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**WHEN PERCEPTION CHANGES REALITY: AN EMPIRICAL STUDY OF
INVESTORS' VIEWS OF THE FAIRNESS OF SECURITIES ARBITRATION***

Jill I. Gross[†] & Barbara Black^{††}

Arbitration in securities industry-sponsored forums is the primary mechanism to resolve disputes between investors and their brokerage firms. Because it is mandatory, participants debate its fairness, and Congress has introduced legislation to ban pre-dispute arbitration clauses in customer agreements. Missing from the debate has been empirical research of perceptions of fairness by the participants, especially investors. To fill that gap, we mailed 25,000 surveys to participants in recent securities arbitrations involving customers to learn their views of the process. The article first details the survey's background, explains the importance of surveying perceptions of fairness, and describes our methodologies, procedures, and survey error structure. We then present our findings, including our primary conclusions that (1) investors have a far more negative perception of securities arbitration than all other participants, (2) investors have a strong negative perception of the bias of arbitrators, and (3) investors lack knowledge of the securities arbitration process. We also offer several explanations for these negative perceptions. We conclude that customers' negative perceptions transform the reality faced by policy-makers and mandate reform of the process, including the elimination of the industry arbitrator requirement and further public deliberation on the value of the explained award.

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I. INTRODUCTION

For the past two decades, arbitration in forums sponsored by the securities industry¹ has been the primary mechanism² for the resolution of disputes among investors, brokerage firms and brokers.³ As a result of the virtually mandatory nature of the process,⁴ participants have debated its fairness despite many improvements over the years. Many investor advocates argue that securities arbitration is unfair, inefficient, expensive, and biased towards the securities industry.⁵ The securities industry, on the other hand, contends that the arbitration process works well, is faster and less expensive than litigation, and is fair to all the parties involved.⁶

The United States Congress has taken a recent interest in securities arbitration. In July 2007, both Houses introduced legislation to declare unenforceable pre-dispute arbitration agreements (PDAAs) in consumer contracts.⁷ Senator Feingold, the bill's sponsor in the Senate,

¹ Until mid-2007, the National Association of Securities Dealers, Inc. (NASD) and the New York Stock Exchange (NYSE) ran separate arbitration forums that handled a combined 99% of all securities arbitrations in the country. On July 30, 2007, NASD and NYSE Regulation, including their respective arbitration forums, consolidated and formed the Financial Industry Regulatory Authority (FINRA). See FINRA Press Release, *NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority – FINRA* (July 30, 2007), available at <http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P036329>. FINRA now operates the largest dispute resolution forum in the securities industry. See *What is FINRA Dispute Resolution?*, <http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/WhatIsDisputeResolution/index.htm> (last visited February 14, 2008).

² Mediation is also utilized, if all parties consent. See Jill I. Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, 21 OHIO ST. J. ON DISP. RESOL. 329 (2006).

³ In the late 1980s, the Supreme Court overruled prior law (*Wilko v. Swan*, 346 U.S. 427 (1953)) and held that brokerage firms could enforce pre-dispute arbitration agreements in brokerage account customer agreements even as to federal securities claims. See *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987).

⁴ See *The Securities Arbitration System: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 109th Cong. 13–14 (2005) [hereinafter *2005 Hearing*] (statement of Constantine Katsoris, Wilkinson Professor of Law, Fordham University School of Law) (testifying that *McMahon* “virtually transformed” securities arbitration “from a voluntary procedure to a mandatory one”).

⁵ See Statement of the Public Investor Arbitration Bar Association (PIABA) in Connection with the Subcommittee’s Review of the Arbitration System, available at https://secure.piaba.org/piabaweb/html/modules/ContentExpress/img_repository/December122007.pdf (last visited March 29, 2008); see also Mark A. Tepper, *Survey Says – SRO Arbitration Unfair*, PIABA BAR JOURNAL, Spring 2005, at 12; Charles Gasparino, *Judging Wall Street*, NEWSWEEK, Sept. 6, 2004, at 56; Gary Weiss and David Serchuk, *Walled Off From Justice?*, BUSINESS WEEK, Mar. 22, 2004, at 91; Richard Karp, *Hardball*, BARRON’S, Oct. 20, 2003; see generally Edward Brunet & Jennifer Johnson, *Substantive Fairness in Securities Arbitration*, 76 U. CIN. L. REV. __ (2008); Jennifer Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123 (2005).

⁶ See Securities Industry and Financial Markets Association (SIFMA), *White Paper on Arbitration in the Securities Industry* (2007), available at <http://www.sifma.org/regulatory/pdf/arbitration-white-paper.pdf> (last visited March 29, 2008) (hereinafter *SIFMA White Paper*). SIFMA “represents the industry which powers the global economy” and has more than 650 member firms, see <http://www.sifma.org/about/about.html>.

⁷ Arbitration Fairness Act of 2007, S. 1782, 110th Cong. (2007); Arbitration Fairness Act of 2007, H.R. 3010, 110th Cong. (2007).

expressly stated that the proposed Arbitration Fairness Act would apply to PDAAAs in securities customers' account agreements.⁸ Shortly before introducing the legislation, Senator Feingold and Senator Patrick Leahy had written to Securities and Exchange Commission (SEC) Chairman Christopher Cox urging the SEC to enact a rule banning mandatory arbitration clauses from broker-dealers' customer agreements.⁹ Both Senate and House subcommittees held hearings on the proposed legislation in 2007,¹⁰ and a critic of the current securities arbitration process testified at each of them.¹¹ Previously, in March 2005, a subcommittee of the House of Representatives Financial Services Committee held a hearing to better understand how the securities arbitration process was working and whether any reforms were needed.¹² At that hearing, witnesses with expertise in securities arbitration testified about, and disagreed on the ramifications of, many aspects of the process, including (1) its mandatory nature,¹³ (2) the inclusion of one industry arbitrator on every three-arbitrator panel,¹⁴ and (3) a lack of transparency in arbitrators' decisions.¹⁵

⁸ *Hearing on "S. 1782, The Arbitration Fairness Act of 2007" Before the S. Judiciary Subcomm. on the Constitution*, 110th Cong. (2007) [hereinafter *Senate Subcommittee Hearing*] (opening statement of Sen. Russell Feingold) ("First, [the Act] is intended to cover disputes between investors and securities brokers. I believe that such disputes are covered by the definition of consumer disputes, but to clear up any uncertainty, we will make the intent even clearer when we mark up the bill in committee.").

⁹ See Letter from Russell D. Feingold, Senator, & Patrick Leahy, Chairman, Committee on the Judiciary, U.S. Senate, to Christopher Cox, Chairman, SEC (May 4, 2007) (on file with author); see also Gretchen Morgenson, "Dear S.E.C., Reconsider Arbitration," N.Y. TIMES, May 6, 2007, § 3, at 1.

¹⁰ *Senate Subcommittee Hearing*, *supra* note 8; *Hearing on "H.R. 3010, The Arbitration Fairness Act of 2007" Before the H. Subcomm. On Commercial and Administrative Law*, 110th Cong. (2007) [hereinafter *House Subcommittee Hearing*].

¹¹ See *Senate Subcommittee Hearing*, *supra* note 8 (statement of Tanya Solov) (representing the North American Securities Administrators Association [NASAA]); *House Subcommittee Hearing*, *supra* note 10 (statement of Theodore G. Eppenstein, Testimony in Support of Prohibiting Mandatory Arbitration in Securities Cases).

¹² See *2005 Hearing*, *supra* note 4.

¹³ *Id.* To open an account with virtually any broker-dealer, investors must sign an agreement that contains a clause requiring them to settle any disputes in arbitration. This clause is regulated, both in form and content, by FINRA Rules. See NASD CONDUCT RULE 3110(f).

¹⁴ At FINRA, if the claim is more than \$50,000, the arbitration panel generally consists of three arbitrators. NASD CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES [hereinafter *Customer Code*] 12401(c). A three-person arbitration panel consists of one non-public arbitrator, customarily referred to as an industry arbitrator, and two public arbitrators, or arbitrators who are not associated with the securities or commodities industry. *Customer Code* Rule 12402(b). The definitions of non-public and public arbitrators have engendered considerable debate in recent years, as FINRA has tightened the definition of who can be considered a public arbitrator. The industry arbitrator includes individuals who have been associated within the past five years with, or who are retired from, the securities or commodities industry and professionals who have devoted at least 20% of their professional work in the past two years to clients in the securities and commodities industry. *Customer Code* Rule 12100(p). An individual who does not meet the definition of non-public arbitrator may, nevertheless, be outside the definition of a public arbitrator under *Customer Code* Rule 12100(u) and thus be ineligible to serve as an arbitrator, even if otherwise qualified. Investor advocates contend that the industry arbitrator "presents an appearance of bias and impropriety to

We both have written frequently on securities arbitration¹⁶ and have concluded that the process is fair, when measured against hallmarks of procedural fairness.¹⁷ Our assessments were based on our analysis of the rules and practices of the forum and our own experiences with the process, both as investors' representatives and as arbitrators. Missing from our assessment was empirical data about the perceptions of fairness by the participants themselves, especially investors who, although they are required to arbitrate their claims, are the least knowledgeable of the process among the participants directly impacted by the arbitrators' decisions.

In recent years, only a few researchers have conducted empirical studies of securities arbitration, and none of them focuses on perceptions of fairness.¹⁸ The most recent attempt to measure party satisfaction with securities arbitration dated back to 1999, before numerous rule changes had altered the process.¹⁹ There was no recent reliable information about how participants viewed their experience, and, in particular, whether investors viewed the arbitration

the investing public," see 2005 Hearing, *supra* note 4, at 105 (statement of PIABA), while the securities industry asserts that industry arbitrators provide valuable expertise. See SIFMA White Paper, *supra* note 6, at 36.

¹⁵ FINRA publicly discloses arbitration awards and during the arbitrator selection process provides information on an arbitrator's past awards, but arbitrators are not required to explain the award or their reasoning. See 2005 Hearing, *supra* note 4, at 34–35, 37 (statement of Fienberg). FINRA's proposal to require arbitrators to include an explanation for their awards at the request of the customer has languished in the rule-making process. See NASD Notice of Filing of Proposed Rule Change to Provide Written Explanations in Arbitration Awards Upon the Request of Customers or Associated Persons in Industry Controversies, 70 Fed. Reg. 41,065 (proposed July 11, 2005). For a more detailed analysis of the benefits and drawbacks of this rule proposal, see Barbara Black & Jill I. Gross, *The Explained Award of Damocles: Protection or Peril in Securities Arbitration*, 34 SEC. REG. L.J. 17 (2006) [hereinafter *Explained Award of Damocles*].

¹⁶ See, e.g., *Explained Award of Damocles*, *supra* note 15; Jill I. Gross & Ronald Filante, Ph.D., *Developing A Law/Business Collaboration through Pace's Securities Arbitration Clinic*, 11 FORDHAM J. CORP AND FINANCIAL LAW 57 (2005); Barbara Black, *The Irony of Securities Arbitration Today: Why Do Brokerage Firms Need Judicial Protection?*, 72 U. CINC. L. REV. 415 (2003); Barbara Black & Jill I. Gross, *Economic Suicide: The Collision of Ethics and Risk in Securities Law*, 64 PITTSBURGH LAW REVIEW 483 (2003) [hereinafter *Economic Suicide*]; Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 999-1005 (2002) [hereinafter *Making it Up*].

¹⁷ See Jill Gross, *McMahon Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. CINC. L. REV. ____ (2008); Barbara Black, *Is Securities Arbitration Fair to Investors?*, 25 PACE L. REV. 1 (2004).

¹⁸ We describe these studies in Part V(G), *infra*. There are also empirical studies that focus on other forms of arbitration. One that deals specifically with perceptions is Harris Interactive Survey, *Arbitration: Simpler, Cheaper, and Faster Than Litigation* (Apr. 2005), at <http://www.instituteforlegalreform.com/issues/docload.cfm?docId=489> (conducted on behalf of the U.S. Chamber of Commerce Institute for Legal Reform, this survey interviewed 609 individuals and found general satisfaction with arbitration).

¹⁹ Gary Tidwell, Kevin Foster & Michael Hummel, *Party Evaluations of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations* (Aug. 5, 1999), available at http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p009528.pdf (concluding that both parties to the arbitration process found arbitrators, and the process itself, to be fair and unbiased) [hereinafter *Tidwell Report*].

process as fair. As a result, when the Securities Industry Conference on Arbitration (SICA)²⁰ sought to sponsor a new empirical study, we leaped at the opportunity.

This Article, based on our Report to SICA dated February 6, 2008,²¹ analyzes the results of our mailed survey of participants' perceptions of fairness of securities Self-Regulatory Organization (SRO) arbitrations involving customers.²² Part II of this Article details the background of the survey and explains the importance of surveying perceptions of fairness of a dispute resolution process. Part III describes the methodologies and procedures we implemented to design and conduct the survey, including the error structure potentially contained in our methodologies. Part IV contains our findings. In Part V we present our analysis of the findings, including our primary conclusions that (1) investors have a far more negative perception of securities arbitration than all other participants, (2) investors have a strong negative perception of the bias of arbitrators in the securities arbitration forum, and (3) investors lack knowledge of the securities arbitration process. We also offer several explanations for these negative perceptions. We conclude in Part VI by noting the implications of the findings, primarily the new reality that Congress, the SEC and FINRA must face that customers' negative perceptions mandate reform of the securities arbitration process. Specifically, because we continue to believe that securities arbitration is a better alternative than litigation, we do not agree that Congress or the SEC should declare PDAAs unenforceable in customers' account agreements with their brokerage firms. We do urge that serious consideration be given to eliminating the requirement of an industry arbitrator on every three-person arbitration panel. While we are less convinced about the investor protection value of an explained award, our survey findings necessitate further public discussion and debate on FINRA's proposal to increase the transparency of securities arbitration awards. At a bare minimum, the survey findings clearly highlight the need for all constituencies to step up their efforts to educate investors as to the securities arbitration process.

²⁰ SICA includes representatives from FINRA, SIFMA, and the public. See Constantine N. Katsoris, *SICA: The First Twenty Years*, 23 *FORDHAM URB. L.J.* 483, 488-90 (1996) (setting forth the background on the creation of SICA).

²¹ Jill Gross & Barbara Black, *Perceptions of Fairness of Securities Arbitration: An Empirical Study*, Report to the Securities Industry Conference on Arbitration (Feb. 2008), available at <http://www.law.pace.edu/files/finalreporttosica.pdf>. SICA sponsored the study, and FINRA paid for it.

²² For purposes of this study, SRO arbitrations include customer-initiated arbitrations at NASD Dispute Resolution and the New York Stock Exchange (NYSE) filed from January 1, 2002 through December 31, 2006 and closed between January 1, 2005 and December 31, 2006. See *infra* Part III (B).

II. SURVEYING PERCEPTIONS

A. Background

In 2002 the State of California and the SROs were engaged in litigation over the state's attempt to impose its conflict disclosure standards on arbitrators in SRO securities arbitrations.²³ The SEC²⁴ filed an *amicus curiae* brief in support of the SROs' position that federal regulation preempted state standards and also requested that Professor Michael A. Perino²⁵ assess the adequacy of the current SRO arbitrator disclosure requirements.²⁶ In the resulting report ("the Perino Report"), Professor Perino concluded that the disclosure rules appeared to be adequate. He went on to observe that any "lingering perceptions of pro-industry bias" relate to "panel composition, not the presence of undisclosed arbitrator conflicts."²⁷ He further noted that, while empirical evidence was limited, past surveys seemed to suggest that parties involved in SRO arbitrations find that arbitrators are fair and impartial.²⁸ However, because of "lingering concerns about pro-industry bias" and the insufficient amount of empirical evidence addressing investors' perceptions of the securities arbitration process, Professor Perino recommended that the "SROs sponsor additional independent studies to further evaluate the impartiality of the SRO arbitration process."²⁹

In response to this recommendation, NASD asked SICA to conduct a study of participants' perceptions of the fairness of securities arbitration. On October 5, 2003, SICA

²³ See *NASD Dispute Resolution v. Judicial Council of California*, 488 F.3d 1065 (9th Cir. 2007) (dismissing appeal because of mootness and vacating district court's judgment); see also *Credit Suisse First Boston v. Grunwald*, 400 F.3d 1119 (9th Cir. 2005) (holding that federal securities law preempted the California standards in the context of SROs); *Jevne v. Superior Court*, 35 Cal. 4th 935 (2005) (to same effect).

²⁴ The SEC has oversight authority over SRO securities arbitration pursuant to Section 19(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78s(b), which requires SEC approval of any changes to the SRO securities arbitration rules. The SEC is required to find that any proposed change is "consistent with the requirements of [the 34 Act] and the rules and regulations thereunder," including the requirement that the rule protect investors and be in the public interest. *Id.* § 78s(b)(2).

²⁵ Dean George W. Matheson Professor of Law, St. John's University School of Law.

²⁶ See Michael Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitration* at 3 (Nov. 4, 2002), available at <http://www.sec.gov/pdf/arbconflict.pdf> [hereinafter *Perino Report*].

²⁷ *Id.*

²⁸ *Id.* at 30. The Perino Report primarily was referring to two GAO studies (see *Securities Arbitration: How Investors Fare*, GEN. ACCT. OFF., REP. NO. GGD-92-71 (1992) (finding that statistical results from industry-sponsored and independent forums did not show any indication of a pro-industry bias in arbitration decisions at industry-sponsored forums); *Securities Arbitration: Actions Needed to Address Problem of Unpaid Award*, GEN. ACCT. OFF., REP. NO. GGD-00-115 (2000) (hereinafter *2000 GAO Report*) (stating that there was no basis to make any conclusions about the fairness of SRO arbitration proceedings, because the small caseloads at alternative forums did not allow for meaningful comparisons)), and NASD's *Tidwell Report*, *supra* note 19.

²⁹ *Id.* at 37.

disseminated a Request for Proposal seeking vendors interested in conducting the recommended study. In 2004, we submitted a proposal to design a survey to investigate the fairness of SRO arbitrations to the individual investor, focusing on an assessment of (1) investors' perceptions of fairness of the SRO arbitration process; (2) whether arbitrators appear competent to resolve investors' disputes with their broker-dealers; (3) investors' perceptions of fairness of SRO arbitration as compared to their perceptions of fairness in securities litigation in similar disputes; and (4) whether the outcome of arbitrations appears fair to the parties. SICA accepted this proposal and, on August 22, 2005, formally retained us to conduct the recommended study.

B. The Importance of Perceptions of Fairness.

Academic literature confirms the importance of surveying perceptions of fairness of a dispute resolution forum.³⁰ These perceptions are important because the substantive (or distributive) fairness of a dispute resolution process³¹ can not readily be measured, especially when the process is confidential and outcomes are not transparent (which is the case in securities arbitration because awards do not typically contain an explanation or reasons).

Dispute resolution scholars recently have focused on procedural justice as a more accessible predictor than substantive justice of parties' assessment of the overall fairness of a process.³² These scholars have found that perceptions of procedural fairness strongly impact perceptions of substantive fairness, which results in a greater willingness to comply with the outcome and greater trust in and respect for the decision-maker.³³ Summarizing prior research

³⁰ See, e.g., Jean R. Sternlight, *ADR Is Here: Preliminary Reflections on Where It Fits In A System of Justice*, 3 NEV. L. J. 289, 297-98 (2003) [hereinafter *ADR Is Here*] (stating that the "subjective perception of fairness is critical, because even assuming objective fairness, the system could not function well if it were perceived to be unfair or unjust").

³¹ A process is substantively fair if equally situated disputants receive equal outcomes. See Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 15 STAN. L. REV. 1637, 1666 (2005) [hereinafter *Creeping Mandatory Arbitration*] (defining substantive, or distributive, justice and stating that "if a single party or group were to win all disputes, if equally situated persons received disparate results, or if the 'justice' system led to increasingly unequal division of resources, few if any of us would feel that justice had been served").

³² See Lawrence B. Solum, *Procedural Justice*, 78 S.CAL. L. REV. 181 (2004) (theorizing importance of procedural justice for legitimacy of dispute resolution processes); Sternlight, *ADR Is Here*, *supra* note 30, at 297.

³³ Susan Franck, *Integrating Investment Treaty Conflict and Dispute System Design*, 92 MINN. L. REV. 161, 214-15 (2007) ("Empirical evidence suggests that when stakeholders believe a system is procedurally just, they are more likely to buy into the result and the process, comply with the outcome, comply with the law in the future, increase commitment to the organization, accord respect and loyalty to the institution, and perceive the system to be legitimate."); Nancy Welsh, *Perceptions of Fairness*, in THE NEGOTIATOR'S FIELDBOOK 165, 170 (Andrea K. Schneider & Christopher Honeyman eds., 2006); Deborah R. Hensler, *Judging Arbitration: The Findings of Procedural Justice Research*, in AAA HANDBOOK ON COMMERCIAL ARBITRATION 41-49 (Thomas E. Carbonneau & Jeanette A. Jaeggi eds., 2006); Sternlight, *Creeping Mandatory Arbitration*, *supra* note 31, at 1666-67 (citing studies).

by social psychologists, a leading scholar of procedural justice writes that “people who believe that they have been treated in a procedurally fair manner are more likely to conclude that the resulting outcome is substantively fair, even if that outcome is unfavorable.”³⁴ She posits that four key elements “reliably lead people to conclude that a dispute resolution process is procedurally fair”: (1) the process provides an opportunity for disputants to voice their concerns to a third party; (2) the disputants perceive that the third party actually considered these concerns; (3) the disputants perceive that the third party treated them in an “even-handed” way; and (4) the disputants feel that they were treated in a dignified and respectful manner.³⁵

Our survey asked participants about their most recent experience with the SRO arbitration process, including their perceptions about the attentiveness, competence and impartiality of the arbitrators, as well as their satisfaction with the outcome. We also asked, more generally, about their opinion of the securities arbitration process. From the survey, we gain valuable insights about procedural and substantive fairness in securities arbitration cases as experienced by the survey participants.

III. METHODOLOGIES AND PROCEDURES

A. *Survey Development and Design.*³⁶

In late 2004, we began developing the survey and determined that the most effective way to gather responses from all participants³⁷ would be to disseminate a paper survey by mail.³⁸ Mail surveys offer the following advantages: (1) they require fewer resources than telephone surveys; (2) they provide a sense of privacy to the survey participant; and (3) they are less

³⁴ Welsh, *supra* note 32, at 170; *see also* Hensler, *supra* note 33, at 48 (stating that “arbitration litigants will be satisfied with arbitration if they think the process is fair and will be dissatisfied if they think the process is unfair”).

³⁵ Nancy A. Welsh, *Remembering the Role of Justice in Resolution: Insights from Procedural and Social Justice Theories*, 54 J. LEGAL ED. 49, 52 (2004) (citing Nancy A. Welsh, *Making Deals in Court-Connected Mediation: What's Justice Got to Do With It?*, 79 WASH. U. L. Q. 787 (2001)); *see also* Hensler, *supra* note 33, at 48 (concluding that “any assessments of the procedural fairness of arbitration by arbitration litigants will depend on several variables: whether they are allowed to participate in, or at least observe, the process firsthand; and whether they believe the arbitrator is unbiased, gave fair consideration to their evidence, treated all parties equally, and treated them in a dignified fashion”).

³⁶ For a more detailed description, *see* SICA Report, *supra* note 21.

³⁷ While our initial proposal contemplated surveying investors only, SICA instructed us to survey all process participants, including investors, securities industry representatives, and lawyers.

³⁸ We determined that an internet-based or telephone survey would not be feasible, primarily because NASD and NYSE did not maintain sufficiently complete databases of e-mail addresses and telephone numbers for investors who filed arbitration claims.

sensitive to bias introduced by interviewers.³⁹ We considered and weighted these advantages against some disadvantages: (1) risk of noncoverage error (*i.e.*, the database of recipients is flawed); (2) risk of nonresponse error (*i.e.*, those who respond are different from those who do not respond in a substantive way that affects the survey results); (3) lack of control over who within the household responds; and (4) risk that survey participants may not fill out the questionnaire completely.⁴⁰

Early on we retained the services of Cornell University's Survey Research Institute (SRI)⁴¹ to provide us with survey design and implementation expertise, and, with SRI's input, we drafted questions for the mail survey. We included four types of questions: (1) questions requiring a binary response (*e.g.*, "yes" or "no"), (2) categorical questions (requiring a response from a list of viable options), (3) Likert scale questions (statements that could be answered by a range of responses, such as strongly agree, agree, neither agree nor disagree, disagree, strongly disagree, don't know), and (4) one open-ended question – the state in which a hearing was scheduled to take place – to study any possible variations among geographic regions.

Within the statement section, we varied the orientation of the statements to include both negative and positive statements. For example, question 16 asked survey participants to agree or disagree with the statement: "The arbitration panel appeared competent to resolve the dispute." In contrast, question 17 asked survey participants to agree or disagree with the statement: "The arbitration panel did not understand the issues involved in the case." This type of contrast helps to ensure that the participants were paying attention to the statements and also maintains the neutrality of the survey.

We instructed survey participants who had been involved in more than one customer dispute that was filed for arbitration to focus on their experiences in their most recent dispute, to minimize survey participants' reliance on more generalized impressions that can yield unreliable data that is subject to "recall bias" or the tendency to exaggerate the consistency between present attitudes and past experiences.⁴² While SICA initially expressed a preference for gathering

³⁹ Priscilla Salant & Don A. Dillman, *HOW TO CONDUCT YOUR OWN SURVEY* (Wiley 1994), at 35-36.

⁴⁰ *Id.* at 36-37.

⁴¹ Since 1996, SRI has been providing survey research, data collection, and analysis services to a wide-range of academic, non-profit, governmental, and corporate clientele. For more information on SRI, see <http://www.cornellsurveyresearch.com/sri/index.cfm>.

⁴² Research around memory bias reveals that personal recall of retrospective questions is a function of past and present experiences. The typical finding is that people exaggerate the consistency between their present (new) attitudes and their past opinions. Furthermore, people tend to bias their memories of previously held attributes in

survey participants' impressions based on numerous experiences, we explained that, to minimize recall bias, it was important to avoid asking people about their impressions. Also, we wanted this study, to the extent possible, to gather "information" rather than "impressions," as impressions are influenced or confounded by other factors for which a survey instrument cannot accurately control. Moreover, the law of averages shows that a "terrible" recent experience reported by one survey participant will smooth out against a "great" recent experience reported by another survey participant. It was our view that survey data would be far more reliable and scientifically accurate if we directed survey participants to focus on their most recent experience. Ultimately, SICA agreed with our recommendation. We did, however, conclude the survey with a series of questions that asked more generally for participants' opinions about the securities arbitration process.⁴³

B. Survey Recipients.

Simultaneously with survey development, we identified the parameters of the target survey recipients. Both arbitration forums could generate a database of all parties and their representatives who had participated in a customer-member arbitration and had provided their contact information for a number of past years. Our objective was to generate contacts from two years of recently closed cases, which we estimated to be a manageable and representative population, but exclude cases that were filed earlier than five years ago and thus were administered before numerous rule changes went into effect.

We determined that we would send out surveys to the following subset of individuals:

Contacts listed for all customer arbitrations **filed** at NASD and NYSE not earlier than January 1, 2002 and **closed** between January 1, 2005 and December 31, 2006;

(1) Including contacts that were: on the case when it closed, removed due to a bankruptcy order or other court order, or dismissed by arbitrator(s); and

ways that deny changes that have actually taken place or overstate them. The literature concludes that there are two forms of systematic bias in personal memories: 1) people will exaggerate their consistency over time and incorrectly recall events, tending to recall past events consistent with current events, or 2) people will overestimate the extent to which their past memories differ from current experiences (sometimes a prominent/extreme event occurred in the past overshadows all other events in the past). See J.M. Tanur, *QUESTIONS ABOUT QUESTIONS* (Russell Sage Foundation, 1991); see also LinChiat Chang & Jon A. Krosnick, *Measuring the Frequency of Regular Behaviors: Comparing the "Typical Week" to the "Past Week,"* 33 *SOCIOLOGICAL METHODOLOGY* 55 (2003); S. Sudman & N.M. Bradburn, *RESPONSE EFFECTS IN SURVEYS* (Aldine 1974).

⁴³ Our proposal, as accepted by SICA, contemplated that we would conduct follow-up telephone interviews with those survey participants who indicated a willingness to be interviewed. SICA later decided, however, that we would not conduct telephone interviews.

(2) Excluding contacts from cases in which the initial pleading was not served (*e.g.*, cases that were closed before service because a deficiency was not cured).

NASD and NYSE generated a combined database of 29,993 contacts to receive the survey. Pace - with logistical assistance from NASD and NYSE -- mailed out the survey between March and July 2007. SRI, under the supervision of Director Yasamin Miller, received and processed results from April to August 2007. Through August 31, 2007, when data collection closed, SRI received and processed **3,087** responses. This reflects a thirteen percent (13.0%) response rate⁴⁴ based on those surveys effectively mailed out to a contact,⁴⁵ which is in line with typical response rates ranging from eight to twelve percent obtained from a one-time mailing of a survey.⁴⁶

C. Error Structure.

It is widely recognized that several sources of error can impact the quality of survey data. It is also accepted practice for survey researchers to disclose the potential error structure in their surveys. Our survey is subject to two possible sources of error: coverage error and nonresponse error.

1. *Coverage error.* The survey is subject to some coverage error, or the risk that the results are not reliable because not all members of the population (NASD or NYSE arbitration participants during a five-year time period) have an equal chance of being surveyed. Specifically, it was less likely that investors who were represented by attorneys would receive the survey compared to the other participants in the arbitration process.

As described above,⁴⁷ we designed parameters for selecting a population of cases that originated on or after January 1, 2002 (but eliminating arbitration participants in cases that had not yet closed). The contacts database generated by our parameters was incomplete because the forums do not require the parties to provide an address if they have a representative. Therefore, many party addresses were missing or otherwise undeliverable. In addition, the database

⁴⁴ Although we conservatively report 13% as the scientifically supported response rate, we firmly believe that the actual rate is much higher, due to additional duplicates surely present on the mailing database but not officially eliminated from the total recipient count. Due to the effort it would require to eliminate those duplicates, we chose not to devote the time.

⁴⁵ Of the 29,993 contacts, 4,710 surveys were either returned to SRI or otherwise not deliverable due to insufficient address. Thus, we effectively mailed out a total of 25,283 surveys. We subsequently determined that *at least* 1500 of those contacts were duplicates. Thus, at most, 23,783 contacts had the opportunity to participate in the survey.

⁴⁶ This range is derived from SRI's experience over twenty years as well as the experience of other prominent survey research organizations.

⁴⁷ For further discussion of the parameters, see *supra* Part III (B).

contained duplications for several reasons. First, entries for certain contacts appeared multiple times if the data entered was just slightly different. While the forums electronically reviewed the database to minimize the duplicates, they could not ensure that no contact received a duplicate survey.⁴⁸ Second, if a firm and one of its subsidiaries were listed as parties, the forums could not limit the database to just the firm, resulting in certain firms with multiple listings. Third, in situations where there were multiple parties with similar names and the same address, there were multiple rows in the report. An example might be an individual, an IRA and a Trust all entered as separate parties. As a result, lawyers, firms and associated persons in the database were more likely to receive a survey than customers.

2. *Nonresponse bias.* Nonresponse bias is the risk that those who responded may be different in their answers to the survey questions from those who did not respond to the survey. Because 13.0% of those who received a survey actually responded, our findings are potentially limited by this nonresponse error.

The preferred method to test for nonresponse bias is to conduct telephone interviews of a random sample of contacts who did not respond to measure whether their answers to the survey questions are statistically significantly different from the survey participants. While we recommended conducting such a follow-up study, due to time and resource constraints, SICA did not endorse that recommendation. As a result, we cannot state with certainty whether there is, in fact, any nonresponse bias in the survey data.

However, recent survey literature indicates that low response rates do not necessarily lead to high nonresponse bias.⁴⁹ At a recent national workshop on nonresponse bias, Robert M. Groves, Professor of Sociology and Director of the Survey Research Center at the University of Michigan and a leading scholar of survey research, argued that “a narrow focus on response rates has likely been leading researchers astray from the more fundamental driver of non-response bias - a relationship between the propensity of a household to respond and the value of that household

⁴⁸ As described *supra* note 45, there were at least 1500 duplicates.

⁴⁹ See, e.g., Robert M. Groves, *Nonresponse Rates and Nonresponse Bias in Household Surveys*, PUBLIC OPINION QUARTERLY, Vol. 70, No. 5, Special Issue 2006, at 646-675 (emphasis added) (stating that “there is little empirical support for the notion that low response rate surveys de facto produce estimates with high nonresponse bias”); John Rogers, Ph.D., *Do Response Rates Matter in RDD Telephone Survey?*, Public Research Institute, Theory and Method, at <http://pri.sfsu.edu/corner.html> (Nov. 13, 2006) (“The continued development of research on nonresponse bias provides comforting news in that RDD surveys can still provide surprisingly accurate and reliable estimates even in an era of declining response rates. But this same research also carries a warning that in some situations our estimates can be biased in important ways by nonresponse.”).

on a given survey measure.”⁵⁰ Groves used a meta-analysis of nonresponse studies to provide empirical support for this argument. Among his main conclusions are that (1) “**response rate is a poor indicator of non-response bias,**” and (2) more variation in nonresponse bias exists *within surveys* (between different estimates) than exists *between surveys* with higher or lower response rates.⁵¹

IV. FINDINGS⁵²

The 3,087 returned surveys produced a large quantity of useful response data for analysis. We have confidence in our findings due to the following factors:

- We designed and administered the survey with a low error structure;⁵³
- A representative cross-section of target categories of arbitration participants responded to the survey;⁵⁴
- Survey participants reflect a representative distribution of geographic regions;⁵⁵ and
- Survey participants reflect a representative cross-section of arbitration participants based on the amount of the claim, the amount of damages awarded (if any), and the manner in which the case was resolved.⁵⁶

We describe in this section the responses to each of the thirty-eight questions and their subparts.

A. *Survey participant type*

The first five questions and their subparts focused on categorizing the survey participants and quantifying the level of survey participants’ involvement in securities arbitrations over the past five years. Question 1 asked survey participants to identify the nature of their involvement “in a dispute between a customer and a securities brokerage firm and/or its registered representative(s) (‘associated person(s)’) that was filed for arbitration before NASD or the NYSE.” The survey participants identified themselves as follows:

⁵⁰ See American Association of Public Opinion Research, D.C. Chapter, *Report on Workshop on Nonresponse Bias in Household Surveys* (Mar. 30, 2007), at 8.

⁵¹ *Id.* (italics in original). At the workshop, Groves remarked: “I must admit for me this was a shocker the first time I saw it. This sort of rocks your belief system if you’ve been training students for the last 30 years that high response rates are really a good thing because it protects you from nonresponse bias.” *Id.*

⁵² When we report a percentage of survey participants, this figure reflects the percentage of “valid” survey participants, or the percentage of those survey participants who answered that question.

⁵³ See *supra* Part III (C).

⁵⁴ See Figure 1A.

⁵⁵ See Figure 9.

⁵⁶ See *infra* Figures 10-12.

Figure 1A

Nature of involvement	Number of survey participants who selected this response	Percentage of survey participants who answered this question
Customers	1,359	45.1
Corporate representatives (of member firms)	202	6.7
Associated persons	460	15.3
Lawyer/other party representative	926	30.8
Not involved in any such dispute	63 ⁵⁷	2.1

Thus, the largest number of survey participants were customers (1,359, or 45.1% of those who identified their role), followed by lawyers/other party representatives (926, or 30.8%).

This analysis of the distribution of type of survey participant led us to consider weighting the responses based on this distribution as compared to the distribution of type of contact in the mailing database. To ensure that a category of survey participants does not have the opportunity to have its opinion counted disproportionately, accepted practice for survey researchers is to apply post-stratified population weights to survey answers so as to adjust the impact of a participant category on the overall answer for each question. However, researchers apply these weights only if they have accurate classifications of both the contacts in the mailing database and survey participants.⁵⁸

Thus, we attempted to compare the classification distributions of survey participants to the classification distributions of contacts in the mailing database:⁵⁹

⁵⁷ These 63 survey participants who answered that they were not involved in a customer arbitration in the past five years were excluded from the remaining survey questions. Thus, totals of valid survey participants for other categories could be no more than 3024 (3087-63).

⁵⁸ See, e.g. *Weighting for Unequal P_i*, 8 JOURNAL OF OFFICIAL STATISTICS 183 (1992).

⁵⁹ FINRA, the entity that maintained the mailing database, categorized the contacts database.

Figure 1B

Category of contact	Percentage of contacts in database	Percentage of survey participants
Customers	33%	45%
Lawyers/representatives	37%	31%
Associated persons	23%	15%
Corporate representatives (of member firms)	5%	7%

We concluded that we do not have sufficient confidence in the accuracy of these classification percentages to justify weighting. We do not have confidence because:

- FINRA has provided us with classifications for 97.5% of the contacts in the database; 756 records, or 2.5% of the 29,850 total contacts, could not be classified according to the categories we used. Thus, we cannot classify 2.5% of the contacts.
- We examined the detail of 1,570 NYSE records (99.6% of which were lawyers) and 9,445 NASD records (100% of which were lawyers) in the contacts database. Of those combined records, *at least* 1,500 are duplicates. Thus, lawyers as a classification are over-represented in the contacts database percentage by at least 5%. Moreover, in SRI’s experience, participants do not fill out more than one survey.
- 77 survey participants, representing 2.5% of the 3,024 valid survey participants, did not answer question one, but did answer other survey questions. Thus, we cannot classify 2.5% of the survey participants.⁶⁰

Question 2 asked parties to a dispute whether they were represented by a lawyer in that dispute. 81.7% (1,650) of those who identified themselves as a party to an arbitration proceeding and who chose to answer the question reported that they were represented by a lawyer. Of the remaining parties who chose to answer:

- 0.3% (6) were represented by a lawyer through a law school clinic;
- 1.7% (35) were represented by a non-lawyer; and
- 16.2% (328) represented themselves, either because:

⁶⁰ Despite our lack of confidence in the weighting percentages to be applied, we tested the weights by assuming the percentages as provided are accurate. We applied those weights to six questions (19, 34, 38a, 38b, 38c, and 38d). With respect to the overall data, the weighted results showed only a marginal difference in the responses [slightly more positive perceptions], and no trends or observations would be changed. With respect to the analysis of customer vs. everyone else data, the customer numbers are unchanged; the “everyone else” numbers are changed less than half of one-percent in every case except one. In sum, even if we were to apply the most extreme weights we could envision applying, there would be no substantial change in the overall results.

- they did not want to be represented [5.4%],
- they could not afford a lawyer [8.6%], or
- they could not find a lawyer [2.2%].

Question 5⁶¹ asked all parties as well as lawyers/representatives involved in more than one dispute to provide the number of disputes in which they have been involved in the past five years. 58.8% (1,510) of these survey participants (2,570) have been involved in only one dispute. 75% of the survey participants who were involved in only one dispute who also answered question one identified themselves as customers (1,115 out of 1,495). The breakdowns are as follows:

Figure 5

Number of disputes involved in - past five years	Number of survey participants who selected this response	Percentage of survey participants who answered this question
One	1,510	58.8
2-5	392	15.3
6-10	119	4.6
More than 10	546	21.2
Do not know	3	0.1

B. Pre-dispute arbitration clause (PDAA)

Questions 6 through 11 asked all survey participants a series of questions about their most recent dispute. Question 6 focused on the PDAA. Of the 2,841 responses, 79.3% of survey participants (2,252) answered question 6(a) that the customer agreement in the most recent dispute contained a PDAA. 7.3% of survey participants (208) answered that the customer agreement did not contain a PDAA, suggesting that PDAAs in brokerage firm agreements are prevalent, but not universal. 13.4% (381) of survey participants did not know or could not recall whether the customer agreement contained such a clause.

Question 6(b) focused on the participants' awareness of the PDAA *before* the dispute arose. Of the 2,187 responses, 78.9% of survey participants (1,726) were aware that the customer agreement contained a PDAA; 16% (351) were not aware; 5% (110) did not know. When broken down by type of survey participant, the percentages shift in a statistically significant

⁶¹ We do not include the responses to questions 3 and 4, since they asked only lawyers or party representatives about the nature of their representation in the past five years.

manner. Thus, 63.29% of survey participants who answered this question and identified themselves as customers (692 responses) were aware that the customer agreement contained a PDAA before the dispute arose; 36.71% of customers were not aware.⁶²

Question 7 asked the survey participants to provide the *primary* reason the dispute was filed in an arbitration forum. As shown below, of the 2,790 responses, the largest number of survey participants answered that the dispute was filed in an arbitration forum because it was required.⁶³ The final column reports the distribution of answers just for those survey participants who identified themselves in response to question one as customers (1,197 responses). This distribution is different in a statistically significant manner from the distribution for all survey participants.

Figure 7

Primary reason for filing the dispute in arbitration	Number of survey participants who selected this response	Percentage of survey participants who answered this question	Percentage of customer survey participants who answered this question
Believed arbitration was required	1,169	41.9	41.6
Did not initiate the claim	709	25.4	3.84
A lawyer recommended it	362	13.0	27.23
Believed arbitration would be less expensive than court	204	7.3	13.45
Believed arbitration would be faster than court	108	3.9	6.93
Do not know/do not recall	110	3.9	N/A
Believed arbitration would be more fair than court	75	2.7	3.59
Preferred arbitration for other reasons	32	1.1	2.01
Believed arbitration would provide a larger recovery than court	21	0.8	1.34

⁶² To ensure enough observations for a response choice in order to run a valid chi-square test, for this analysis and all subsequent statistical analyses, we did not include the “do not know” response as a category if the response rate for that choice was less than 5% or less than 150 responses. Thus, because fewer than 5% of customers answered “do not know” to question 6(b), we eliminated that response from the “customer only” analysis.

⁶³ When recalculated to exclude those survey participants who indicated that they did not initiate the claim, those who filed in an arbitration forum because it was required totals 56.2%.

C. Concerns about arbitration before filing

Question 8 asked about parties’ concerns before the dispute was filed in arbitration. We asked about their pre-filing concerns because we believe it is useful to compare the parties’ concerns *before* filing with the perception of the process *after* the case closed. Survey participants indicated as follows:⁶⁴

Figure 8

Concerns before arbitration filed	Number of survey participants who selected this response	Percentage of survey participants who answered this question who self-identified as a non-customer⁶⁵	Percentage who answered this question who self-identified as a customer
I was concerned that it would not be a fair process	1,178	40.1	39.1
I had no concerns	965	36.1	28
I was concerned that the arbitrators would be biased	951	30.6	33.6
I was concerned about the composition of the arbitration panel	847	31.6	25
I was concerned that it would be expensive	508	16.8	17.5
I was concerned that it would be a slow process	423	12.3	16.6
I had other concerns	410	17.0	9.8
I don’t recall if I had any concerns	170	3.2	8.7

D. Geographic distribution

Question 9 asked survey participants to write the state in which the hearing was scheduled to take place in their most recent dispute. If the dispute was a Simplified

⁶⁴ The question instructed survey participants to select all that applied.

⁶⁵ The difference between the answers for all survey participants and customers only was not statistically significant for the choices regarding the cost and fairness of the process, and the bias of the arbitrator.

Arbitration,⁶⁶ the survey directed participants to write “paper case.” We then coded the 2,523 responses by region, according to FINRA Dispute Resolution’s four regions – Northeast, Southeast, Midwest and West. The responses demonstrate that the survey participants represent a fairly even cross-section of the four regions in the country:⁶⁷

Figure 9

Region	Number of survey participants whose hearing was scheduled to take place in this region	Percentage of survey participants who answered this question
Northeast	559	22.16
Southeast	586	23.23
Midwest	526	20.85
West	644	25.53
Paper case	208	8.24

E. Nature of most recent arbitration dispute

Questions 10-12 asked survey participants to identify certain parameters about the dispute. Question 10 (2,947 responses) asked about the amount of damages claimed (excluding punitive damages, attorneys’ fees, interest and costs) in the most recent dispute:

Figure 10

Amount of damages claimed in most recent dispute	Number of survey participants who selected this response	Percentage of survey participants who answered this question
Not exceeding \$25,000	358	12.1
\$25,001-\$50,000	210	7.1
\$50,001-\$100,000	351	11.9
\$100,001-\$250,000	642	21.8
\$250,001-\$1,000,000	861	29.2
More than \$1,000,000	425	14.4
Don’t know	100	3.4

⁶⁶ Simplified Arbitration is required for claims of \$25,000 or less. A single public arbitrator decides the dispute, there is limited discovery, and a hearing is not conducted unless the customer requests it. Customer Code Rule 12800.

⁶⁷ In 2006, NASD Dispute Resolution closed its Mid-Atlantic region, and realigned the regional office assignments for several of its 68 hearing locations. Since not all hearing locations were reassigned to the same region, it is not possible to compare the regional distributions of survey participants’ hearing location with the regional distribution of the NASD and NYSE dockets during the same time period.

Question 11 (2,885 responses) asked how the dispute was resolved:

Figure 11

How the most recent dispute was resolved	Number	Percentage of those who answered this question	Percentage of customers who answered this question (N=1237)
Award to customer after hearing	676	23.4	24.41
Award to customer based on papers	129	4.5	8.25
Claimant withdrew the claim	63	2.2	1.86
Parties settled on their own	682	23.6	22.47
Parties settled with aid of mediator	456	15.8	16.41
No award to customer based on papers	95	3.3	6.22
Dismissed before hearing	62	2.1	1.94
No award to customer after hearing	630	21.8	18.43
Do not know	92	3.2	N/A

Only survey participants involved in a dispute that resulted in an award for the customer answered question 12. Question 12a (789 responses) asked the amount of the total award (excluding punitive damages, attorneys' fees, interest and costs):

Figure 12A

Amount of damages awarded in most recent dispute	Number of survey participants who selected this response	Percentage of survey participants who answered this question
\$1.00-\$10,000	108	13.7
\$10,001-\$50,000	239	30.3
\$50,001-\$250,000	290	36.8
\$250,001-\$1,000,000	102	12.9
More than \$1,000,000	38	4.8
Don't know	12	1.5

Question 12b (786 responses) asked what percentage of damages originally claimed (excluding punitive damages, attorneys' fees, interest and costs) the award represents:

Figure 12B

For awards, percentage of damages originally claimed	Number of survey participants who selected this response	Percentage of survey participants who answered this question
Less than 1%	42	5.3
1-10%	134	17.0
11-25%	148	18.8
26-49%	158	20.1
50-74%	99	12.6
75-99%	57	7.3
100%	66	8.4
Don't know	82	10.4

These responses demonstrate that the survey participants represent a cross-section of arbitration participants based on the amount of the claim, the amount of damages awarded (if any), and the manner in which the case was resolved.⁶⁸ No one type of arbitration participant dominated the survey participants.

F. Composition of arbitration panel

Questions 13-15 focused on the composition of the arbitration panel and any perceived differences between public and industry arbitrators.⁶⁹ Question 13 (2,898 responses) asked all survey participants how many arbitrators were appointed to decide the dispute. 66.2% of survey participants (1,919) reported that three arbitrators were appointed to decide the dispute; 16.1% (466) reported that one arbitrator was appointed. In addition, 6.8% (197) answered that no arbitrators were appointed; another 10.9% (316) did not know.

The survey directed those who responded that three arbitrators were appointed to answer questions 14a-14e.

- ❖ **Q14a** (1,817 responses): 47% (250) of customer-survey participants (531) knew, prior to the filing of the arbitration, that one arbitrator would be an “industry arbitrator.” In contrast, 94% (1,211) of all other types of survey participants (1,286) reported that they knew this fact.

⁶⁸ Although it would be instructive to compare the distribution of survey participants by how the dispute was resolved to FINRA’s statistics on how its cases closed, comparisons are not possible because the categories FINRA tracks are different from those tracked in this survey.

⁶⁹ If the claim is more than \$50,000, the arbitration panel generally consists of three arbitrators, one non-public arbitrator, customarily referred to as an industry arbitrator, and two public arbitrators, or arbitrators who are not associated with the securities or commodities industry. *See supra* note 14.

- ❖ **Q14b** (1,757 responses): 48% (244) of customer-survey participants (508) knew, at some time during the dispute, which arbitrators were “public” and which arbitrator was “industry,” compared to 88% (1,099) of all other types of survey participants (1,249) who knew this information.
- ❖ **Q14c** (1,878 responses): 24% (138) of customers (576) perceived a difference in performance between the industry and public arbitrator, while 21.5% (124) of customers did not perceive a difference. 42.8% (247) of customers reported that they had no opportunity to assess the arbitrators’ performance; and 12% (67) of customers did not know whether there was a difference. In contrast, for all other types of survey participants (1,302), 42% (543) did not perceive a difference; 28% (368) had no opportunity to assess; 25% (325) perceived a difference; and 5% (67) did not know.
- ❖ **Q14d** (1,748 responses): 36.5% (186) of customers (510) perceived that the industry arbitrator favored at least one securities party at some time during the dispute; 22% (122) of customers disagreed that the industry arbitrator favored one side over the other at any time during the dispute; 1.8% (9) perceived that the industry arbitrator favored the customer; and 39.8% (203) of customers had no opportunity to assess the performance of the industry arbitrator. In contrast, for all other types of survey participants (1,238): 50% (618) disagreed that the industry arbitrator favored one side over the other at any time during the dispute; 15.3% (189) perceived that the industry arbitrator favored at least one securities party; 7.7% (95) perceived that the industry arbitrator favored the customer; and 27.1% (336) had no opportunity to assess the performance of the industry arbitrator.⁷⁰

Question 15 (2,250 responses) asked whether any public arbitrator favored one side over the other at any time during the dispute. 24.2% (213) of customers (881) responded that the public arbitrator did not favor one side over the other at any time during the dispute; 28.7% (253) said the public arbitrator favored at least one securities party; 2.2% (19) of customers said that the public arbitrator favored the customer; 33.37% (294) said there was no opportunity to assess; and 11.58% (102) did not know or recall. In contrast, for all other types of survey participants (1,369), 49% (671) responded that the public arbitrator did not favor one side over the other at any time during the dispute: 7.7% (105) said the public arbitrator favored at least one securities party; 13.2% (181) said that the public arbitrator favored the customer; 24.3% (332) said there was no opportunity to assess; and 5.8% (80) said that they did not know or recall.

Notably, the differences in customer-only vs. all survey participant types for responses to questions 14a-15 were statistically significant.

⁷⁰ Question 14e asked participants whether the award in their most recent three-arbitrator dispute was unanimous or not. Because the number of survey participants who answered this sub-question was so low, perhaps because of the sub-question’s assumption that there was an award, we do not include data for this sub-question.

G. Statements seeking range of responses (Likert scale questions)

Questions 16-34 are “Likert scale” questions that directed survey participants to read a statement and then indicate their response to that question as “strongly agree, agree, neither agree nor disagree, disagree, or strongly disagree.” Each statement also supplied a “not applicable” as well as a “don’t know” option. For these questions, survey participants were reminded to base their responses on their most recent dispute in which they were involved.

The following charts provide the statement and the range of responses distributed by percentage with respect to two categories of survey participants: those who identified themselves as customers and those who identified themselves as non-customers, in order to determine whether customers’ responses were different from the responses of the other survey participants (excluding “not applicable” responses). In general, customers had more negative perceptions, based on their most recent experience, of the arbitration process. In addition, in some questions, the customers expressed a greater lack of knowledge about the process than other survey participants. *For all questions, the differences were statistically significant.*

Figure 16

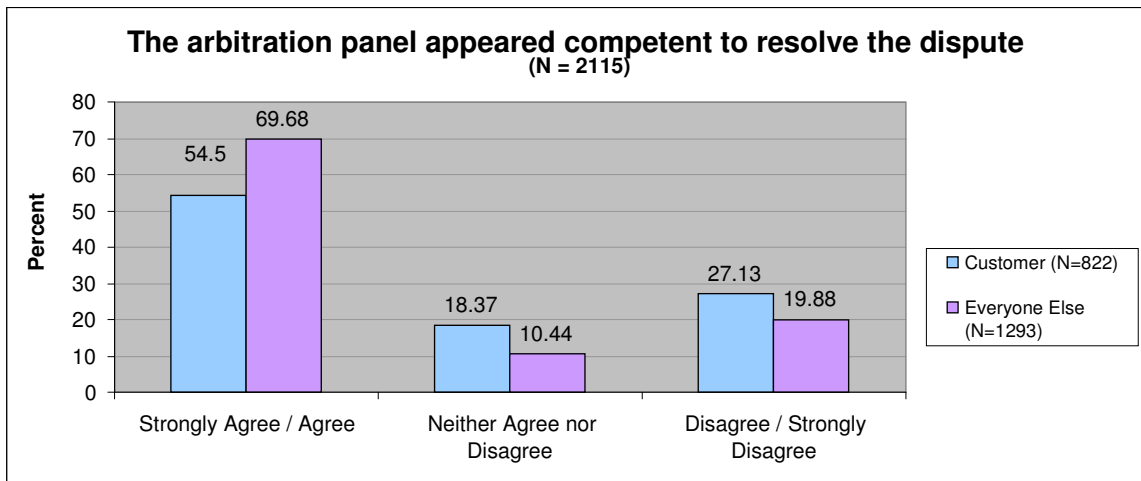


Figure 17

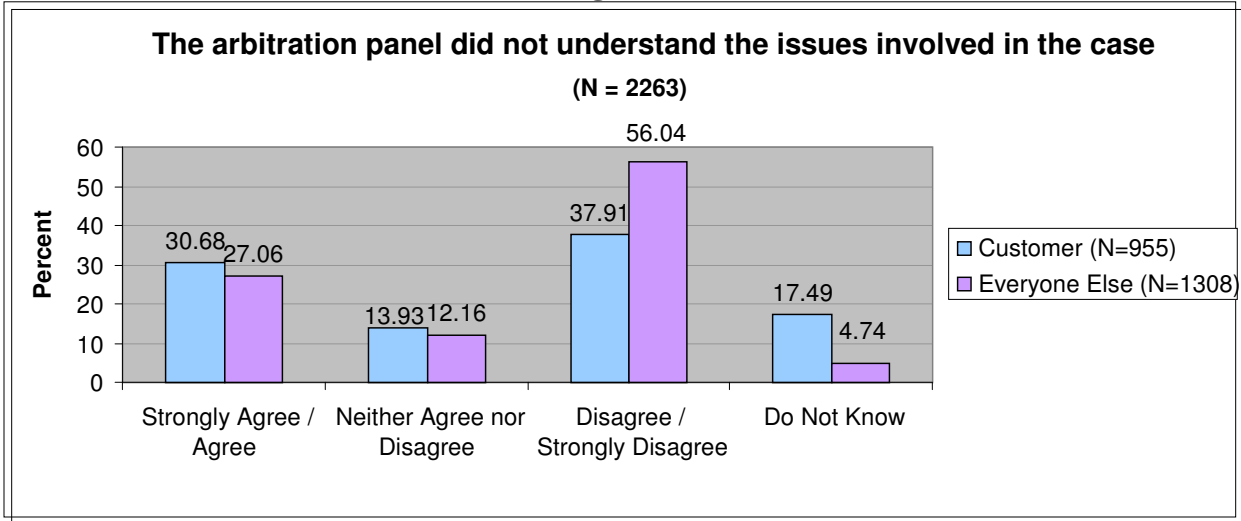


Figure 18

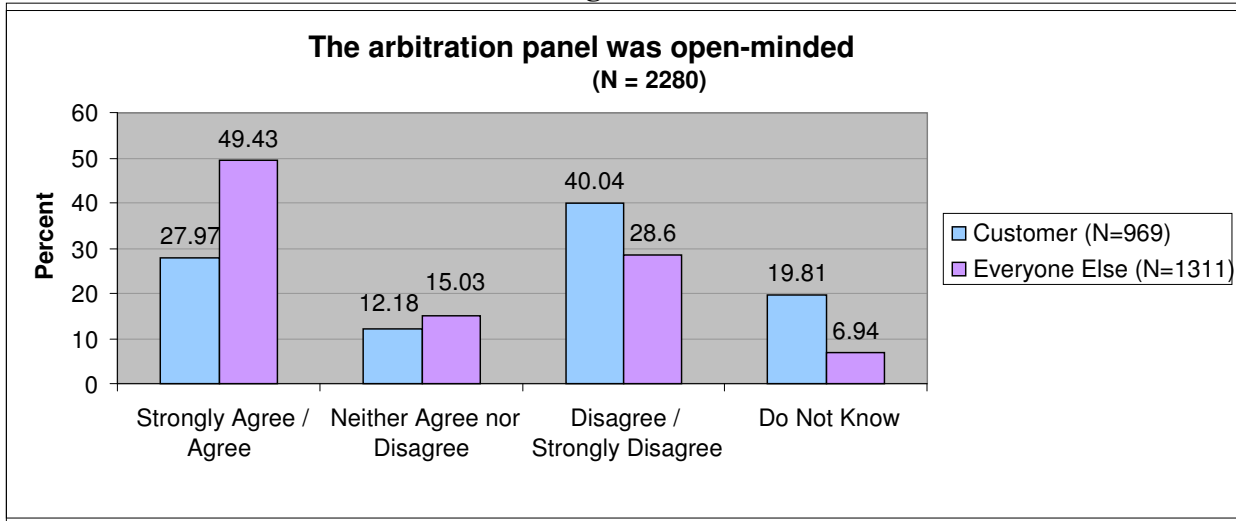


Figure 19

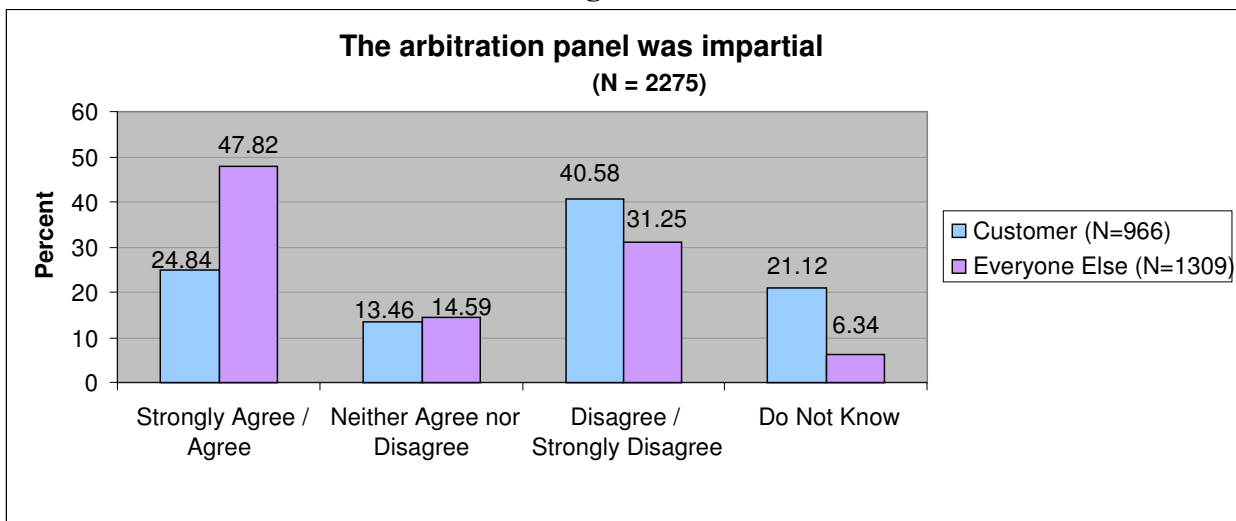


Figure 20

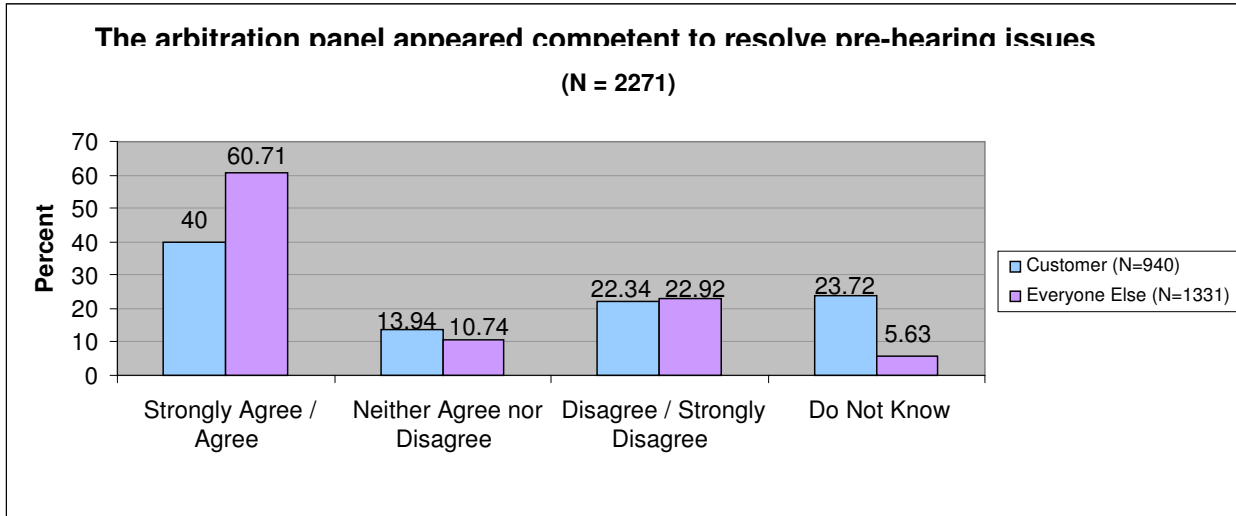


Figure 21

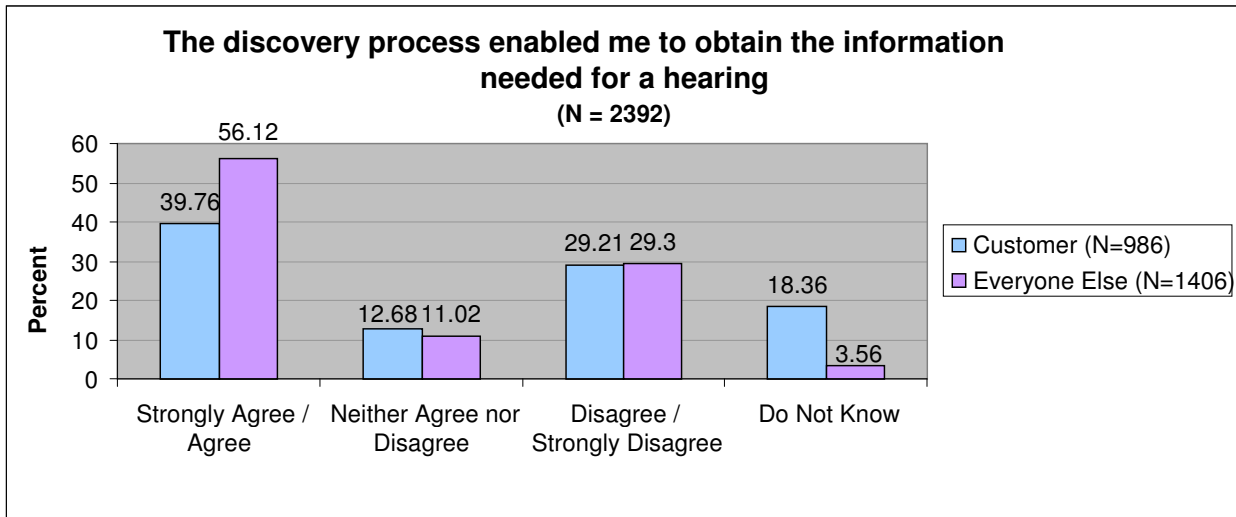


Figure 22

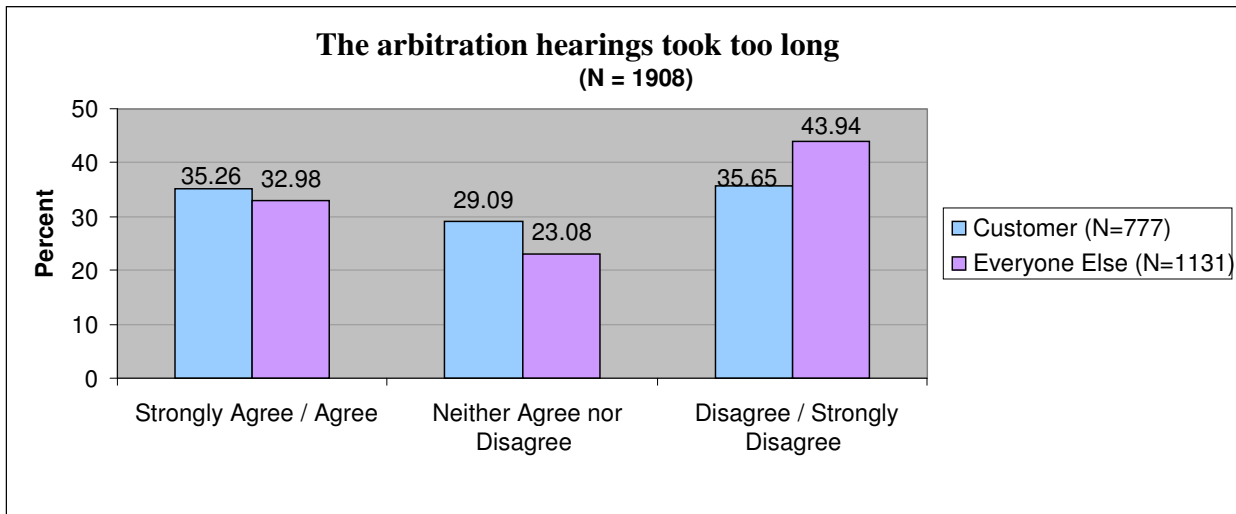


Figure 23

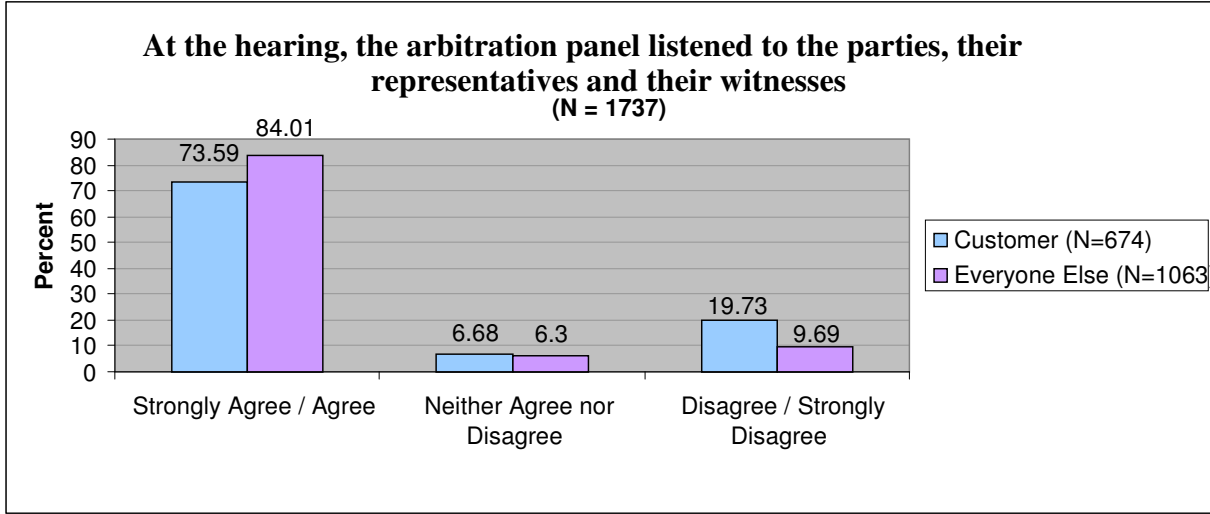


Figure 24

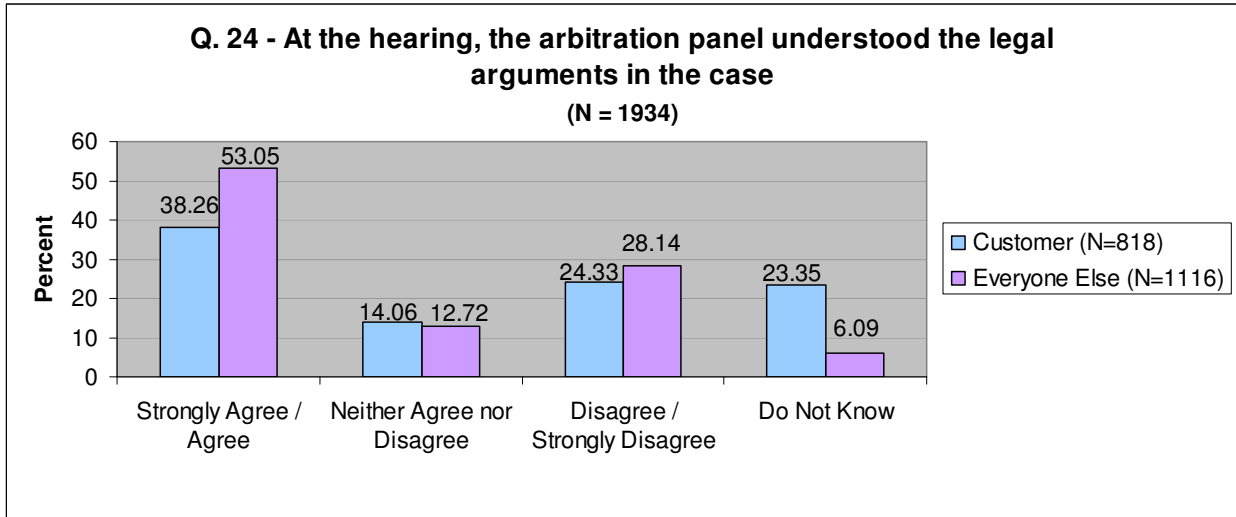


Figure 25

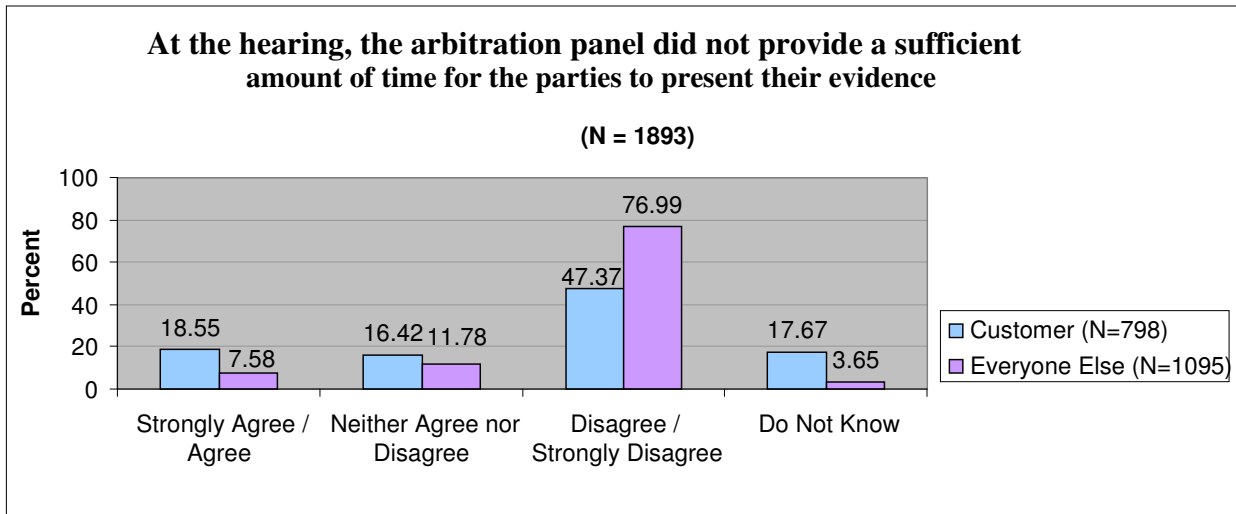


Figure 26

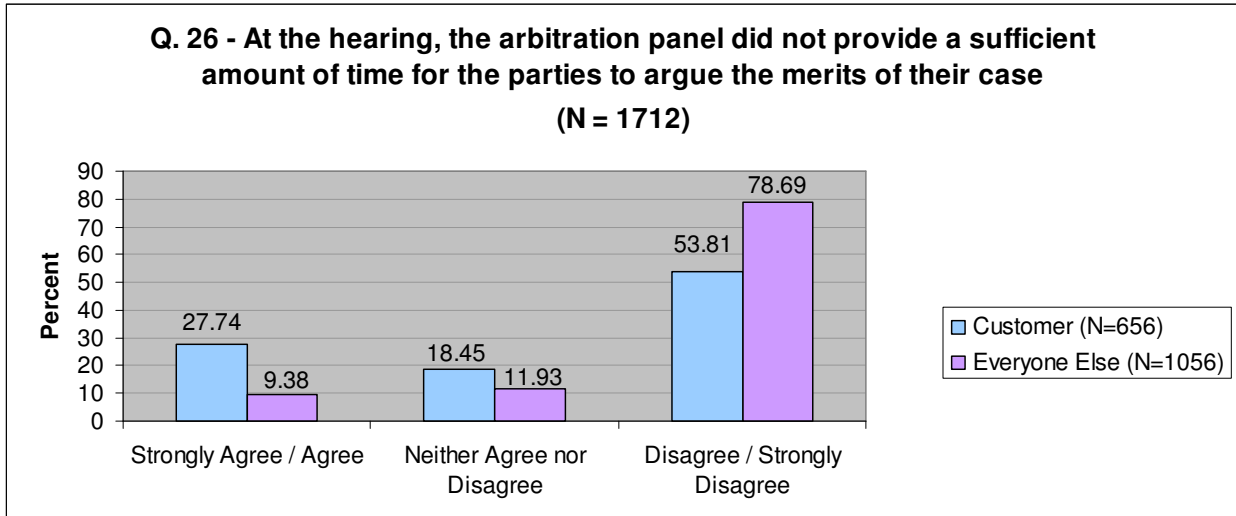


Figure 27

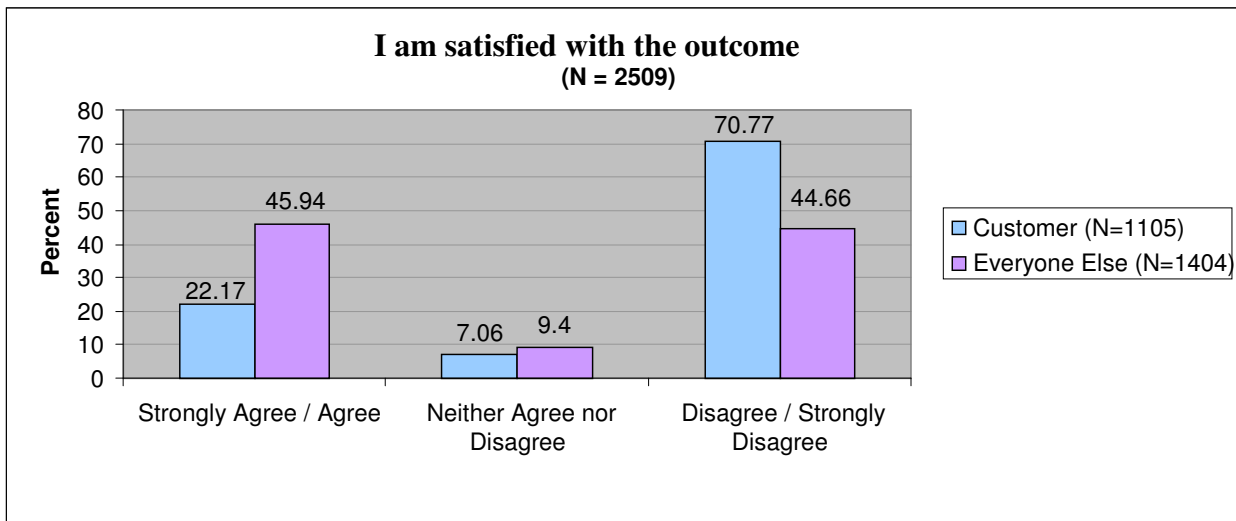


Figure 28

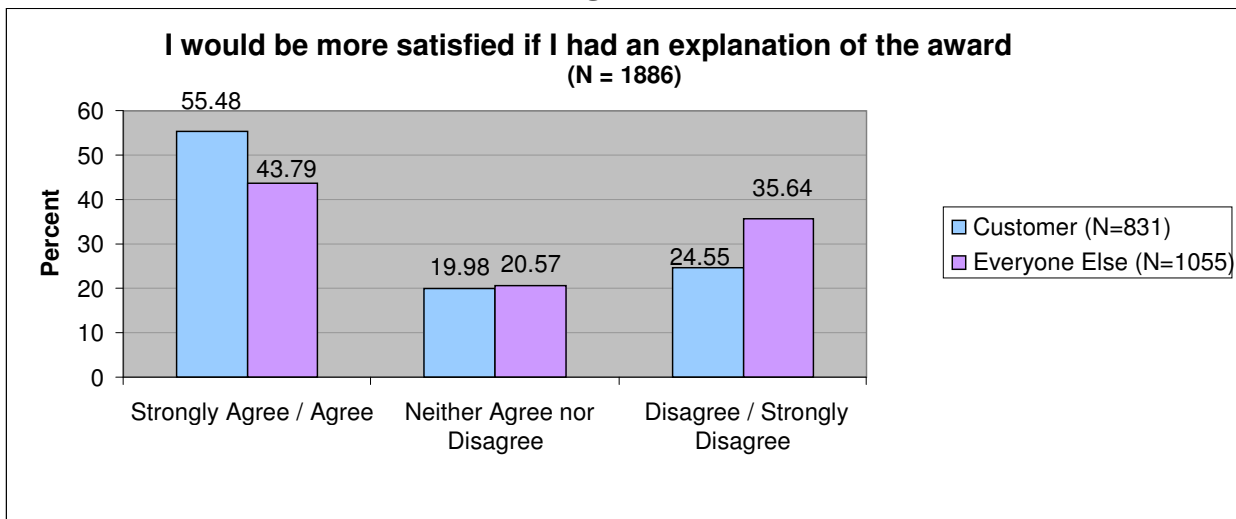


Figure 29

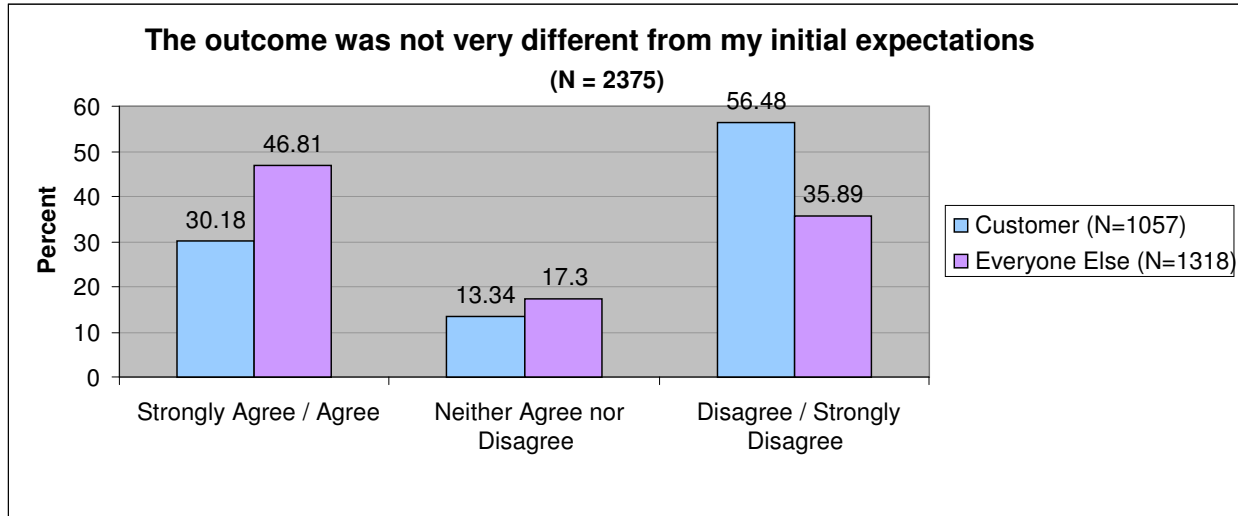


Figure 30

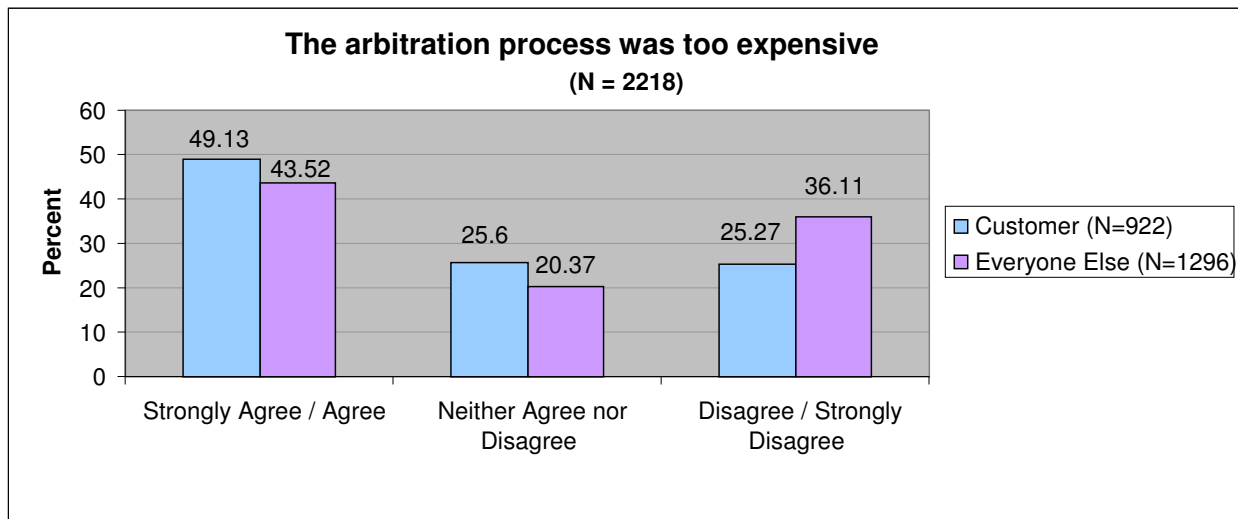


Figure 31

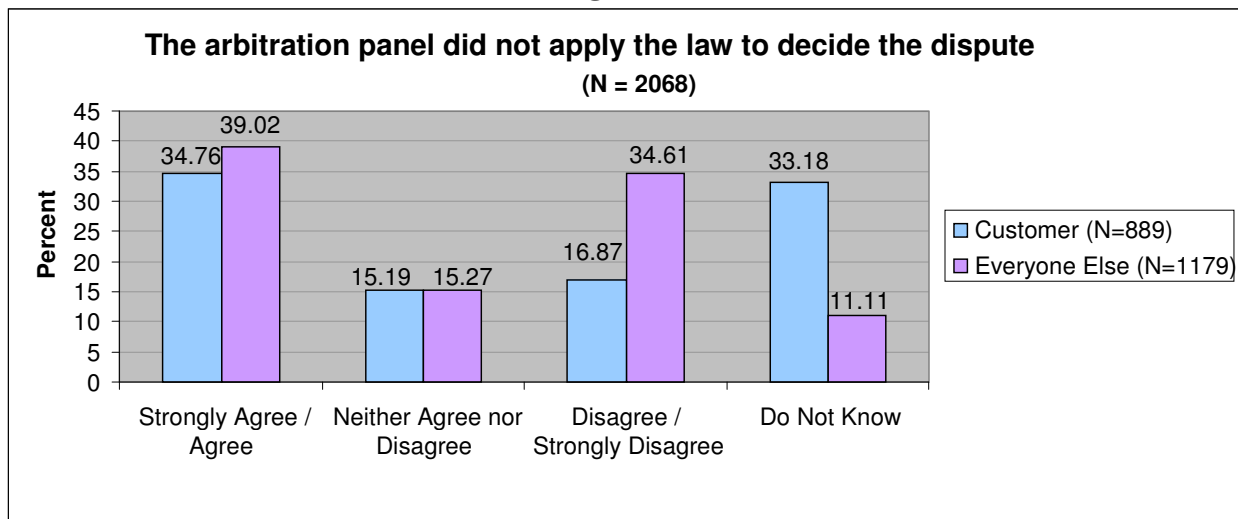


Figure 32

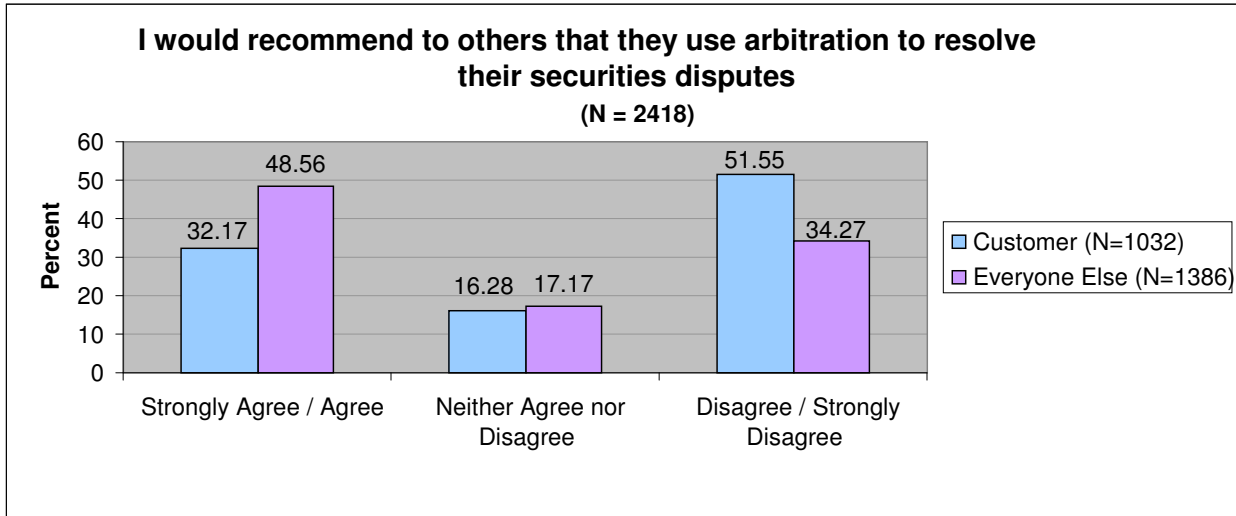


Figure 33

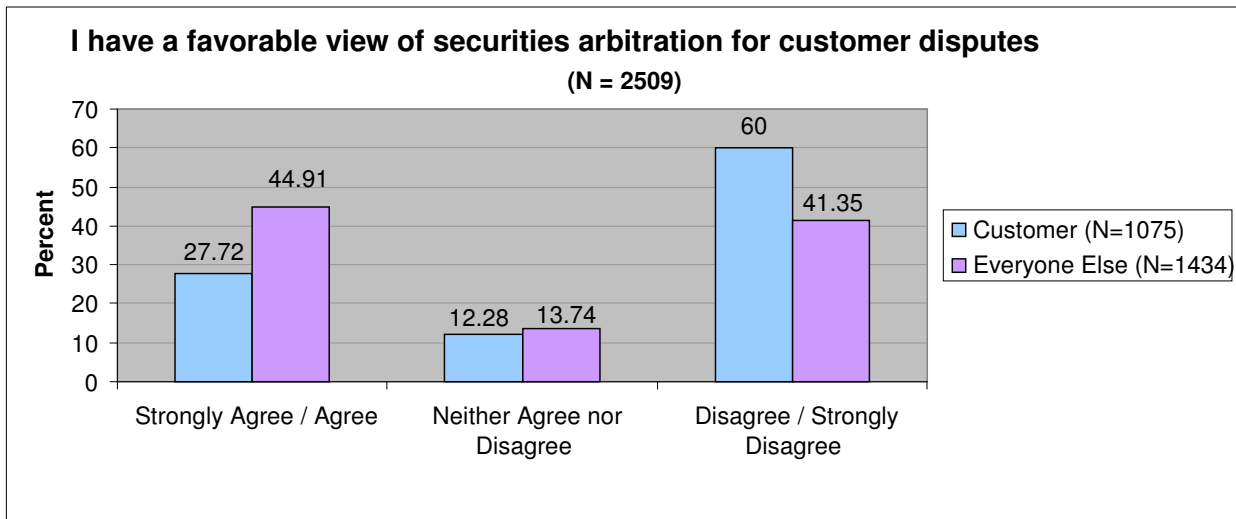
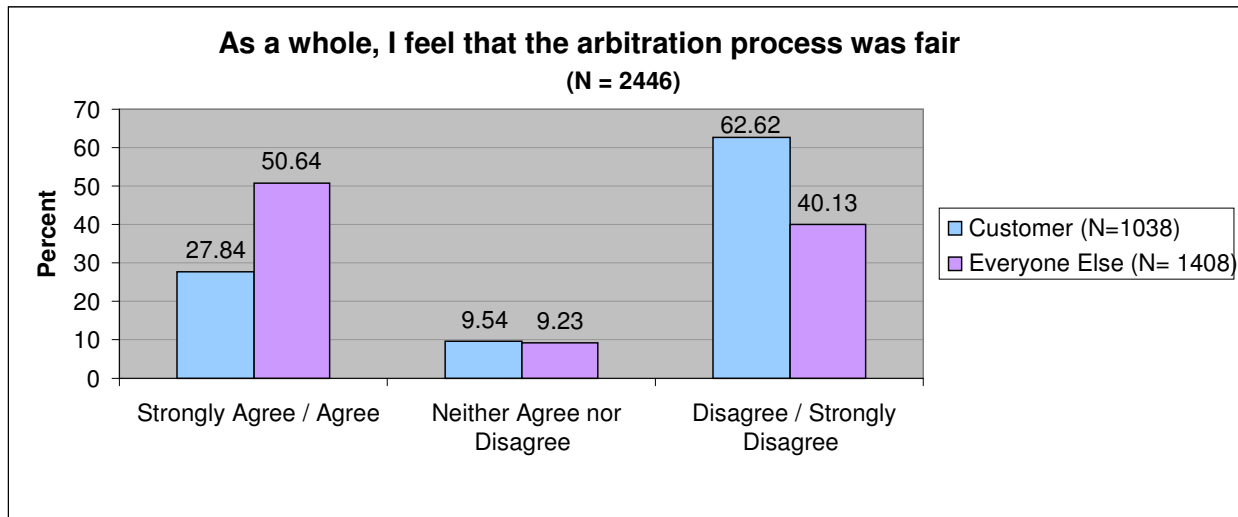


Figure 34



H. Arbitration vs. litigation

Question 35 asked survey participants if, in the last five years, they had been a party or represented a party in at least one civil court case (not involving a criminal, matrimonial or custodial matter and excluding class action lawsuits). Of the total responses (3,024), 59.6% (1,802 responses) said no. The others (1,222 responses) stated their involvement as follows:⁷¹

Figure 35

Nature of involvement in a civil case	Number of survey participants	Percentage of survey participants who answered this question
None	1,802	59.6
Plaintiff in civil case	195	6.4
Represented plaintiff in civil case	563	18.6
Defendant in civil case	140	4.6
Represented defendant in civil case	585	19.3
Do not know/do not recall	42	1.4

The survey directed those survey participants who indicated they were involved in a civil case in the last five years to answer questions 35a and 35b, which asked them to compare their experiences in court and arbitration.⁷² Question 35a (1,084 responses) instructed survey

⁷¹ The totals add up to more than 1,222 because this question directed survey participants to select all that applied.

⁷² For both questions 35a and 35b, the number of customer survey participants who answered the question is far lower than the total number of survey participants who answered this question, thus making the comparisons between the two less meaningful.

participants to focus on their most recent experience in a civil court case and asked how different they thought the result from the arbitration would have been had it proceeded in court.

Figure 35A

How different in court	Number of survey participants who selected this response	Percentage of those who answered this question (N=1,084)	Percentage of customers who answered this question (N=168)
Very different	539	49.7	51.8
A little different	236	21.8	14.29
Exactly the same	131	12.1	4.17
Do not know	178	16.4	29.8

Question 35b (1,088 responses) asked those same survey participants about the fairness of securities arbitration as compared to their most recent experience in a civil court case. While 30.9% found arbitration “very fair” or “somewhat fair,” another 48.9% found arbitration “very unfair” or “somewhat unfair.” In contrast, only 17% of customer-survey participants found arbitration “very fair” or “somewhat fair,” and a striking 75.55% of customers found arbitration “very unfair” or “somewhat unfair.”

Figure 35B

How fair is securities arbitration as compared to court?	Number of survey participants who selected this response	Percentage of those who answered this question (N=1,088)	Percentage of customers who answered this question (N=135)
Very fair	196	18.0	9.63
Somewhat fair	140	12.9	7.41
Equally fair	149	13.7	7.41
Somewhat unfair	197	18.1	12.59
Very unfair	335	30.8	62.96
Do not know	71	6.5	N/A

Question 36 (2,947 responses) asked all survey participants if, based on their experiences in one or more customer arbitrations, given the choice, they would choose arbitration to resolve a customer dispute in the future. 24.65% (335) of customers (1,359) said they would, in

comparison with 46% (730) of all other participants (1,588). In contrast, 35% (473) of customers said they would not choose arbitration because it is unfair, in comparison with 25% (395) of all other participants. The breakdown of all responses, as well as by customer-survey participants, is as follows:⁷³

Figure 36

Would you choose arbitration in the future?	Number of survey participants who selected this response	Percentage of non-customers who answered this question	Percentage of customers who answered this question
I would choose arbitration over court	1,065	46	24.7
I would not choose arbitration because it is not fair	868	24.9	34.8
Not sure	602	15.9	25.8
I would not choose arbitration because the arbitrators are not competent to resolve customer-broker disputes	472	15.9	16.2
I would not choose arbitration because it is more expensive	218	8.4	6.18
None of the above			
I would not choose arbitration because it takes more time	133	4.5	4.5

We then asked, in question 37 (2,857 responses), all survey participants whether they were familiar with procedural rule changes made by the forums in the past five years and, if so, their opinion of the changes. 93% (1,213) of customers (1,306) said they were not familiar with the changes, in comparison with 40% (623) of all other participants (1,551).⁷⁴

I. Overall perceptions of arbitration

Finally, question 38 asked all survey participants the extent to which they agreed or disagreed with four statements regarding the securities arbitration process. For these questions, the survey participants were asked their “opinion” and were not instructed to focus on their experience in their most recent dispute.

⁷³ The question directed survey participants to select all that applied.

⁷⁴ We do not provide the opinions of customers who said they were familiar with the changes because there were so few of them.

Figure 38a (N=2617)
Arbitration was Simple for All Parties
Customers = 1109; All Others = 1508

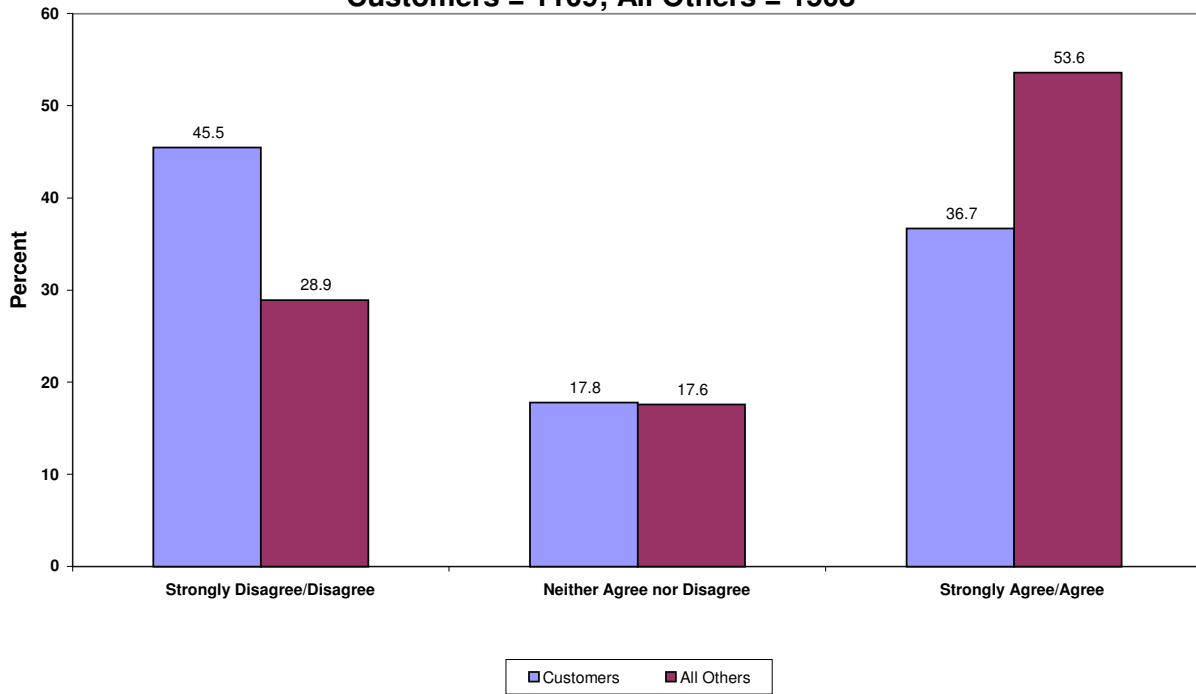


Figure 38b (N=2613)
Arbitration was Fair for All Parties
Customers = 1104; All Others = 1509

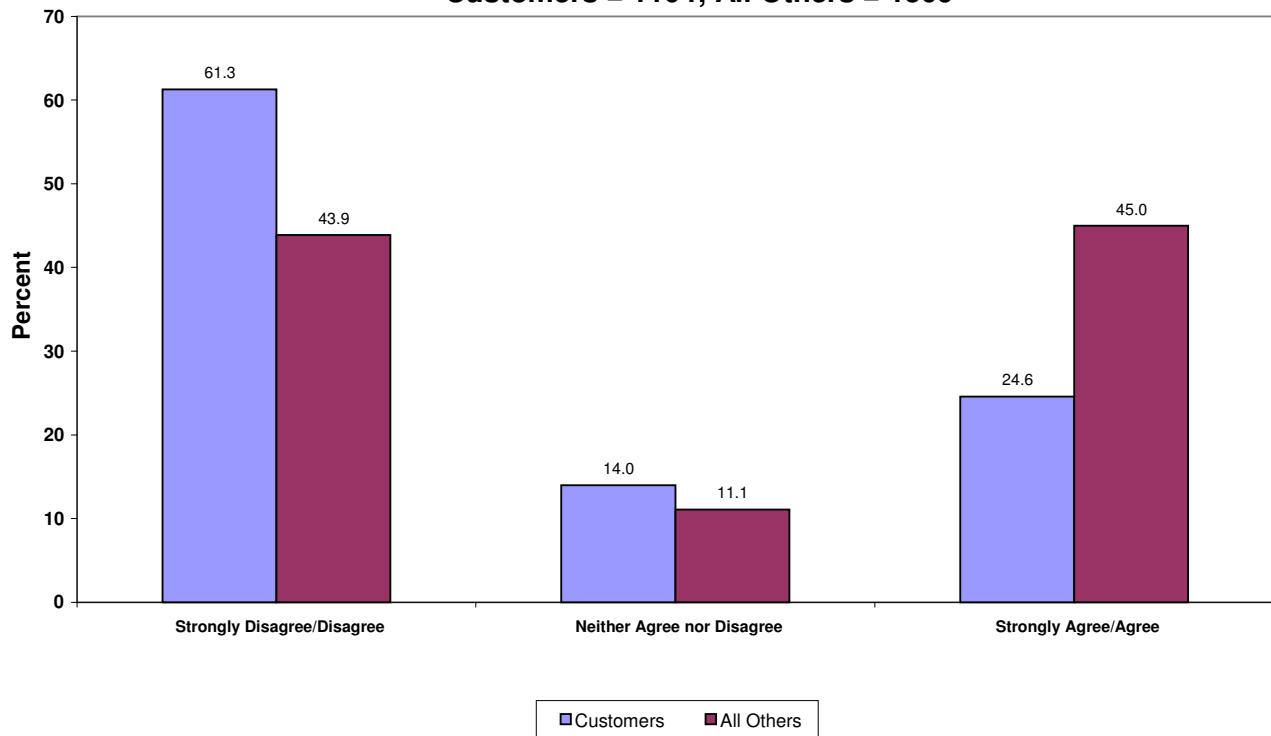


Figure 38c (N=2824)
Arbitration was Economical for All Parties
Customers = 1268; All Others = 1556

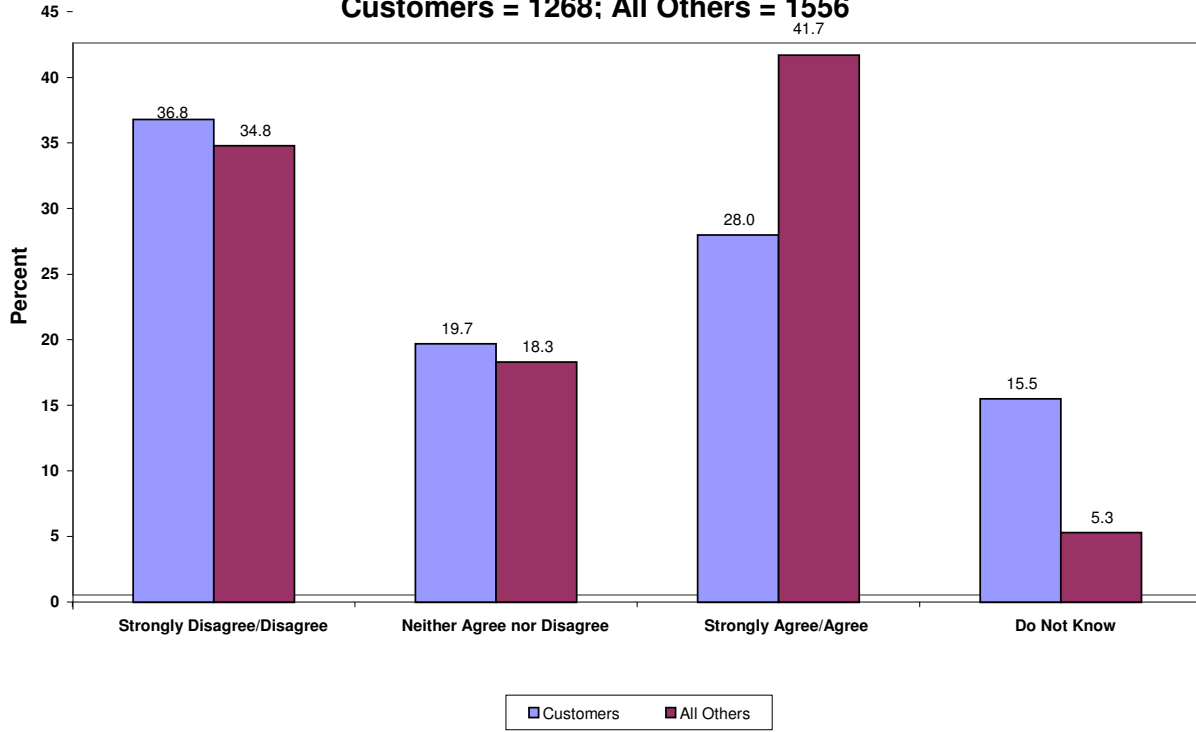
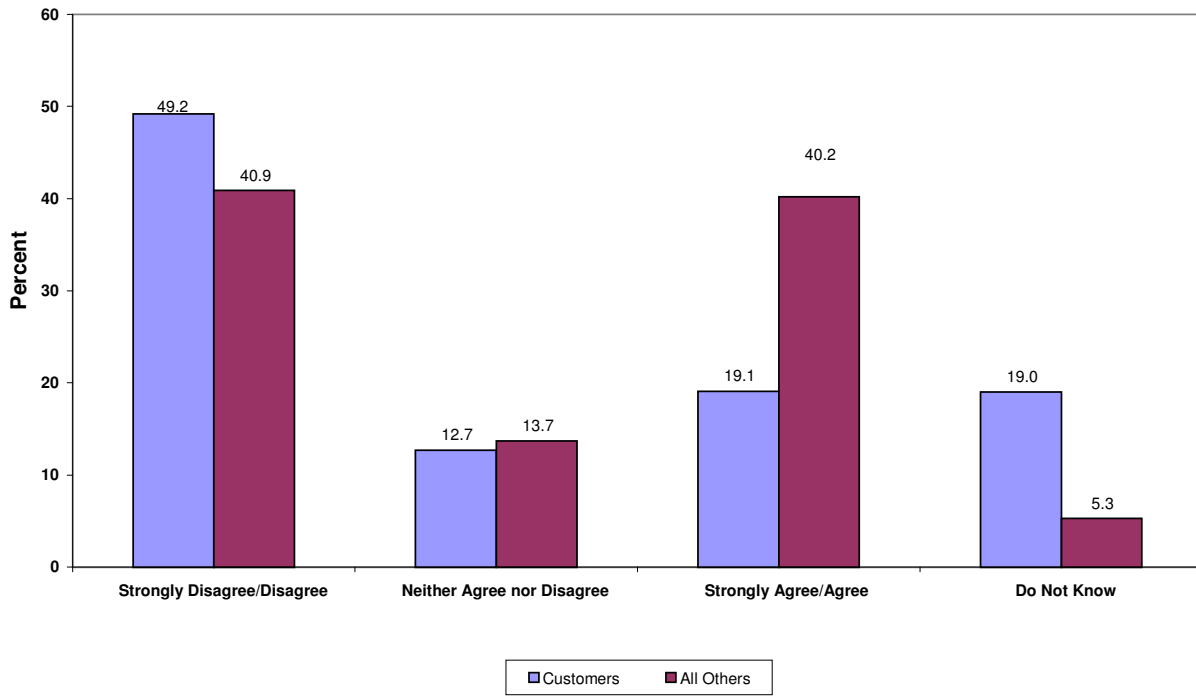


Figure 38d (N=2826)
Arbitration was Without Bias for All Parties
Customers = 1273; All Others = 1553



V. ANALYSIS OF THE FINDINGS

This survey gathered a wealth of useful data that adds to the current understanding of participants' perceptions of the fairness of securities arbitration. Our analysis of the data indicates that, overall, survey participants' perceptions of securities arbitration are nuanced, complex and resist summary categorization. Individual investors (customers), however, spoke with a clearer voice. As discussed below, customers have more negative views about their most recent securities arbitration experience than all other participants (as a group) in the process.

A. Customers Have a Favorable View of Arbitrators' Attentiveness and Competence

A majority of customers gave positive assessments, based on their experience at their most recent dispute, of the arbitrators' attentiveness at the hearing and their competence, as well as the sufficiency of time at the hearing to argue the merits of the case (although, for each question, customers' responses were less favorable than those of all other participants as a group). Thus:

- 74% of customers agreed with the positive statement that “at the hearing, the arbitration panel listened to the parties, their representatives and their witnesses,” while 20% of customers disagreed with the statement. In comparison, 84% of all other participants agreed with the statement, and 10% of all other participants disagreed with it.⁷⁵
- 54.5% of customers agreed with the positive statement that “the arbitration panel appeared competent to resolve the dispute,” while 27% of customers disagreed with the statement. In comparison, 70% of all other participants agreed with the agreement, and 20% of all other participants disagreed with it.⁷⁶
- 54% of customers disagreed with the negative statement that “at the hearing, the arbitration panel did not provide a sufficient amount of time for the parties to argue the merits of their case,” while 28% of customers agreed with the statement. In comparison, 79% of all other participants disagreed with the statement, and 9% of all other participants agreed with it.⁷⁷

A high percentage of customers also expressed general satisfaction about other aspects of the performance of the arbitrators, based on their most recent experience (although, again, they did not give them as high marks as did all other participants). Thus,

- 47% of customers disagreed with the negative statement that “at the hearing, the arbitration panel did not provide a sufficient amount of time for the parties to present their evidence,” while 19% of customers agreed with the statement. In comparison, 77%

⁷⁵ Figure 23.

⁷⁶ Figure 16.

⁷⁷ Figure 26.

of all other participants disagreed with the statement, and 8% of all other participants agreed with it.⁷⁸

- 40% of customers agreed with the positive statement that “the arbitration panel appeared competent to resolve pre-hearing issues,” while 22% of customers disagreed with the statement. In comparison, 61% of all other participants agreed with the statement, and 23% of all other participants disagreed with it.⁷⁹
- 40% of customers agreed with the positive statement that “the discovery process enabled me to obtain the information necessary for a hearing,” while 29% of customers disagreed with the statement. In comparison, 56% of all other participants agreed with the statement, and 29% of all other participants disagreed with it.⁸⁰
- 38% of customers disagreed with the negative statement that “the arbitration panel did not understand the issues involved in the case,” while 31% of customers agreed with the statement. In comparison, 56% of all other participants disagreed with the statement, and 27% of all other participants agreed with it.⁸¹
- 38% of customers agreed with the positive statement that “at the hearing, the arbitration panel understood the legal arguments in the case,” while 24% of customers disagreed with the statement. In comparison, 53% of all other participants agreed with the statement, and 28% of all other participants disagreed with it.⁸²

Customers were about equally divided on whether “the arbitration hearings took too long,” with 36% of customers disagreeing with the negative statement and 35% of customers agreeing with it. In comparison, 44% of all other participants disagreed with the negative statement, and 33% of all other participants agreed with it.⁸³ Finally, 35% of customers believed that the arbitrators “did not apply the law to decide the dispute,” while 17% of customers disagreed with that statement. If customers believe that arbitrators should apply the law, then that is a negative assessment of their performance. In comparison, 39% of all other participants believed that the arbitrators did not apply the law, and 35% of all other participants disagreed with the statement.⁸⁴

⁷⁸ Figure 25.

⁷⁹ Figure 20.

⁸⁰ Figure 21.

⁸¹ Figure 17

⁸² Figure 24. This rare instance where all other participants have a greater negative response to a positive statement than the customers may reflect the likelihood that all other participants have a better understanding of the legal principles, because 23% of customers said “they did not know,” compared with 6% of all other participants.

⁸³ Figure 22.

⁸⁴ Figure 31.

B. A Significant Percentage of Customers Believe the Arbitration Panel is Biased

The questions that generated the most negative customer reactions asked about perceptions of arbitrator impartiality, based on their most recent experience in arbitration. Thus:

- 41% of customers disagreed with the positive statement that “the arbitration panel was impartial,” while 25% of customers agreed with it. In comparison, 31% of all other participants disagreed with the statement, and 48% of all other participants agreed with it.⁸⁵
- 40% of customers disagreed with the positive statement that “the arbitration panel was open-minded,” while 28% of customers agreed with it. In comparison, 29% of all other participants disagreed with the statement, and 49% of all other participants agreed with it.⁸⁶

Customers were more equivocal, however, when asked directly to compare the performance of the public and the industry arbitrator, perhaps because many of them had no opportunity to assess the arbitrators’ performance.⁸⁷ Thus,

- 24% of customers perceived a difference between the performance of the public arbitrators and the industry arbitrator, while 21.5% of customers said there was no difference. In comparison, 25% of all other participants perceived a difference, and 42% did not.⁸⁸
- 36.5% of customers perceived that the industry arbitrator favored at least one securities party, while 22% of customers disagreed with the statement that the industry arbitrator favored one side over the other. In comparison, 15% of all other participants perceived that the industry arbitrator favored at least one securities party, and 50% of all other participants disagreed with the statement that the industry arbitrator favored one side over the other. 2% of customers answered that the industry arbitrator favored the customer, compared with 8% of all other participants⁸⁹
- 29% of customers said the public arbitrator favored at least one securities party, while 24% of customers responded that the public arbitrator did not favor one side over the

⁸⁵ Figure 19. A small number of survey participants answered this question while indicating in response to question 11 that their most recent dispute did not progress to a hearing. Thus, a small number of responses to this question appear to be based on perceptions derived from something *other than* those participants’ experiences at a hearing in their most recent dispute that was filed for arbitration. This observation also applies to the data for questions 22 through 26.

⁸⁶ Figure 18.

⁸⁷ 43% of customers said that they had no opportunity to assess the performance of the public vs. the industry arbitrator, compared with 28% of all other participants (Question 14c), 40% of customers said they had no opportunity to assess the performance of the industry arbitrator, compared with 27% of all other participants (Question 14d), and 33% of customers said there was no opportunity to assess the performance of the public arbitrator, compared with 24% of all other participants (Question 15).

⁸⁸ Figure 14c.

⁸⁹ Figure 14d.

other at any time during the dispute, and 2% of customers said that the public arbitrator favored the customer. In comparison, 8% of all other participants said the public arbitrator favored at least one securities party, 49% of all other participants said that the public arbitrator did not favor one side over the other at any time during the dispute, and 13% of all other participants said that the public arbitrator favored the customer.⁹⁰

C. Customers Are Dissatisfied With The Outcome

Customers expressed strong dissatisfaction with the outcome of their most recent securities arbitration case. An overwhelming 71% of customers disagreed with the positive statement that “I am satisfied with the outcome,” and only 22% of customers agreed with that statement. In comparison, the responses of all other participants were about equally divided, with 45% disagreeing with the statement and 46% of all other participants agreeing with it.⁹¹ Furthermore, a majority of customers (56%) disagreed with the positive statement that “the outcome was not very different from my initial expectation,” while 30% of customers agreed with the statement. In comparison, 36% of all other participants disagreed with the statement, and 47% of all other participants agreed with it.⁹² We cannot, of course, assess the basis for their initial expectations or their reasonableness. As expected, upon closer examination, a party’s satisfaction rates tended to decrease in direct correlation to that party’s degree of success in his/her most recent dispute as measured by his/her response to questions 11 (manner of resolution) and 12b (percentage of damages originally claimed that were actually awarded).

Moreover, 55% of customers agreed with the negative statement that “I would be more satisfied if I had an explanation of the award,” and only 25% of customers disagreed with that statement. In comparison, 44% of all other participants said they would be more satisfied if they had an explanation, and 36% of all other participants disagreed with the statement.⁹³ We cannot assess whether this response is more a reflection of their dissatisfaction with the outcome than an actual desire for an explanation. Over two years ago, NASD proposed changing the arbitration rules to require arbitrators to issue an explained award if the customer requests it.⁹⁴ It remains to be seen whether these findings will provide momentum for FINRA’s revival of the proposal.

⁹⁰ Figure 15.

⁹¹ Figure 27.

⁹² Figure 29.

⁹³ Figure 28.

⁹⁴ See *supra* note 15.

D. Customers Do Not Believe Arbitration Compares Favorably To Litigation

The survey asked participants to compare their experience in arbitration to a comparable litigation experience.⁹⁵ Because of the small number of customers who answered these questions, we believe the responses are of limited utility. Moreover, because so few customer-broker disputes have proceeded through the courts in the last twenty years, we do not believe those who responded to this question could have been making a valid comparison. However, from the perspective of those customers who responded, arbitration fared poorly by comparison.⁹⁶

All survey participants were asked if, based on their overall arbitration experience, given the choice, they would choose arbitration to resolve a customer dispute in the future. 35% of customers responded that they would not choose arbitration because it is unfair, 25% of customers said they would choose arbitration, and another 26% of customers were not sure. In comparison, 25% of all other participants said they would not choose arbitration because it is unfair, 46% of all other participants said they would choose arbitration, and 16% said they were not sure.⁹⁷

Particularly with respect to customers, who are unlikely to have had any comparable litigation experience,⁹⁸ these responses may be best explained as a reflection of their dissatisfaction with their arbitration experience – “anything else must be better than this.”

E. Customers Lack Knowledge of the Securities Arbitration Process

Perhaps our most consistent – though not surprising -- finding was the lack of knowledge of customers about securities arbitration. Individual investors stated that they have less knowledge about the arbitration process more frequently than other participants in the process. Some of this lack of knowledge relates to the composition of the arbitration panel. Thus,

- 47% of customers knew, prior to the filing of the arbitration, that one arbitrator would be an “industry arbitrator,” compared with 94% of all other participants.⁹⁹

⁹⁵ Figure 35a and b.

⁹⁶ See *supra* Figure 35b.

⁹⁷ Figure 36.

⁹⁸ Since the Supreme Court declared PDAs enforceable in all customer disputes, *supra* note 3, few customers have been able to litigate their claims, as reflected in the small number of customers who responded to questions 35a and b, *supra* note 72.

⁹⁹ Figure 14a.

- 48% of customers knew, at some time during the dispute, which arbitrators were “public” and which arbitrator was “industry,” compared with 88% of all other types of survey participants.¹⁰⁰

Customers also stated they “did not know” in response to questions assessing the arbitrators’ performance more frequently than all other participants as a group. Customers may answer “do not know” because they believe they do not have sufficient knowledge of the substantive and procedural law governing arbitration to answer these questions. Thus,

- 33% of customers said they did not know whether “the arbitration panel did not apply the law to decide the dispute,” compared to 11% of all other participants.¹⁰¹
- 24% of customers said they did not know whether “the arbitration panel appeared competent to resolve pre-hearing issues,” compared with 6% of all other participants.¹⁰²
- 23% of customers said they did not know whether “at the hearing, the arbitration panel understood the legal arguments in the case,” compared with 6% of all other participants.¹⁰³
- 21% of customers said they did not know whether “the arbitration panel was impartial,” compared with 6% of all other participants.¹⁰⁴
- 20% of customers said they did not know whether “the arbitration panel was open-minded,” compared with 7% of all other participants.¹⁰⁵
- 18% of customers said they did not know whether “at the hearing, the arbitration panel did not provide a sufficient amount of time for the parties to present their evidence,” compared with 4% of all other participants.¹⁰⁶
- 17% of customers said they did not know whether “the arbitration panel did not understand the issues involved in the case,” compared with 5% of all other participants.¹⁰⁷
- 12% of customers said they did not know or did not recall whether the public arbitrator favored one side over the other at any time during the dispute, compared with 6% of all other participants.¹⁰⁸

¹⁰⁰ Figure 14b.

¹⁰¹ Figure 31.

¹⁰² Figure 20.

¹⁰³ Figure 24.

¹⁰⁴ Figure 19.

¹⁰⁵ Figure 18.

¹⁰⁶ Figure 25.

¹⁰⁷ Figure 17.

¹⁰⁸ Figure 15.

Moreover, in responses to some other questions that relate to aspects of arbitration other than arbitrators' performance, customers said they "did not know" more frequently than all other participants. This expression of lack of knowledge, again, may reflect less familiarity with the substantive law and arbitration procedure than what all other participants are likely to have. For example, 18% of customers said that they did not know whether "the discovery process enabled me to obtain the information necessary for a hearing," compared with 4% of all other participants.¹⁰⁹ So few customers indicated familiarity with recent changes in arbitration rules that we did not tabulate their responses to this question.¹¹⁰

It is certainly not surprising that many customers express less knowledge of the process since, unlike the other participants, few of them are likely to be lawyers with an expertise in this area or members of the securities industry. While customers may believe (rightly or wrongly) that they have a good understanding of other aspects of the judicial system – for example, criminal trials which are frequently featured in popular media both in fictionalized and real-life accounts – they are less likely to believe this about a specialized process whose proceedings do not make headlines, are kept confidential and are not the subject of television shows. While investors' lack of knowledge may color their views of their most recent securities arbitration experience, we have no basis to assume it results in a more negative assessment. It does indicate, however, that the forum and customers' lawyers¹¹¹ need to step up their efforts to educate investors about brokerage firms' legal duties to their customers and, in particular, the securities arbitration process.

F. Customers Have Unfavorable Perceptions Overall of the Fairness of Securities Arbitration.

Our study found that customers express a consistently negative impression of the overall arbitration process, whether based on their most recent experience or on their general impressions. Thus, 63% of customers did not believe that, overall, the process was fair,¹¹² 60%

¹⁰⁹ Figure 21.

¹¹⁰ Figure 37.

¹¹¹ We have heard anecdotally about investors' complaints that their lawyers misled them about their chances of success in arbitration, about the cost and/or length of the process, and about the anti-investor securities laws.

¹¹² Specifically, 63% of customers disagreed with the positive statement that "as a whole, I feel the arbitration process was fair," and 28% of customers agreed with the statement. In comparison, 40% of all other participants disagreed with the statement, and 51% of all other participants agreed with it. Figure 34.

of customers did not have a favorable view of arbitration,¹¹³ 52% of customers would not recommend arbitration to others,¹¹⁴ and 49% of customers said it was too expensive.¹¹⁵

Moreover, when directed to respond based on their overall impressions of the fairness of the securities arbitration process, customers responded even more negatively than when directed to focus on their most recent arbitration experience.¹¹⁶ Thus,

- 61% of customers disagreed with the statement that “arbitration was fair for all parties,” 25% of customers agreed with the statement, and 14% of customers neither agreed nor disagreed with the statement. In comparison, 44% of all other participants disagreed with the statement, 45% of all other participants agreed with the statement, and 11% of all other participants neither agreed nor disagreed with the statement.¹¹⁷
- 49% of customers disagreed with the statement that “arbitration was without bias,” 19% of customers agreed with the statement, 19% of customers said they did not know, and 13% of customers neither agreed nor disagreed with the statement. In comparison, 41% of all other participants disagreed with the statement, 40% of all other participants agreed with the statement, 5% of all other participants said they did not know, and 14% of all other participants neither agreed nor disagreed with the statement.¹¹⁸
- 45.5% of customers disagreed with the statement that “arbitration is simple for all parties,” and 37% of customers agreed with the statement. In comparison, 29% of all other participants disagreed with the statement, and 54% of all other participants agreed with it. An equal percentage (18%) of customers and all other participants neither agreed nor disagreed with the statement.
- 37% of customers disagreed with the statement that “arbitration is economical for all parties,” 28% of customers agreed with the statement, 20% of customers neither

¹¹³ 60% of customers disagreed with the positive statement that “I have a favorable view of securities arbitration for customer disputes,” and 28% of customers agreed with the statement. In comparison, 41% of all other participants disagreed with the statement, and 45% of all other participants agreed with it. Figure 33.

¹¹⁴ 52% of customers disagreed with the positive statement that “I would recommend to others that they use arbitration to resolve their securities disputes,” and 32% of customers agreed with the statement. In comparison, 34% of all other participants disagreed with the statement, and 49% of all other participants agreed with it. Figure 32.

¹¹⁵ 49% of customers agreed with the negative statement that “the arbitration process was too expensive,” and 25% of customers disagreed with the statement. In comparison, 44% of all other participants agreed with the statement, and 36% of all other participants disagreed with it. Figure 30.

¹¹⁶ These findings must be reconciled with the reality that customers are likely to have had only one experience with the process. Surveyors typically devalue answers to questions seeking impressions because they are much more subject to recall bias. See *supra* note 42 and accompanying text. The fact that customers’ impressions were more negative than for their most recent experience, even though most of the population likely only had one experience, lends support to the hypothesis that recall bias and other factors other than their actual experience contributed greatly to their negative perceptions.

¹¹⁷ Figure 38b.

¹¹⁸ Figure 38d.

agreed nor disagreed with the statement, and 15.5% of customers did not know. In comparison, 35% of all other participants disagreed with the statement, 42% of all other participants agreed with the statement, 18% of all other participants neither agreed nor disagreed with the statement, and 5% of all other participants did not know.¹¹⁹

In the next section, we explore some possible explanations for these consistently negative impressions.

G. Explanations for Customers' Negative Perceptions

Because the survey (intentionally) did not ask open-ended questions, we can offer only theories explaining customers' negative perceptions about the fairness of securities arbitration.¹²⁰ Our first three theories directly stem from the process itself; our remaining theories stem from more remote factors.

1. Explanations Related to the Process.

Securities Arbitration is Unfair. One explanation may be that securities arbitration is, in fact, unfair. Indeed, certain of our survey data buttresses this conclusion: while 39% of customers had concerns about the fairness of the process *before* they filed their dispute with the arbitration forum,¹²¹ a disturbing 63% of customers do not agree that, *after* their most recent arbitration experience, the process was fair.¹²² We were particularly struck by the fact that customers' level of discontent increased by more than 20 percentage points after going through a securities arbitration proceeding.

Moreover, all recent studies of outcomes based on published awards show a decline in investors' win rates in recent years, providing some support for this theory.¹²³ First, *Empirical Evidence of Worsening Conditions for the Investor in Securities Arbitration*,¹²⁴ a 2002 report, concluded that conditions have worsened over time for investors: their success rate has declined, brokers are more likely to prevail on their counterclaims, and repeat players have a competitive advantage. Second, a 2007 study entitled *Mandatory Arbitration of Securities Disputes: A*

¹¹⁹ Figure 38c.

¹²⁰ We had hoped to explore some of these theories in follow-up telephone interviews with survey participants who expressed a willingness to speak about their experience, but SICA declined to allow this.

¹²¹ Figure 8.

¹²² Figure 34.

¹²³ Awards generally give insufficient information to make an assessment of the merits of the claim, and over 50% of filed claims are concluded by settlement that does not result in an award; *see* How Arbitration Cases Close, available at <http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/Statistics/index.htm>.

¹²⁴ 12 SECURITIES ARBITRATION COMMENTATOR 7 (June 2002). The study was conducted by Richard A. Voytas, Jr.

*Statistical Analysis of How Claimants Fare*¹²⁵ (“O’Neal/Solin Study”) analyzed SRO awards from 1995-2004. Its findings include: (1) claimant win rates have declined since 1999, (2) claimant win rates are lower against larger brokerage firms, (3) awards as a percent of amount claimed have declined since 1998, and (4) the larger the case, the lower the award as a percent of the amount claimed. Third, in 2007, the *Securities Arbitration Commentator* (SAC) completed a two-part survey of SRO awards, in which it compared results in 2005 to 2000-04 results.¹²⁶ Its findings include: (1) a decline in customer win rates from 53% in 2001 to 43% in 2005 and (2) a decline in customer median recovery rates (median award/median compensation claimed) from 47% in 2000 to 34% in 2005.

These studies arguably provide some evidence of a decline in substantive justice for investors, but the inability to assess the merits of the claims¹²⁷ and the absence of comparable statistics for settled cases makes this evidence of limited value.¹²⁸ However, we are aware of no study that has measured the substantive fairness of securities arbitration, taking into account both the merits of the claims and the outcomes of settled cases, nor do we think one could be readily accomplished without more transparent awards and a healthy volume of comparable cases in court or an independent arbitration forum.¹²⁹

Appearance of Bias. A second process-related explanation is that the mere appearance of bias from the presence of an industry arbitrator on a three-arbitrator panel fuels customers’ negative perceptions, outweighing other hallmarks of procedural fairness contained in FINRA arbitration rules, such as requirements of notice, a right to be heard, fee waivers for demonstrated hardship, automatic discovery and a convenient hearing location.¹³⁰ Our findings lend credence to this theory: 33.6% of customers had concerns about arbitrator bias pre-filing,¹³¹ 41% did not

¹²⁵ The report was authored by Edward S. O’Neal, Securities Litigation and Consulting Group, and Daniel R. Solin, a securities arbitration attorney representing investors, and is available at <http://www.smartestinvestmentbook.com/> or <http://www.sleg.com/>. This report is discussed further *infra* notes 149-54 and accompanying text.

¹²⁶ 2006 SECURITIES ARBITRATION COMMENTATOR 1, No. 7 & 8 (Feb. 2007), 2006 SECURITIES ARBITRATION COMMENTATOR 1, No. 2 (Apr. 2006).

¹²⁷ The industry, for example, accounts for the drop in investors’ win rates in recent years by asserting that many of investors’ claims arising out of the tech crash were without merit. See *SIFMA White Paper*, *supra* note 6, at 38, 40-42.

¹²⁸ Thus, while 37% of cases decided in 2007 awarded damages to customers, FINRA asserts that nearly 80% of customer cases closed through settlement or award resulted in monetary or non-monetary recovery for investors; see *Results of Customer Claimant Arbitration Award Cases*, available at <http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/Statistics/index.htm>.

¹²⁹ See 2000 GAO Report, *supra* note 28.

¹³⁰ See Gross, *The Regulation of Fairness*, *supra* note 17, at ____.

¹³¹ Figure 8.

believe the arbitration panel was impartial in their most recent arbitration¹³² and 49% of customers disagreed with the statement that arbitration was without bias for all parties.¹³³

SAC conducted the most thoughtful attempt to measure the presence or absence of the industry arbitrator's bias ("SAC Industry Arbitrator Study").¹³⁴ For 2003, it compared the win rates for customers in Simplified Arbitrations,¹³⁵ where there is only one public arbitrator, with win rates in disputes decided by three-person panels, where one member is an industry arbitrator. SAC recognized that a significant limitation of its survey is the different nature of the Simplified Arbitration experience, including smaller amounts involved and the nature of the claim.¹³⁶ Most significantly, 73% of the claims were decided on the papers and not by a hearing. All these factors make a comparison between the two categories of dubious validity. It found, for small claims, a 42% win rate on the papers, a 58% win rate after a hearing, and, for three-person hearings, a 51% win rate. Recognizing that attempting to extrapolate these findings into a conclusion about the presence of the industry arbitrator is "a more difficult calculation,"¹³⁷ SAC stated that the 51% win rate of the three-person panel and the 58% win rate for a one-person hearing prevented it from concluding that the presence of the industry arbitrator "proves neutral to helpful."¹³⁸

To be sure, the problem of biased arbitrators is not confined to the industry arbitrator. Investors' advocates frequently complain that some public arbitrators consistently favor brokerage firms, either by finding against the customer or awarding low damages amounts, because they want brokerage firms to select them for additional cases. One empirical study found that pro-industry arbitrators, as determined based on published awards, are selected more often to panels than pro-investor arbitrators, particularly where a large brokerage firm is a party,

¹³² Figure 19.

¹³³ Figure 38d.

¹³⁴ SAC, *Does the Securities Industry Arbitrator's Presence Create a Discernible Shift in Award Outcomes?* (May 2005).

¹³⁵ See *supra* note 66.

¹³⁶ Thus, it decided not to focus on 2004, because it believed the results may be aberrational, in part, because of the large number of unsuccessful claims and the presence of more pro se claimants resulting from the "conflicted analysts" claims in the aftermath of the Analysts' Global Settlement, see *SAC Industry Arbitrator Study*, *supra* note 134, at 4.

¹³⁷ *Id.*

¹³⁸ *Id.* at 5.

the requested compensatory damages are large, and the customer alleges firm misconduct.¹³⁹ Moreover, selection on the basis of arbitrator bias increased after FINRA changed to a system where parties, and not the forum, selected the arbitrators.¹⁴⁰ Ironically, the SEC approved the adoption of the Neutral List Selection System (“NLSS”) because it believed “that allowing parties greater input into the selection of the arbitrators to hear their cases will help ensure a more fair and neutral arbitration process.”¹⁴¹

Investor advocates also criticize the definition of public arbitrator as including individuals who nonetheless have connections to the industry. A recent study focused on the role of attorneys as arbitrators and found that panels where the chair was an attorney who represented brokerage firms in other securities arbitrations awarded customers significantly less in compensatory damages.¹⁴² In contrast, the study did not find that attorneys who represented investors, or who represented both investors and firms, in securities arbitrations were more generous in awards.¹⁴³ The study also tested for the effect of the adoption of NLSS and found that greater party involvement in the selection process correlates with a reduction in the size of awards.¹⁴⁴ It found no evidence that the 2004 rule changes that expanded the definition of non-public arbitrator and tightened the definition of public arbitrator had any effect.¹⁴⁵ Both these studies suggest that brokerage firms have more influence over the arbitration forum by reason of their “repeat player” status than does the customers’ bar and that reform to place the arbitrator selection process in the control of the parties has increased firms’ dominance. They also provide support for investor advocates’ frequent assertion that the industry is successful in selecting public arbitrators who will side with the industry. To some extent, the SEC’s 2007 approval of the revised list selection system, precluding, among other things, the industry arbitrator from

¹³⁹ Jiro E. Kondo, *Self-Regulation and Enforcement in Financial Markets: Evidence from Investor-Broker Disputes at the NASD 2*, 13 (academic working paper examining arbitration awards from January 1991 to December 2004) (Nov. 20, 2006), available at http://web.mit.edu/jekondo/www/jobmkt_paper.pdf.

¹⁴⁰ *Id.* at 3, 22.

¹⁴¹ Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendments Nos. 3 and 4 to Proposed Rule Change by the Nat’l Assoc. of Sec. Dealers, Inc., Relating to the Selection of Arbitrators in Arbitrations Involving Public Customers, 63 Fed. Reg. 56670, 56681 (Oct. 22, 1998).

¹⁴² Stephen J. Choi, Jill E. Fisch, & A.C. Pritchard, *Attorneys as Arbitrators* 4, 22-23 (using a dataset of 422 randomly selected arbitrators and their 6724 awards from 1992-2006), available at <http://www.ssrn.com/abstract=1086372>.

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 37. The study recognized the difficulty in establishing causality but concluded that the evidence is “at least inconsistent with the view that this reform assisted investor claimants.”

¹⁴⁵ *Id.*

serving as chairperson,¹⁴⁶ as well as its 2008 approval of FINRA's tightened definition of a public arbitrator¹⁴⁷ may redress these criticisms going forward.

Outcome Trumps All. One final process-centered explanation as to why customers believe securities arbitration is unfair despite many procedural protections is that outcome trumps everything. A customer, however fairly treated by objective standards, will not, in the face of an unfavorable outcome, accept that he was treated fairly. Moreover, a customer is likely to view as unfavorable an award of damages that is considerably less than the requested amount.

The previously mentioned recent empirical studies¹⁴⁸ provide some support for this explanation. In particular, the O'Neal/Solin Study¹⁴⁹ provides an extensive review of awards in NASD and NYSE customer arbitrations between January 1995 and December 2004.¹⁵⁰ As with other studies it reports on how often customers win and their recovery as a percentage of the claimed compensatory damages and reaches conclusions consistent with other reports. Thus, it finds that, while the overall win rate for the ten-year period was 51%, the win rates declined from a high in 1999 of 59% to a low of 44% in 2004. It also finds that awards as a percentage of claimed compensatory damages declined from a 1998 high of 68% to a consistent 49-50% in 2002-2004.¹⁵¹ In addition, this study focuses on amounts awarded in comparison with the size of the claim and the size of the securities firm named as respondent. It finds that the greater the amount of claimed damages, the lower the percentage of recovery; thus, the percentage of recovery ranges from 37% in claims over \$250,000 to 76% of claims of less than \$10,000.¹⁵² It also finds that the win rate was 39% against the three largest brokerage firms and 43% against the next seventeen largest firms,¹⁵³ in contrast to the overall 51% win rate. As in other studies, the analysis necessarily cannot take into account the merits of the customers' claims or the reasonableness of the amount claimed as damages, as well as the outcomes of many settled

¹⁴⁶ Self-Regulatory Organizations; Nat'l Assoc. of Sec. Dealers, Inc.; Order Approving Proposed Rule Change and Amdts. 1, 2, 3, and 4 to Amend NASD Arbitration Rules of Customer Disputes, 72 Fed. Reg. 4574, 4585 (Jan.31, 2007).

¹⁴⁷ See Self-Regulatory Organizations; Nat'l Assoc. of Sec. Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.); Order Approving Proposed Rule Change to Amend the Definition of Public Arbitrator, 75 Fed. Reg. 15025 (Mar. 20, 2008).

¹⁴⁸ See *supra* notes 23-26 and accompanying text.

¹⁴⁹ See *supra* note 125.

¹⁵⁰ In all, they examined 13,810 awards, 90% of which were from the NASD forum, the other 10% from NYSE. *Id.* at 6.

¹⁵¹ *Id.* at 11.

¹⁵² *Id.* at 12.

¹⁵³ *Id.* at 10.

outcomes that do not result in an award. Its findings, however, are at least consistent with the frequently-expressed view that some arbitrators will rule in favor of large brokerage firms, particularly in cases claiming a large amount in damages, because they seek the repeat business.¹⁵⁴ It also confirms that, for whatever reason, investors have had more difficulty prevailing in securities arbitration in recent years. Thus, a focus solely on outcomes based on published awards provides grounds for customers' dissatisfaction with the process.

2. Explanations Unrelated to the Process.

A myriad of factors unrelated to the fairness of the arbitration process itself also could contribute to customers' negative perceptions, some of which are necessarily more conjectural than others.

Investors have lost money. One incontrovertible fact is that investors enter the process after a bad investment experience in which they have lost money and/or believe that they have been wronged by the industry. This fact is very likely to color their perceptions in a negative way, even if they achieve an outcome that, viewed objectively, would be considered favorable.

Unrealistic Expectations. Any attorney that represents customers knows that many of them enter the process with unrealistic expectations. Particularly if they relied on their broker's expertise, investors may have difficulty understanding that the broker is not responsible for the loss of value in the portfolio unless he has violated the law or breached a duty owed to the customer.¹⁵⁵ In addition, investors may not realize that the applicable law in most jurisdictions is anti-investor.¹⁵⁶ Claimants' attorneys also may unduly inflate their clients' expectations about their chances of success. Unless investors' attorneys provide them with a realistic assessment of their chances in arbitration, investors may view any outcome less than a full recovery as "unfair" and "biased" and judge the process accordingly.

Dissatisfaction with Attorney. Investors' perceptions of the arbitration process are likely to be bound up with their assessment of the performance of the attorney who represented them. We did not ask investors questions about their attorneys since this was a survey about the SRO forum. However, if the investor perceived that his lawyer acted unprofessionally, we can expect

¹⁵⁴ See also Kondo academic working paper, *supra* note 139 and accompanying text.

¹⁵⁵ See Black & Gross, *Economic Suicide*, *supra* note 16; Black & Gross, *Making It Up*, *supra* note 16.

¹⁵⁶ See Jennifer O'Hare, *Retail Investor Remedies under Rule 10b-5*, 76 U. CINN. L. REV. __ (2008); Black & Gross, *Making It Up*, *supra* note 16, at notes 286-311 and accompanying text.

that this would negatively color his experience.¹⁵⁷ Ultimately, this aspect of the arbitration experience is outside the control of the securities arbitration forum.

Contemporaneous Media Coverage. Customers' negative perceptions could be fueled by what they read in the media. Indeed, 39% of customers reported they had concerns about the fairness of the process before their claim was filed.¹⁵⁸ These concerns may stem from a variety of sources including media coverage.

Exploring this hypothesis, we reviewed 51 articles on customers' securities arbitration that were printed in major newspapers between January 1, 2002 and December 31, 2006. We determined that 46% of the articles contained objective, neutral assessments of customer arbitration, 45% of them were critical of customer arbitration, and 8% contained favorable assessments of the process.¹⁵⁹ Thus, contemporaneous media coverage of securities arbitration was far more negative than positive. Whether the media coverage's portrayal of securities arbitration was accurate or not is somewhat inapposite; it may well have colored customers' subjective perceptions.

The Forum Does Not Adequately Educate Investors . One fairly obvious reaction to the survey findings is that the securities arbitration forum does not adequately educate the users of its services, particularly investors, as to the process and recent reforms to increase its fairness. While there can be no doubt that additional education efforts are warranted, previous investor education initiatives in a variety of contexts have not remedied the problems they were designed to address.¹⁶⁰ Thus, we are not optimistic that lack of knowledge is the sole explanation for investors' negative perceptions nor is it the sole target for correction.

Finally, we offer two explanations suggested by the securities industry for customers' negative perceptions, both of which we reject.

The Study's Methodology is Flawed. In its immediate response to the SICA Report -- despite the fact that SIFMA itself is a member of SICA and thus participated in and approved of

¹⁵⁷ Unhappy investors have, in the past, contacted the authors, in their capacities as Directors (either current or past) of a law school securities arbitration clinic, for assistance in pursuing claims against their previous attorneys for what the investors viewed as malpractice. As a matter of policy, we decline to represent investors in these cases.

¹⁵⁸ Figure 8. 39% of all survey participants who answered this question shared this concern.

¹⁵⁹ Copies of the articles are on file with the authors. While our review is necessarily subjective, and one might debate some of the categorizations, we have heard this same assessment of media coverage from others who follow media coverage of securities arbitration.

¹⁶⁰ See James Fanto, *We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education*, 49 CASE W. RES. L. REV. 105, 161-62 (1998) (doubting that SEC's investor education efforts are likely to succeed).

the survey's design and methodology – SIFMA criticized the study's methodology and thus its findings as flawed.¹⁶¹ In support of its critique, however, SIFMA offers only fuzzy math (*e.g.*, it inaccurately reported a 10% response rate)¹⁶² and a misunderstanding of key findings (*e.g.*, its claim that “a large majority (58%) of persons who responded to the survey never took their cases to a decision following an arbitration hearing” is wholly unsupported by the raw data).¹⁶³ We remain confident of the survey's design and methodology, subject to its limitations, as we previously described.¹⁶⁴

The Study's Findings Are Meaningless. SIFMA's “knee-jerk” response also distances itself from the survey's findings by discounting the importance of subjective perceptions because, in its view, many of these perceptions are at variance with objective reality.¹⁶⁵ Specifically, it asserts that it has demonstrated that arbitration is faster and less expensive than litigation and that industry arbitrators are not biased and do not adversely affect customer wins.¹⁶⁶ Accordingly, it argues, the subjective perceptions of less knowledgeable participants in the process should be dismissed as “faulty and out of touch with the objective reality.”¹⁶⁷

SIFMA has not demonstrated the objective reality that it asserts. It is true that the duration of cases in arbitration is shorter than litigation.¹⁶⁸ This fact does not conflict with some participants' perceptions that the arbitration hearings took too long.¹⁶⁹ Furthermore, SIFMA offers no recent empirical data that legal costs in securities arbitration are less than in litigation.¹⁷⁰ An actual comparison would not be easy to make. Filing and forum costs are higher in arbitration than in court, but there may be overall cost savings through lower attorneys' fees because the discovery process is more streamlined in arbitration, particularly since

¹⁶¹ Press Release, SIFMA Questions Middling Results, Flawed Process of SICA Survey (Feb. 6, 2008), *available at* <http://www.sifma.org/news/62459045.shtml> (last visited Apr. 5, 2008).

¹⁶² *Id.* The actual response rate was 13%; see *supra* notes 44-46 and accompanying text.

¹⁶³ *Id.* See Figure 11, which shows that 53% of those who answered “how the most recent dispute was resolved” (and 57% of customers who answered the question) indicated that their most recent dispute ended with an award after a hearing or on the papers.

¹⁶⁴ See *supra* notes 53-56 and accompany text.

¹⁶⁵ SIFMA, *The Thinking Person's Guide to Interpreting the Latest Survey on Subjective Perceptions of Fairness of Securities Arbitration* (Feb. 6, 2008) at 3, *available at* <http://www.sifma.org/regulatory/pdf/Guide-Fair-Securities-Arbitration.pdf> (last visited Apr. 5, 2008).

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ See *SIFMA White Paper*, *supra* note 6, Appendix B.

¹⁶⁹ In fact, customers were about equally divided on this question. 36% of customers disagreed with the statement that hearings took too long, and 35% agreed with it. Figure 22.

¹⁷⁰ The only empirical evidence it cites is a study of costs for the period 20 years ago between Oct. 1, 1987 and June 30, 1988. See *SIFMA White Paper*, *supra* note 6, at 29.

depositions are rarely used in arbitration. Even assuming that arbitration is less expensive than litigation, the perceptions of 49% of customers that the arbitration process was too expensive are not at variance with the objective reality. Customers could rationally perceive the process as too expensive, particularly if their recovery is less than what they claimed.

The most pertinent argument made by SIFMA is its assertion that empirical evidence establishes that industry arbitrators are not biased. SIFMA cites the SAC Industry Arbitrator Survey¹⁷¹ in support of its assertion but does not explain the nuanced and tentative nature of that survey's findings. More disturbingly, it cites the bare percentages of win rates in Simplified Arbitration claims and three-person panels for 2005 and 2006 as evidence of non-bias, without accounting for the various factors that do not allow for unqualified comparisons between two types of claims, all of which the SAC Industry Arbitrator Survey took into account. Again, SIFMA's "reality" is not supported by the evidence.

In our view, SIFMA's over-reaction to our Report to SICA and its findings suggests a more pernicious attempt to discount investors' opinions and obscure the need for reform.¹⁷² Since SIFMA's stated mission includes "earning, inspiring and upholding the public's trust in the industry...",¹⁷³ it is puzzling that SIFMA uncritically champions a system that many investors perceive as unfair and that contributes to distrust of the industry. Strategically, SIFMA apparently has decided that unconditional support for the current system is the best tactic to oppose the proposed legislation eliminating mandatory consumer arbitration. Thus, SIFMA identified as a "key project" for 2008 the defense of "pre-dispute agreements to arbitrate in the SRO-sponsored forum,"¹⁷⁴ it testified in Congress against the application of the Arbitration Fairness Act to securities arbitration,¹⁷⁵ and the SIFMA White Paper is largely a promotion piece for what it describes as "the success story of an investor protection focused institution that has delivered timely, cost-effective, and fair results for over 30 years."¹⁷⁶ While we agree with SIFMA that securities arbitration cannot usefully be compared to "some idealized, utopian

¹⁷¹ See *supra* note 134 and accompanying text.

¹⁷² In contrast, FINRA – the forum itself – does not mandate that investors arbitrate their industry disputes.

¹⁷³ SIFMA, "SIFMA Mission," <http://www.sifma.org/>.

¹⁷⁴ SIFMA, "2008 Key Projects," <http://www.sifma.org/about/pdf/keyProjects.pdf>.

¹⁷⁵ See *Senate Subcommittee Hearing, supra* note 8 (SIFMA Testimony).

¹⁷⁶ *SIFMA White Paper, supra* note 6, at cover page.

version” of litigation¹⁷⁷ we reject the assertion that investors’ perceptions of the securities arbitration system should not be taken into account in reforming the process.

VI. CONCLUSION

Whatever the underlying explanation, we have no doubt that our survey results are illuminating as to *subjective* perceptions by arbitration participants of fairness, albeit inconclusive as to *objective* standards of fairness. As stated above,¹⁷⁸ subjective perceptions are important because participants’ views of fairness, particularly procedural fairness, are critical to the integrity of the dispute resolution process.¹⁷⁹ Simply put, even if the system meets objective standards of fairness, a mandatory system that is not perceived as doing so cannot maintain the confidence of its users and, in the long run, may not be sustainable. As a result, customers’ negative perceptions are changing the realities of the current system of securities arbitration and require a re-thinking by policy-makers.

Accordingly, based on the findings of our Report, we urge the SEC and FINRA to give serious consideration to eliminating the requirement of an industry arbitrator on every three-person arbitration panel.¹⁸⁰ Rightly or wrongly, investors are simply suspicious of a mandatory process with an opaque outcome that is sponsored by the regulatory arm of the securities industry and that includes an industry representative on every three-arbitrator panel hearing a claim greater than \$25,000. The frequently-made argument – that no one can prove that the presence of an industry arbitrator harms the investor – misses the point. Given the widespread distrust of the industry arbitrator, it would seem that the presence of an industry arbitrator would have to contribute great value to the process -- which no one can establish either -- to justify the continuation of this practice. We are less convinced about the value of requiring arbitrators to

¹⁷⁷ See *Senate Subcommittee Hearing, supra* note 8 (SIFMA Testimony), at 5.

¹⁷⁸ See *supra* Part II (B).

¹⁷⁹ See *supra* notes 30-35 and accompanying text. While academics are right to focus on the importance of procedural fairness, particularly where substantive fairness is difficult to judge, they may overstate its importance. Procedural justice scholars present a more sophisticated variation of SIFMA’s argument – if the procedures are fair, customers will (or should) perceive the process and outcome as fair. Yet, as this survey shows, customers have an unfavorable overall impression of securities arbitration even though, in their most recent experience, they report largely favorable impressions of arbitrator competence and attentiveness.

¹⁸⁰ We have no preconceived notion of the best way to accomplish this and believe this should be the subject of public discussion and debate. For example, the current composition of the panel could remain the default rule, but customers could be allowed to opt out of the requirement of the industry arbitrator. Alternatively, the inclusion of an industry arbitrator on every three-person panel could be permitted if both parties agreed to it. Most radically, the distinction between industry and public arbitrators could be eliminated, and parties would select the arbitrators that they believe have the preferred background and experience for deciding their case.

explain their awards at the request of the customer, because of the dangers it will lead to more attempts to vacate awards and thus prolong the arbitration process. However, based on our findings, we believe that this proposed reform should be revisited.

Despite FINRA's commendable efforts to improve the process, these efforts will likely prove unsuccessful in winning customers' confidence so long as they are required to accept both an industry arbitrator and an unexplained award. While SIFMA's dismissive and patronizing response to customers appears to be "get over it," we submit that this is not a helpful response. Rather, in light of these findings of customers' dissatisfaction and perceptions of unfairness, the indisputable reality is that it is incumbent upon regulators, the forum and the industry to work toward further improvements in the system.

APPENDIX A



SICA

Securities Industry
Conference on
Arbitration

Date

«PREFIX» «FIRST_NAME» «MIDDLE_NAME» «LAST_NAME»
«TITLE»
«COMPANY»
«ADDRESS_1»
«ADDRESS_2»
«CITY», «STATE_PROVINCE» «ZIP»

RE: Securities Arbitration Fairness Survey - 2007

Dear «PREFIX» «LAST_NAME»:

Over the past twenty years, arbitration has become the primary method of resolving disputes in the securities industry. Recently, a report to the Securities and Exchange Commission (SEC) recommended independent research to evaluate the fairness of securities arbitration.

The Securities Industry Conference on Arbitration (SICA), a group created with the encouragement of the SEC and made up of representatives of securities regulators, the securities industry and public investors, has commissioned the Pace Investor Rights Project (affiliated with Pace University School of Law) to conduct a survey to evaluate the fairness of the arbitration of customer claims at both NASD Dispute Resolution, Inc. (“NASD”) and the New York Stock Exchange (“NYSE”). This survey has been developed with our input and support, and will be administered through Cornell University’s Survey Research Institute. Our mission is to study whether participants believe the securities arbitration process is conducted simply, fairly, economically and without bias by the arbitrators.

We need YOUR participation and feedback. You are receiving this survey because NASD or NYSE records show that you were involved in a dispute that was filed for arbitration in its forum in the last five years. Please take a few minutes to complete the questionnaire below and return it in the self-addressed postage-paid return envelope provided. Please be assured that

your responses will be kept completely confidential and will never be used in any way to permit identification of you. Your responses will be used only in aggregate form. We hope that you will complete and return it as soon as possible.

We greatly appreciate your cooperation. If you have any questions, please do not hesitate to call the Survey Research Institute at 1-888-367-8404.

Sincerely,

A handwritten signature in black ink, appearing to read "Constantine N. Katsoris". The signature is written in a cursive style with some stylized flourishes.

Constantine N. Katsoris

■ FOR SRI USE ONLY:



SECURITIES ARBITRATION FAIRNESS SURVEY 2007

The **Pace Investor Rights Project** (affiliated with Pace University School of Law) is conducting this survey for the **Securities Industry Conference on Arbitration (SICA)**, a group created with the encouragement of the United States Securities and Exchange Commission and made up of representatives of securities regulators, the Securities Industry Association and public investors.

The purpose of this survey is to evaluate the fairness of the arbitration of customer claims at both NASD Dispute Resolution, Inc. ("NASD") and the New York Stock Exchange ("NYSE"). Our mission is to study whether participants believe the securities arbitration process is conducted simply, fairly, economically and without bias by the arbitrators. We need YOUR participation and feedback to accomplish this mission.

You are receiving this questionnaire because NASD or NYSE records show that you were involved in a dispute between a customer and a brokerage firm and/or its registered representative(s) ("associated person(s)") filed for arbitration in its forum in the last five years. Please take a few minutes to complete the questionnaire below and return it in the self-addressed postage-paid return envelope provided. Please be assured that your responses will be kept completely confidential and will never be used in any way to permit identification of you. Your responses will be used only in aggregate form.

If you have been involved in more than one such dispute in the last five years, please answer the questions below by focusing on the **MOST RECENT** dispute that resulted in an arbitration award following a live or paper hearing.



General Instructions

PLEASE READ THESE INSTRUCTIONS CAREFULLY

- Please fill in the oval next to your answer completely using **blue or black ink**.

Example: Fill in ovals completely, like this:
Not like this: Or this:

- Please follow any instructions that direct you to the next question.

Example: No → Go to Question 3.

- If you mark an answer with a line after it, please write the specific information on the line.

Example:
 Other, please specify: _____ *paper case* _____

- Mark only one response for each question, unless other instructions are given.

1. In the past five years, have you been involved in a dispute between a customer and a securities brokerage firm and/or its registered representative(s) ("associated person(s)") that was filed for arbitration before NASD or the NYSE?

- Yes, I was involved as a customer. → Go to Question 2.
- Yes, I was involved as a corporate representative of a securities brokerage firm. → Go to Question 2.
- Yes, I was involved as an associated person of a brokerage firm. → Go to Question 2.
- Yes, I was involved as a lawyer or other representative of a party. → Go to Question 3.
- No, I was not involved in any such dispute. → STOP. Do not continue with this survey, but please mail it back in postage paid envelope.

2. Were you represented by a lawyer in that dispute? (If you were involved in more than one such dispute, answer with respect to the most recent one.)

- Yes, I was represented by a lawyer.
- Yes, I was represented by a lawyer through a law school clinic.
- No, I chose to represent myself because I did not want to be represented.
- No, I represented myself because I could not afford to retain a lawyer.
- No, I represented myself because I could not find a lawyer to represent me.
- No, I was represented by a non-lawyer.

For those who answered Question 2, please go to Question 5.



3. (Lawyers/Representatives only) In the past five years, how many disputes between a customer and a securities brokerage firm and/or its registered representative(s) ("associated person(s)") that were filed for arbitration before NASD or the NYSE were you involved in?

- I have been involved in only one such dispute, and I represented (select all that apply):
 - the customer.
 - the brokerage firm.
 - the associated person.

Go to Question 6a.

- I have been involved in more than one such dispute.

4a. Overall, in the past five years, have you primarily represented customers or securities industry parties in these disputes?

- I primarily represented customers.
- I primarily represented registered representatives/"associated persons."
- I primarily represented the brokerage firm.
- Do not know/Do not recall

4b. In the most recent of these disputes, whom did you represent (select all that apply)?

- The customer
- The brokerage firm
- The associated person

5. In the past five years, how many of these disputes have you been involved in?

- One
- 2 to 5
- 6 to 10
- More than 10
- Do not know/Do not recall

6a. Did the customer agreement in the most recent dispute contain a clause requiring the parties to resolve that dispute through arbitration?

- Yes → Go to Question 6b.
- No → Go to Question 7.
- Do not know/Do not recall → Go to Question 7.

6b. Were you aware before the dispute arose that the customer agreement contained an arbitration clause?

- Yes
- No
- Do not know/Do not recall

7. What was the primary reason this dispute was filed in an arbitration forum?

- Believed arbitration would be faster than court.
- Believed arbitration would be less expensive than court.
- Believed arbitration would be more fair than court.
- Believed arbitration would provide a larger recovery than court.
- Believed arbitration was required.
- Preferred arbitration for other reasons.
- A lawyer recommended it.
- Did not initiate the claim.
- Do not know/Do not recall



8. Before the most recent dispute was filed in arbitration, did you have concerns about the securities arbitration forum? (select all that apply)




- No, I had no concerns.
- Yes, I was concerned that it would be expensive.
- Yes, I was concerned that it would be a slow process.
- Yes, I was concerned that it would not be a fair process.
- Yes, I was concerned about the composition of the arbitration panel.
- Yes, I was concerned that the arbitrators would be biased.
- Yes, I had other concerns.
- I do not recall if I had any concerns.

9. With respect to your most recent dispute, in what state was the hearing scheduled to take place? (If the dispute was a Simplified Arbitration that took place on the papers, write "paper case.")

10. What was the approximate amount of damages (excluding punitive damages, attorneys' fees, interest and costs) claimed in this most recent dispute?

- Not exceeding \$25,000
- \$25,001 - \$50,000
- \$50,001 - \$100,000
- \$101,000 - \$250,000
- \$250,001 - \$1,000,000
- More than \$1,000,000
- Do not know/Do not recall

11. How was this most recent dispute resolved?

- The arbitration panel issued an award of damages to the customer after a live hearing.
- The arbitration panel issued an award of damages to the customer based on written submissions (a "paper" case). 
- The claimant voluntarily withdrew the claim. 
- The parties settled the claim on their own.
- The parties settled the claim with the aid of a mediator.
- The arbitration panel did not award damages to the customer based on written submissions (a "paper" case).
- The arbitration panel dismissed the case before a live hearing began.
- The arbitration panel did not award damages to the customer after a live hearing.
- Do not know/Do not recall 

Go to Question 12a.

Go to Question 13.

12a. What was the approximate amount of the total award in this most recent dispute?

- \$1.00 - 10,000
- \$10,001 - 50,000
- \$50,001 - 250,000
- \$250,001 - 1,000,000
- More than \$1,000,000
- Do not know/Do not recall



12b. What percentage of damages (excluding punitive damages, attorneys' fees, interest and costs) originally claimed does this represent?

- Less than 1
- 1-10
- 11-25
- 26-49
- 50-74
- 75-99
- 100
- Do not know/Do not recall

13. How many arbitrators were appointed to decide this dispute?

- Three → Go to Question 14a.
- One → Go to Question 15.
- No arbitrators were appointed. → Go to Question 16.
- Do not know/Do not recall → Go to Question 16.

14a. Did you know, prior to the filing of the arbitration, that one arbitrator would be connected in some way with the securities industry (an "industry arbitrator")?

- Yes
- No
- Do not recall

14b. Did you know, at any time during the dispute, which arbitrator was the industry arbitrator and which arbitrators were public arbitrators?

- Yes
- No
- Do not recall

14c. Would you say that the performance of the industry arbitrator and the public arbitrators was different?

- Yes
- No
- There was no opportunity to assess the performance of the arbitrators.
- Do not know/Do not recall

14d. Would you say that the industry arbitrator favored one side over the other at any time during the dispute?

- No
- Yes, the industry arbitrator favored the customer.
- Yes, the industry arbitrator favored at least one securities industry party.
- There was no opportunity to assess whether the arbitrators favored any party.
- Do not know/Do not recall

14e. Was the award unanimous?

- Yes
- No
- Do not know/Do not recall



15. Would you say that any public arbitrator favored one side over the other at any time during the dispute?

- No
- Yes, a public arbitrator favored the customer.
- Yes, a public arbitrator favored at least one securities industry party.
- There was no opportunity to assess whether the arbitrator favored any party.
- Do not know/Do not recall

Based on your experiences in the MOST RECENT dispute in which you were involved that was filed for arbitration before NASD or the NYSE, please indicate the extent to which you agree or disagree with the following statements. If your dispute did not progress enough to enable you to evaluate the statement, select "Not Applicable." Please answer these questions, to the extent they apply, even if your dispute did not progress to a hearing.

	Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree	Not Applicable	Don't Know
16. The arbitration panel appeared competent to resolve the dispute.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
17. The arbitration panel did not understand the issues involved in the case.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
18. The arbitration panel was open-minded.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
19. The arbitration panel was impartial.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
20. The arbitration panel appeared competent to resolve pre-hearing issues.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
21. The discovery process enabled me to obtain the information needed for a hearing.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
22. The arbitration hearings took too long.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
23. At the hearing, the arbitration panel listened to the parties, their representatives and their witnesses.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
24. At the hearing, the arbitration panel understood the legal arguments in the case.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
25. At the hearing, the arbitration panel did not provide a sufficient amount of time for the parties to present their evidence.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
26. At the hearing, the arbitration panel did not provide a sufficient amount of time for the parties to argue the merits of their case.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
27. I am satisfied with the outcome.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
28. I would be more satisfied if I had an explanation of the award.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
29. The outcome was not very different from my initial expectations.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
30. The arbitration process was too expensive.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
31. The arbitration panel did not apply the law to decide the dispute.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
32. I would recommend to others that they use arbitration to resolve their securities disputes.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
33. I have a favorable view of securities arbitration for customer disputes.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
34. As a whole, I feel that the arbitration process was fair.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>



35. In the last five years, have you ever been a party or represented a party in at least one civil court case (not involving a criminal, matrimonial or custodial matter and excluding class action lawsuits)? (select all that apply)
- No → Go to Question 36.
 - Yes, I was a plaintiff.
 - Yes, I represented a plaintiff.
 - Yes, I was a defendant.
 - Yes, I represented a defendant.
 - Do not know/Do not recall
- 35a. Focusing on your most recent experience in a civil court case, how different do you think your result from the arbitration would have been had it proceeded in court?
- Very different
 - A little different
 - Exactly the same
 - Do not know
- 35b. As compared to your most recent experience in a civil court case, how fair is securities arbitration?
- Very fair
 - Somewhat fair
 - Equally fair
 - Somewhat unfair
 - Very Unfair
 - Do not know
36. Based on your experiences in one or more securities arbitration customer disputes, if you had the choice, would you choose arbitration to resolve a customer dispute in the future? (select all that apply)
- Yes, I would choose arbitration over court.
 - No, I would not choose arbitration because the process is not fair.
 - No, I would not choose arbitration because the process is more expensive than court.
 - No, I would not choose arbitration because the process takes more time than court.
 - No, I would not choose arbitration because the arbitrators are not competent to resolve customer-broker disputes.
 - I'm not sure.
 - None of the above.
37. Are you familiar with changes that the securities arbitration forums have made to their procedural rules in the last five years?
- Yes, I think the changes have made the process fairer.
 - Yes, I think the changes have not made a difference.
 - Yes, I think the changes have made the process less fair.
 - No, I am not familiar with the changes.



38. Please indicate the extent to which you agree or disagree with the following statements.

In your opinion, do you believe that the securities arbitration process is conducted by the arbitrators in a way that is:

	Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree	Don't Know
a. simple for all parties involved	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
b. fair to all parties involved	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
c. economical	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
d. without bias	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

THANK YOU FOR YOUR PARTICIPATION!

Please return this survey in the postage-paid envelope provided, or mail it to:

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