

The Securities Arbitration Process

by [Drew Clayton](#), Securities Attorney

Most disputes between investors and brokerage firms are resolved by arbitration, instead of a lawsuit in court. This is because most brokers require their customers to sign agreements at the time accounts are opened requiring arbitration of any disputes. Most investors are unaware they have waived their right to a trial in court at the time they sign these "customer agreements." Although securities disputes may sometimes be resolved by means of a traditional lawsuit in court, this discussion will focus on the more commonly-used arbitration procedure. For present purposes, it will suffice to state that court litigation is more expensive and time consuming than arbitration, although it presents certain procedural advantages which can be the topic of further discussion between us, if necessary.

Securities arbitration is similar to a court proceeding in that it is started by the filing of a legal pleading setting forth the factual and legal grounds for the claim. This is known as a "statement of claim." The investor pays a filing fee to the securities arbitration forum, the amount of which is determined by the size of the claim. For claims larger than \$25,000, the initial filing fee and "hearing session deposit" (for arbitrator compensation) may range from \$600 to \$2,250, depending upon the size of the claim. The defendants (called "respondents" in arbitration) are ordinarily required to file an "answer," which sets forth their factual and legal defenses. Once the parties have filed their initial pleadings, they engage in a process known as "discovery." Discovery in securities arbitration ordinarily involves requests by attorneys for both sides for documents and other information that may lead to evidence supporting the claims and defenses.

In order to bolster their defense, brokers are usually entitled to "discover" investors' tax returns, other brokerage account statements, financial statements and other documents and information investors often construe as invading their privacy. However, once an investor files a claim alleging, for instance, that the securities at issue were too risky given the investor's financial circumstances, an examination of that investor's financial circumstances and investment history is relevant to the defense.

Approximately 12 to 18 months after the statement of claim is filed, a trial, known as a "final arbitration hearing," is conducted. Three arbitrators are assigned to hear securities cases where more than \$50,000 in damages is claimed. One of the arbitrators works in the securities industry; the other two arbitrators on the "panel" are not affiliated with the securities industry. The arbitrators are paid by the parties, and generally receive \$300 per hearing session (which is a four hour block of time). Chairpersons receive an additional \$125 per day. Most final arbitration hearings take two to three days. The final arbitration hearing, which ordinarily occurs in a conference room, resembles a trial in that the investor's attorney presents the case through testimony and introduction of documents. Depending upon the facts of a case, the investor may call an expert witness to help explain the case to the arbitration panel. Once the investor's part of the case has been presented, the defense presents its witnesses and documents. All witnesses are subject to cross-examination by the opposing attorneys. They may also be questioned by the arbitrators.

At the conclusion of the case, the arbitrators confer to reach a decision. Their decision, known as an "award" in FINRA proceedings, is supposed to be announced in written form within 30 business days from the conclusion of the final hearing. Arbitration is intended to be final and binding; therefore, appeals are granted only in extremely limited circumstances. Arbitrators may dismiss a claim outright, or they may award an investor money "damages" and attorney fees; in rare cases, punitive damages may be awarded. Although it is hoped that the

arbitrators will "follow the law," their decisions will not be reversed unless they act in "manifest disregard of the law." In any event, in order to make an arbitration award enforceable by a court, the parties may elect to petition a court to "confirm" an arbitration award.

The vast majority of securities arbitrations are presently administered by the securities industry's self-regulatory body, the which is the [Financial Industry Regulatory Authority](#) ("FINRA"). The [American Arbitration Association](#) also provides securities arbitration services, although most brokers will not agree to arbitrate outside of a securities industry forum.

Settlements

Given the inherent uncertainty of the arbitrators' decision, parties often seek a settlement of meritorious cases before a case is decided by the arbitration panel. The timing of settlement is impossible to predict. Some cases settle before a statement of claim is filed; other cases settle after all of the testimony and evidence has been presented. Settlement almost invariably represents a compromise of both parties' positions. Investors may be encouraged to settle for less than they lost; brokers may settle for more than they may have intended at the outset of a case.

FINRA has instituted a mediation program to encourage settlement. Mediation is available through other sources as well. In mediation, a neutral third person, who is paid by the parties, evaluates the case and encourages the parties to reach a settlement. Attorneys for the parties play an active role in presenting each side's positions to the mediator. The parties do not testify in mediation, and all discussions are deemed confidential and privileged, as is true of all settlement discussions. Depending upon the facts of a particular case, mediation may not be advisable until discovery has been completed. Mediation it is an alternative means of resolving disputes that helps the parties by avoiding the "all or nothing" risks of turning the final decision over to the arbitrators.

Attorney's Fees & Costs in Securities Arbitrations

Investors are naturally concerned about the expenses of arbitration. Although every case is different, the routine securities arbitration case ordinarily requires at least 90 to 120 hours of an attorney's time to review and analyze a case (3-5 hours), prepare and file a statement of claim (10-12 hours), engage in the discovery process (15 hours), participate in anticipated discovery disputes with opposing counsel (5 hours), conduct a pre-hearing conference with the arbitrators (5 hours), interview prospective witnesses (5-10 hours), prepare witnesses for testimony (10-15 hours), prepare hearing exhibits (3-5 hours), and participate in a two to three day securities arbitration final hearing (24 to 36 hours). However, certain cases can take considerably more time to prosecute. For example, if the respondents refuse to produce discovery, additional legal proceedings may be required in order to obtain such information. There are many other circumstances, sometimes beyond the control of the investor's attorney, which can result in the expenditure of considerable additional attorney time. In fact, it is not unusual for some cases to require more than 200 hours of an attorney's time.

Hourly Fees - On an hourly fee basis, assuming an average rate of \$400 per hour, you should assume legal fees for an ordinary proceeding will cost at least \$36,000 to \$48,000 for a case concluding with a three-day arbitration hearing. Of course, if a case settled earlier in the process, the legal fees would be less. Approximately one-half of the attorney's time estimated above is expended within the last 60 to 90 days of the arbitration process. Clients always have the right to pay attorneys on an hourly basis, if that is the client's desire.

Contingency Fees - In certain cases, a contingency fee arrangement might be possible. In a contingency fee contract, the attorney receives a percentage of the recovery. If there is no recovery, the attorney does not receive a contingency fee. Of course, the client benefits by not having to pay the legal fees that would otherwise be incurred, win or lose, in an hourly fee arrangement. Contingency fee cases will only be considered by an attorney where a sufficient recovery is contemplated to offset the attorney's additional risk of being paid for his investment of substantial time in such cases. If a case results in a substantial recovery, the attorney receives a proportionate fee. The percentage of the contingency fee varies depending upon the attorney's assessment of the risks posed by the representation, and the client's willingness to share in the recovery. For many clients, the only feasible way to afford the costs of legal representation is to find an attorney who will accept the case on a contingency fee basis.

"Hybrid" Fees - A "hybrid" fee arrangement may also be possible. In this situation, the attorney may charge a lower hourly rate in addition to a lower contingency fee percentage. For example, this type of fee arrangement might be appropriate where the merits of a case are strong, but there are doubts as to whether the broker would be capable of paying an award or offering a settlement.

Fee Retainers - Attorneys often charge a "retainer," regardless of the fee arrangement. A retainer, which is ordinarily a lump sum payment by the client at the outset of representation, and possibly required at other times during the representation, may be applied against hourly billings, and/or it may serve to reduce the risks of representation in a contingency or hybrid fee contract. As each client's situation is different, so are the retainers required by this and other law firms. In addition to fee retainers, law firms often require clients to make cost deposits to cover the anticipated costs of postage, long distance telephone calls, expert witnesses, filing fees, arbitration fees, and other items.

Costs - The following is a very rough estimate of the costs of a routine securities arbitration proceeding requiring one pre-hearing conference with three arbitrators and a two to three day final arbitration hearing:

- Filing Fees - \$600 - \$2,250
- Arbitrators Compensation - \$3,000 - \$4,000
- Expert Witnesses - \$3,000 - \$15,000
- Hearing Exhibits - \$500
- Long Distance Telephone/Fax Charges - \$50 - \$100
- Photocopying Charges - \$1,000 - \$2,000

These costs can vary widely depending upon whether and when a case settles. For instance, if a case settles before a final arbitration hearing, there may be little or no arbitrator compensation due. Expert witnesses usually charge for most of their time in the month or so prior to the final arbitration hearing. Therefore, if a case is resolved well before that time, it is possible that expert witness costs may be minimized, or avoided altogether.

Recovery of Attorney's Fees and Costs - Ordinarily, attorney's fees and costs will not be identified as a separate component of any settlement reached with a broker. If a case does not settle and is instead decided by the arbitrators, they may decide that the prevailing party is entitled to seek an award of attorney's fees and/or costs from a court. At this time, Florida law states that only a court may award attorney's fees in a separate legal proceeding following the arbitration itself, unless all parties expressly agree that the arbitration panel may award fees. However, attorney's fees and costs are not awarded by the arbitrators in many cases, and it is by no means certain that a court will award some or all of the fees to the winner in a securities arbitration case. Therefore, it is impossible to predict whether an award of attorney fees will be made in any particular case.

Pro Se Representation - Given the costs of legal representation, some investors desire to represent themselves. Such people are known in the legal profession as pro se parties. It is rarely advantageous for a novice to represent himself. Most brokerage firms retain very capable and experienced attorneys to represent their interests. Investors will be expected to carry the burden of proof in their cases, whether or not they are represented by counsel. Unfortunately, in the absence of legal representation, pro se parties are often incapable of evaluating the strengths and weaknesses of their cases, or in presenting the facts and law in a persuasive manner.

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***Drew Clayton** is a shareholder at Icard Merrill with a practice focused on securities arbitration and litigation. Drew has been involved in hundreds of securities-related disputes during his 31-year career, and has not only represented customers in cases against financial advisors and brokerage firms, but investors in closely-held businesses, securities industry employees in disputes with their former employers, and in regulatory proceedings initiated by state and federal regulators as well as the Financial Industry Regulatory Authority.*



Drew Clayton, Shareholder
phone // 941.366.8100
fax // 941.366.6384
dclayton@icardmerrill.com