This would force the respondent to present their closing argument first and then the claimant would close. As a practical matter, there is no reason for the claimant to insist that the respondent close first.

Once closing arguments are complete, the panel will close the record and excuse the parties. Technically, the record remains open until the award is tendered. Except for proof of legal fees, rarely is any additional evidence presented to the panel after the close of the hearing.

VI --The award

Usually within 30 days of the last hearing session, the panel will issue its award. You should not expect the award to explain the reasoning behind the award. Similarly you should not expect the award to make any specific findings. Indeed, panels generally avoid making specific findings unless there is a specific request to do so. The NASD will mail the award to the parties.

VII-- What happens after the award is issued

Once the award is issued, the respondents have 30 days in which to satisfy any award. As a practical matter however, if a respondent who has an award issued against them tells the NASD that they intend to seek review of the award, the NASD will not entertain a complaint that an award has not been honored until after the statutory period for seeking review has passed. Usually, parties who have lost an arbitration have 90 days in which to seek review of an arbitration award.

In the event that you are faced with a respondent seeking review, you will need to oppose the application in court. The good news is that arbitration awards are extremely difficult to overturn. Thus, rarely do respondents bother filing an application to vacate an arbitration award.

Occasionally, an award may have a defect that you will want corrected. To do that you or your lawyer should file an application for reconsideration with the NASD before asking to have a court modify an award. This is usually done when there is a mathematical or technical error in the award. If the arbitrators refuse to modify the award on their own volition, then you will need to file a motion to modify the award in court. As is true of the application to vacate an award, you will need to file this application within 90 days of the final award.

VIII -- Settlement Discussions and Mediation

No guide to the arbitration process would be complete without at least mentioning the fact that most cases settle before hearing. Indeed, of the approximately 6,000 or more cases that are filed each year with the NASD and NYSE, only about 1,000 actually go to hearing. The remainder of these cases are settled either through negotiation between the parties or through mediation.

The NASD has a very successful mediation program. In mediation, an independent third party assists the parties to a dispute in reaching a settlement agreement. The parties are able to pick the mediator and will be provided with his/her background. Mediators are usually experienced attorneys and arbitrators who can offer the parties an experienced objective perspective of the case. Settlement agreements reached through the NASD's mediation program are binding and the member of the NASD is required to honor its terms. The failure to honor a mediation settlement can result in the summary suspension of the brokerage firm's membership in the NASD.

Regardless of whether you negotiate directly or use a mediator, it is important to remember that settlement negotiations are very much a give and take proposition. In negotiating a settlement you must always keep in mind the fact that there are no guarantees in litigation and that there is always a chance that the arbitration panel will rule against you. For that reason, if you are serious about settling your case you should be prepared to accept something less than the full amount of your claimed damages.

CONCLUSION

This guide is not intended to be a handbook to the arbitration process and is certainly not to be construed as legal advice nor is it to be construed as the solicitation of legal representation. It is intended to provide persons interested in the arbitration process with an introduction to the process and some ideas as to what should be expected as their arbitration proceeds.