Keep it Dark

by Richard A. Roth

Registered Rep.
The Source for Investment Professionals

April, 2005

The NASD historically has resisted explaining its arbitration rulings. Though it has softened that stance somewhat, reps should not expect any major changes.

Arbitrations are designed to be the final word in disputes between investors and the firms and reps that serve them. Thus, it is not surprising that when an NASD arbitration panel hands down a ruling, it measures its words carefully. Very carefully. A typical ruling might read like this: "Respondent must pay Claimant $55,000 as compensatory damages and $500,000 in punitive damages."

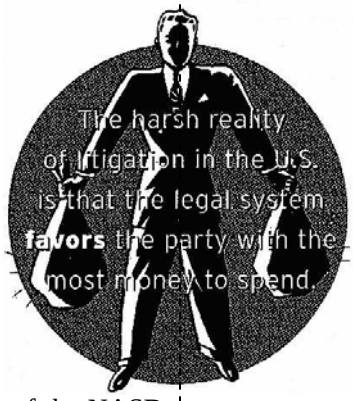
That's it. No explanation, no elaboration, no detail about how the Panel reached its conclusions or its award figures. The NASD does not want to invite further litigation in the matter, and by withholding specifics it avoids providing fodder for appeal.

Good for the Goose

This tight-lips routine might be a little hard to swallow for a rep or a firm who feels wronged in the arbitration process. It's understood that anyone who works as an "associated person" for an NASD broker/dealer must submit to NASD rulings. But in cases involving big awards and allegations of heinous misconduct, it would seem appropriate for the involved parties to receive some sort of window into the arbitration panel's reasoning.

Indeed, the NASD this year has recognized the inherent lack of confidence in arbitration awards. On Jan. 27 it announced that its board of governors approved an amendment to the NASD code of arbitration procedure. The amendment would create a monumental shift in arbitration law by giving customers arbitrating disputes against brokers and/or b/ds the right to request that an arbitration panel issue a written explanation of its award.

That takes care of clients' need for some transparency, but what about the firms and their reps? On its surface, the amendment appears to be a step in the right direction, if only because any requirement of elaboration is a good thing. But why would the NASD not give the right to request a written explanation to all of the parties to the arbitration? Chairman and CEO Robert Glauber says the amendment will "increase investor confidence in the fairness of the NASD arbitration process." But why should the confidence of b/ds and reps in the "fair-ness of the NASD arbitration process" be any less important? Isn't the purpose of arbitration (and the legal system in general) to be fair to all of the parties?



If the Suit Fits

The answer may lie in the possibility that "investor confidence" is not the whole story.

The harsh reality of litigation in the U.S. is that the legal system favors the party with the most money to spend. One popular strategy for the wealthier party in litigation is to pursue every available legal avenue, in hopes of winning a battle of attrition by exhausting the financial resources of the opposition. In a battle between a brokerage firm and a client, it's not hard to imagine the firm playing this sort of hardball. Since explanations of arbitration rulings could help fuel counteractions by firms, the NASD is reluctant to provide them. Simple as that.

In and of itself, however, this reasoning does not justify denying brokerage firms the same rights afforded to their opponents in a legal battle. On its face, the amendment is one-sided and inherently unfair to b/ds. Though one function of the NASD is to police its member firms and protect investors, another of its functions is to provide a fair and just arbitration forum for dispute resolution. After all, member firms of the NASD are required to submit all disputes between member firms, associated persons and customers to arbitration. The NASD should protect the sanctity of the process by ensuring that all parties are treated equally and fairly. While the amendment is a good start in furthering the rights of the parties and advocating a reduction in the need for future arbitration, it must go further by granting the same right of written rationale, not just to customers, but to b/ds as well.

Richard A. Roth is founder of the The Roth Law Firm in New York City, which specializes in securities law. rich@rrothlaw.com.

Jordan Kam, an associate at The Roth Law Firm, contributed to this article.