# The Brokers Strike Back

## They're dragging their feet in investor cases and suing ex-customers for damages

Wall Street is sending a tough message to investors: Beware of suing your brokers -- they might just sue you back. Brokerage firms are playing hardball with investors who have filed a pile of arbitration claims since the tech stock bubble burst in 2000. Many are dragging their feet in producing documents requested by investors. Others are neglecting to pay awards if they lose or, if they win, suing investors for costs. "Cases that would have settled quickly a few years ago are being tried to the bitter end," says Charles W. Austin Jr., a Richmond (Va.) securities lawyer and president of the Public Investors Arbitration Bar Assn., an organization of investors' lawyers.

Kimberly C. Marcucci, a 47-year-old artist with a day job as a manager at a motorbike dealer in Anchorage, Alaska, ran into this resistance after she filed a claim in January, 2003. She alleged that her broker at Merrill Lynch & Co. lost her approximately $100,000 nest egg in part by plowing much of it into volatile tech stocks. Merrill delayed providing certain documents requested by her lawyer during the discovery phase despite an order from the arbitration panel.

Merrill paid dearly for its tardiness. Last January arbitrators ordered it to pay Marcucci $52,000 for failing to produce documents in a timely fashion -- on top of $40,000 in compensation for the money she lost. And on July 19, Merrill was one of three firms, with Morgan Stanley and Citigroup each fined $250,000 by the NASD for failing to produce documents in a total of 20 cases, including Marcucci's, from 2002 to 2004. Merrill spokesman Mark Herr notes that the firm's volume of arbitration cases tripled over the period, that the cases cited are less than half of 1% of the arbitrations the firm defended, and that it did provide hundreds of documents in the Marcucci case alone. "This must be kept in perspective," he says.

Still, such aggressive tactics are raising troubling questions about the arbitration system. Since the late 1960s most brokerages have required investors to agree to take any dispute to arbitration panels instead of to court. The NASD, which regulates brokers and runs most of the panels, says the system is "faster, fairer, and less expensive" for investors than going to trial. In the early days investors sometimes simply wrote the panel, and the firm responded by mail.

Now it's getting harder to tell the difference between an arbitration and a trial. Even in arbitrations, the parties often fire off flurries of motions, delays are becoming endemic, and batteries of lawyers are in attendance. "Arbitration is still a 100-yard dash compared with a trial in terms of how soon you get before a judge and jury," says New York securities lawyer Bill T. Singer. "But once you're there, they often take the same amount of time." The NASD says arbitration cases that go to panels now take a record 17.6 months on average from start to finish, up 3% from last year.

Firms are fighting back in large part because damages are soaring. Many are sick and tired of paying out on claims they often regard as frivolous. Brokers shelled out $162 million in arbitration awards to investors last year. That may be peanuts compared with the billions that top firms earn each year, but it's a lot to hundreds of smaller brokerages. It's also more than double the $76 million awarded in 2000 and only slightly less than the record $163 million paid in 1998. Damage awards could set a new high this year: By June 30, securities firms had already been ordered to pay $109 million to their customers, according to the NASD.

Not all investors are angels, either. Since January, arbitration panels have fined six investors for abusing rules requiring them to hand over documents without delay. In the same period, they have cited 16 firms for the same reason. "Almost every case I handle now involves a discovery dispute on both sides," says Mark J. Astarita, a New York lawyer who represents both investors and firms.

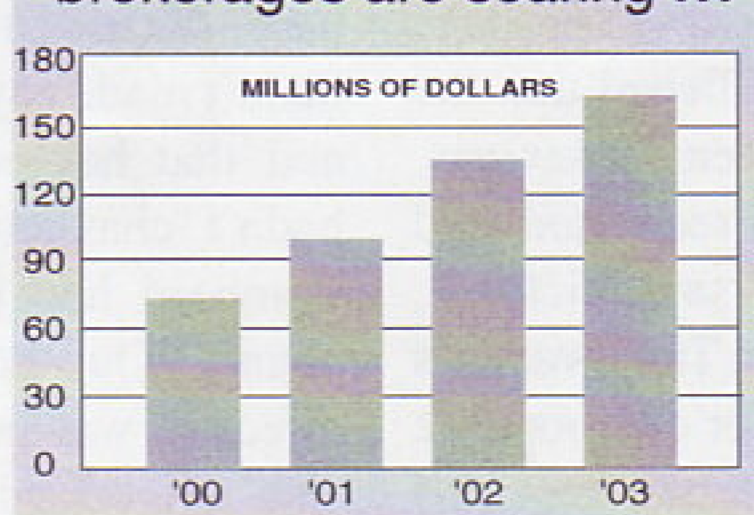
### "FRIVOLOUS CASES"

Faced with thousands of claims, firms argue that their tougher stance is fair play. They often feel beset by former customers who refused to accept the risks of investing in the market and then try to recoup their money by blaming their brokers. That's easier to do now because, in the wake of the tech bust, personal-injury lawyers started taking on securities cases in return for a share of any award or settlement they win. "Brokerages are trying to weed out frivolous cases by forcing customers to accept some risk," says **Richard A. Roth**, a New York lawyer who represents firms and has won fees for them.

Some firms are going after

**PLAYING HARDBALL**

Arbitration awards against brokerages are soaring ...




... so firms are starting to react by:

**FAILING** to supply documents requested during discovery

**SUING** losing plaintiffs to recoup legal costs

**REFUSING** to pony up arbitration awards

Data: NASD, BusinessWeek

ERIC HOFFMANN/BW

**MARCUCCI**
Her case against Merrill was hard-won

CLARK JAMES MISHLER

investors who break arbitration rules. In January a panel awarded Birmingham (Ala.)-based SouthTrust Securities $17,511 in legal expenses and damages after an investor failed to comply with two orders to produce certain documents. He had alleged that the firm lost $142,145 of his retirement savings. "I never got the documents I requested, and I couldn't understand why," says Victor L. Hayslip, SouthTrust's lawyer. The investor's lawyer, James Richard Hooper of Hooper & Weiss in Orlando, did not return repeated calls from BusinessWeek.

Other firms are winning damages by arguing that a claim was merely frivolous. In July, 2003, a panel ordered an investor to pay Baltimore-based Lombard Securities Inc. $46,225 in punitive damages, attorney fees, expenses, and interest for her "reckless, malicious, grossly negligent behavior." Her lawyers alleged that the firm made excessive and improper trades in a claim withdrawn later in 2001. In 2003, an NASD panel, responding to a counterclaim filed by Lombard, decided that she hadn't made any trades and that her portfolio hadn't changed while Lombard had her account. "Our board of directors was outraged and authorized us to fight this case as a matter of principle," says Daniel T. McHugh, Lombard's CEO. One year later, Lombard says it has not received a penny of the damages and fees. Manchester, (N.H.)-based McLane, Graf, Raulerson & Middleton, which represents the investor, says the attempt to enforce the award is pending in a court in Massachusetts and the award was made without any representative present on behalf of the investor. The investor's law firm says neither it nor the investor was served Lombard's claim, although the arbitration-panel ruling says otherwise.

**Arbitration can be as bitter and prolonged as a normal court battle**

The NASD has started cracking down on some brokers' tactics. "Since investors depend almost exclusively on the arbitration system, anytime we see discovery abuses where arbitrators see fit to levy sanctions, that is an area of increased concern to us," says Barry R. Goldsmith, the NASD's executive vice-president and director of enforcement. The NASD has temporarily suspended 122 brokers and 23 firms since 2001 for failing to pay arbitration awards. In April it charged Ann Arbor (Mich.) broker Sigma Financial Corp. and its president with violating arbitration procedures by suing a couple who had won an arbitration award against the firm. Sigma says it followed advice of counsel and that there is a difference of opinion that it is discussing with the NASD. BusinessWeek has learned that the Securities & Exchange Commission, which oversees the NASD, has approved two changes in NASD bylaws that will enable it to prevent brokers who leave the securities industry from reentering if they have failed to pay an arbitration award or settlement.

### DOUBLE WHAMMY

**Some experts worry** that the NASD's tough line could have an unintended consequence by building momentum for dismantling the arbitration system. Some firms may "think twice about the relative benefits of industry arbitration," says Samantha Rabin, senior editor of Securities Arbitration Commentator, an arbitration-support service in Maplewood, N.J. "Adding regulatory sanctions to what the arbitrators have already done imposes a double whammy on brokerage firms."

A total breakdown of the arbitration system isn't likely, but pressure to improve it is mounting. If investors once again had to go to court to pursue claims, proponents of arbitration argue that lawyers would be the big winners. Plaintiffs' lawyers and their clients who believe the panels too often favor the firms over the investors say the investors would come out ahead. Either way, if the system is to survive, it needs to be above reproach. And it won't be if both sides continue to bend the rules to the breaking point.

*- By Emily Thornton in New York*