Is Securities Arbitration Fair for Investors?

Written Testimony of Professor Michael A. Perino

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BIOGRAPHICAL STATEMENT

Michael A. Perino is currently a Professor at St. John's University School of Law in New York. Professor Perino's primary areas of scholarly interest are securities regulation and litigation, corporations, and complex litigation. Professor Perino has also been the Justin W. D'Atri Visiting Professor of Law, Business and Society at Columbia Law School and a Lecturer and Co-Director of the Roberts Program in Law, Business, and Corporate Governance at Stanford Law School.

Professor Perino has authored numerous articles on securities regulation, securities fraud, and class action litigation. Congress relied on the empirical findings of his article *Fraud and Federalism: Preempting Private State Securities Fraud Causes of* Action, 50 Stanford Law Review 273 (1998), in enacting the Securities Litigation Uniform Standards Act of 1998. He is the author of the leading treatise on the Private Securities Litigation Reform Act, *Securities Litigation After the Reform Act* (CCH 2000). He has testified in both the United States Senate and the House of Representatives and is frequently quoted in the media on securities and corporate matters. The SEC has retained Professor Perino to provide it with a report and recommendations on the adequacy of arbitrator conflict disclosure requirements in securities arbitration. Professor Perino was also one of the principal developers of Stanford Law School's Securities Class Action Clearinghouse, which was nominated by the Smithsonian Institution for the 1997 Computerworld-Smithsonian Award as one of the five most important applications of information technology created by an educational institution.

Professor Perino received his LL.M. degree from Columbia Law School, where he was valedictorian, a James Kent Scholar, and the recipient of the Walter Gellhorn Prize for outstanding proficiency in legal studies. He received his J.D. from Boston College Law School, where he was elected to the Order of the Coif.

A full curriculum vitae and a completed "Truth in Testimony" Disclosure Form are appended to this written testimony.

INTRODUCTION

Mr. Chairman and members of the Subcommittee, I am honored by the invitation to appear before you today and to participate in these hearings. I understand that these hearings are intended to review the current system of securities arbitration. As the members of the Subcommittee are well aware, the fairness and adequacy of the system are crucially important because arbitration is the primary dispute resolution mechanism for customer and broker-dealer disputes. Arbitration is potentially beneficial for both parties because it provides a streamlined, expeditious, and final mechanism for resolving disputes through the use of experts in the matters at issue. To attain these benefits and to foster confidence in the integrity of the process, the system must not only be fair and impartial, but investors, the public, the judiciary, and Congress must believe that it is fair and impartial.

I am particularly grateful for the opportunity to share my views with the Subcommittee because I have studied securities industry arbitration in detail, with particular emphasis on the procedures used for resolving customer disputes. In September 2002, the United States Securities and Exchange Commission (SEC) retained me to analyze and write a report and recommendations on the adequacy of arbitrator conflict disclosure requirements in National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) securities arbitrations.[1] My report concluded

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[1] REPORT TO THE SECURITIES AND EXCHANGE COMMISSION REGARDING ARBITRATOR CONFLICT DISCLOSURE REQUIREMENTS IN NASD AND NYSE SECURITIES ARBITRATIONS (Nov. 4, 2002) [hereinafter SEC REPORT]. A copy of the SEC Report is available on the SEC's website (http://www.sec.gov/pdf/arbconflict.pdf).

that there is little if any indication that undisclosed conflicts represent a significant problem in securities arbitrations sponsored by these self-regulatory organizations (SROs)[2] and that adding more stringent disclosure requirements might impose significant costs on the arbitration system while yielding few benefits for investors. In addition to this in-depth study of the securities arbitration system, in 2004 I helped to found the St. John's University School of Law Securities Arbitration Clinic, which uses our students, under the guidance of an experienced clinic director, to provide representation to small investors in securities arbitrations.

To aid the Subcommittee in its inquiry, I have organized my testimony as follows. Part I provides an overview of securities arbitration and describes how regulatory and legislative oversight as well as the SROs' rational self-interest tends to prevent the system from developing industry-favorable biases. Part II discusses the existing empirical evidence, which provides little if any support for the hypothesis that there are systemic problems in the securities arbitration system. Overall, I conclude that the available evidence does not suggest that the heavily regulated securities arbitration system has any apparent pro-industry bias. While it is important to continue to study and monitor the arbitration system, any substantial overhaul should be contingent upon the presentation of persuasive empirical evidence of systemic problems.

[2] SROs are statutorily created entities that are given primary responsibility for regulating broker-dealers. 15 U.S.C. §§ 78f, 78o-3 (2000); *see* Richard L. Stone & Michael A. Perino, *Not Just a Private Club: Self Regulatory Organizations as State Actors When Enforcing Federal Law*, 1995 COLUM. BUS. L. REV. 453.

I. AN OVERVIEW OF SECURITIES ARBITRATION

Arbitration is the primary dispute resolution vehicle in the securities industry and dates back to at least 1872.[3] It is mandatory both for broker-dealers and for customers.[4] Arbitrations involving customer complaints are generally the result of pre-dispute arbitration agreements, which broker-dealers typically include in customer contracts. Today, most of these contracts require use of an SRO arbitration forum. In 1987, the United States Supreme Court upheld pre-dispute arbitration agreements as consistent with the strong public policy in favor of arbitration.[5] As Figure 1 demonstrates, the number of SRO-sponsored arbitrations has grown substantially with the widespread use of these agreements and as more individual investors have engaged in securities transactions.[6]

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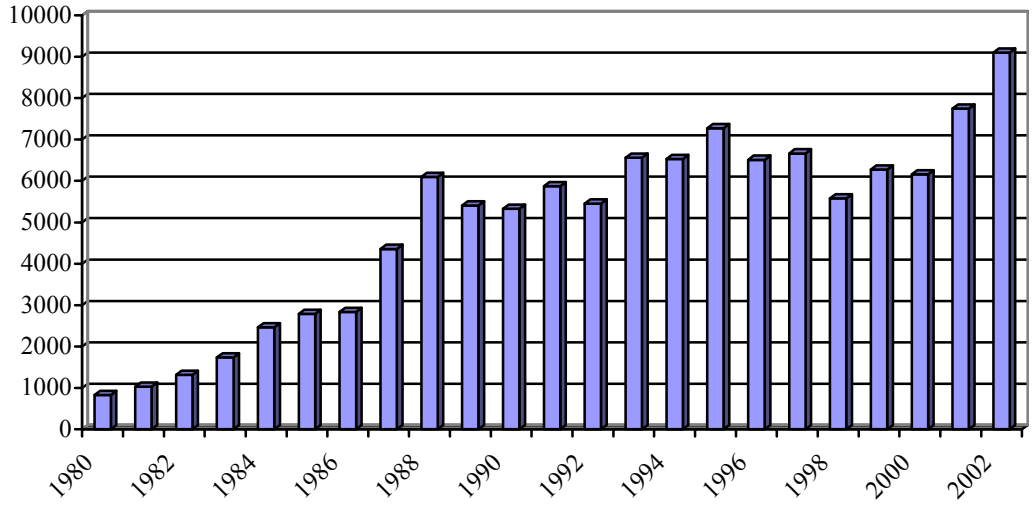
[3] *See* J. KIRKLAND GRANT, SECURITIES ARBITRATION FOR BROKERS, ATTORNEYS, AND INVESTORS 94-95 (1994); REPORT OF THE ARBITRATION POLICY TASK FORCE TO THE BOARD OF GOVERNORS NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. (Jan. 1996), *reprinted in* [1995-1996 Tr. Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,735, at 87,433.

[4] SRO rules require broker-dealers to submit disputes with customers to arbitration. NASD CODE OF ARBITRATION §§ 10301(a), 10101(c); *see* NASD MANUAL IM-10100(a) (stating that failure to submit a dispute for arbitration as required by NASD Code of Arbitration may be deemed a violation of fair practice rules).

[5] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 242 (1987); *see* Federal Arbitration Act, 9 U.S.C. § 2 (2000); Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 480 (1989) (holding that pre-dispute agreement to arbitrate claims is enforceable); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 223–224 (1985) (holding that lower court erred in failing to grant motion to compel arbitration); Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24 (1983) (stating that FAA establishes "liberal federal policy favoring arbitration agreements").

[6] The data for Figure 1 comes from the Securities Industry Conference on Arbitration (SICA).

Figure 1
Annual SRO Arbitration Filings (1980-2002)



Resolving securities disputes through arbitration provides potential benefits for both customers and industry members. Arbitration is generally less expensive and faster than litigation.[7] Claims that are too small to pursue cost-effectively in litigation are viable when arbitration is available. While arbitration has grown more "litigious," in recent years,[8] thereby eroding some of its transaction costs savings, the participants also benefit from expert decision-makers who appear, on average, to yield quick and accurate decisions.[9] There are limited grounds for courts to overturn arbitration awards, thereby

[7] GRANT, *supra* note 3, at 96–97.

[8] RUDER REPORT, *supra* note 3, at 87,433; Bruce M. Selya, *Arbitration Unbound: The Legacy of McMahon*, 62 BROOK. L. REV. 1433, 1445-48 (1996).

[9] *See* Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145, 150 (1968) (White, J., concurring) ("It is often because they are men of affairs, not apart from but of the marketplace, that they are effective in their adjudicatory function."); Deborah R. Hensler, *Science in the Court: Is There a Role for Alternative Dispute Resolution*?, LAW & CONTEMP. PROBS., Summer 1991, at 171, 186 ("Arbitrations' chief benefit to many disputants may be that it reduces the uncertainty of outcomes by substituting expert

providing a greater degree of finality than litigation. Arbitrators are not bound by precise legal or evidentiary standards, which may benefit investors, particularly as federal securities remedies have become more restrictive.[10] Indeed, lawyers experienced in representing customers in securities arbitrations note that arbitration can be a better dispute resolution forum for investors because "innocent, unsophisticated investors generate sympathy from arbitrators, in the form of an award, for tragic, seemingly avoidable losses, despite the well-established law that suggests no liability by the broker."[11] Recently, "arbitration panels seem to have reached beyond existing legal authorities to expand the rights and protections accorded to the investing public."[12]

Critics of securities arbitration, however, contend that members of the securities industry prefer arbitration because SRO-sponsored arbitrations tend to yield pro-industry outcomes.[13] While it is theoretically possible for an arbitration forum to develop just

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decisionmakers for lay juries."); Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEG. STUD. 1, 5 (1995).

[10] *See* Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1040 (2002); Marc I. Steinberg, *Securities Arbitration: Better for Investors than the Courts*, 62 BROOK. L. REV. 1503 (1996). Arbitrators may not completely ignore the law; most courts hold that they may overturn SRO arbitration awards based on "manifest disregard of the law." *See, e.g.*, Halligan v. Piper Jaffray, Inc., 148 F.3d 197 (2d Cir. 1998); Montes v. Shearson Lehman Brothers, Inc., 128 F.3d 1456 (11th Cir. 1997); *see also* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 942 (1995) (recognizing manifest disregard standard in dicta).

[11] Black & Gross, *supra* note 10, at 1040.

[12] Gretchen Morgenson, *Why Investors May Find Arbitrators on their Side*, N.Y. TIMES, Aug. 8, 2001, at Sec. 3, p. 1 (quoting securities regulation expert Lewis D. Lowenfels).

[13] *See, e.g.*, Black and Gross, *supra* note 10, at 993 (citing Seth Lipner, *Ideas Whose Time Has Come: The Single Arbitrator and Reasoned Awards*, SECURITIES ARBITRATION 2000, at 659, 661 (PLI Corporate Law & Practice Course, Handbook Series No. 659, 2000) (indicating suspicion of SRO forum independence and "belief that arbitration reduces investors' substantive rights"); Marc I. Steinberg, SECURITIES REGULATION 884 (3d ed. 1998) (noting that many believe securities arbitration favors the securities industry). Not all commentators share these views. *See, e.g.*, Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous*, 40 WM. &

such a bias,[14] two factors—regulatory and legislative oversight and economic self-interest—appear to provide a significant check on any tendencies toward the development of systemic industry biases in SRO-sponsored securities arbitrations.[15]

The NASD and NYSE are likely subject to more regulation and greater oversight than any other arbitration forum. The SROs are the primary regulators of securities broker-dealers and have a statutory mandate to provide a fair dispute resolution forum.[16] If they fail to do so, they run the risk of losing their SEC registrations.[17] The SEC exercises substantial oversight of the SROs and approves all arbitration rules before they become effective.[18] Proposed rules are published in the *Federal Register* and are subject to extensive public comment.[19] Section 19 of the Securities Exchange Act requires the SEC to approve SRO rules only if they are consistent with the requirements of the federal securities laws.[20] This requires that any proposed rules promote just and equitable principles of trade and protect investors and the public interest.[21] The Commission

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MARY L. REV. 1055, 1121 (1999) (indicating empirical studies show no evidence of unfairness to investors); Deborah Masucci, *Securities Arbitration—A Success Story: What Does the Future Hold?*, 31 WAKE FOREST L. REV. 183 (1996).

[14] There are examples of precisely this kind of apparently biased forum in non-securities contexts. *See, e.g.*, Hooters of America, Inc. v. Phillips, 173 F.3d 933 (4th Cir. 1999).

[15] As is discussed more fully in Section II, *infra*, the available empirical evidence on outcomes in customer-broker arbitration does not support the hypothesis that the securities arbitration system has a pro-industry bias.

[16] *See* 15 U.S.C. §§ 78f(b), 78o-3(b) (2000).

[17] *Id.*

[18] 15 U.S.C. § 78s(b)(1) (2000).

[19] 15 U.S.C. § 78s(b) (2000).

[20] 15 U.S.C. § 78s(b)(2) (2000).

[21] 15 U.S.C. §§ 78f(b), 78o-3(b) (2000).

retains the power to amend or abrogate SRO rules "as [it] deems necessary or appropriate to insure the fair administration of the [SRO]."[22]

The Commission oversees SRO arbitrations through its inspection process as well, which is intended to "identify areas where procedures should be strengthened, and to encourage remedial steps either through changes in administration or through the development of rule changes."[23] The SEC staff reviews whether the SROs are complying with their own rules and whether the SROs can enhance their rules and procedures. In this regard, the SEC staff evaluates SRO administration and processing of arbitration cases and the management of the arbitration pool, including the selection, training, rotation, and evaluation of arbitrators. The SEC's staff has consistently worked with the SROs and others to develop procedural protections to guard the integrity of SRO arbitrations. For example, in 1987 and 1988, the SEC raised concerns with the SROs about the need to revise arbitration procedures and about the use of pre-dispute arbitration clauses.[24] Those concerns prompted the SROs to revise substantially their procedures and to adopt new disclosure requirements for arbitration clauses.[25]

Congress also plays an important and substantial oversight role with respect to securities arbitrations. In addition to holding hearings such as this, Members have

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[22] 15 U.S.C. § 78s(c) (2000); *see* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 233–34 (1987) (noting that the Commission has "expansive power to ensure the adequacy of the arbitration procedures employed by the SRO… including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights").

[23] *See* SEC Rel. No. 34-40109, 63 FED. REG. 35299, 35303 n.53 (June 29, 1998).

[24] SEC Rel. No. 34-26805, 54 FED. REG. 21144 (May 16, 1989).

[25] *Id.*

frequently requested the United States Government Accountability Office (GAO) to evaluate various aspects of the securities arbitration system. The GAO has investigated investor outcomes in securities arbitrations,[26] whether problems exist with respect to unpaid arbitration awards,[27] whether arbitration provides an appropriate system for resolving employment discrimination claims,[28] whether problems exist with respect to updating arbitrator disclosure information,[29] and other matters.[30] Although the GAO has recommended changes from time to time, it has never found that SRO-sponsored arbitrations were biased in favor of securities industry members.

This regulatory and legislative oversight system provides an important independent review of the fairness of SRO arbitration procedures. The securities industry, however, also has a rational self-interest in providing a fair dispute resolution system. The SROs recognize that because arbitration is mandatory for most customer disputes, public perceptions of the fairness of the arbitration process are crucial to its

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[26] GAO, SECURITIES ARBITRATION: HOW INVESTORS FARE, Rep. No. GAO/GGD-92-74 (May 1992) [hereinafter HOW INVESTORS FARE]; SECURITIES ARBITRATION: ACTIONS NEEDED TO ADDRESS PROBLEM OF UNPAID REWARDS, Rep. No. GAO/GGD-00-115, at 16, 30 (June 2000) [hereinafter PROBLEM OF UNPAID AWARDS].

[27] PROBLEM OF UNPAID AWARDS, *supra* note 26; GAO, EVALUATION OF STEPS TAKEN TO ADDRESS THE PROBLEM OF UNPAID ARBITRATION AWARDS, Rep. No. GAO-01-654R (April 27, 2001).

[28] *See, e.g.*, GAO, EMPLOYMENT DISCRIMINATION: HOW REGISTERED REPRESENTATIVES FARE IN DISCRIMINATION DISPUTES, Rep. No. GAO/HEHS-94-17 (March 1994).

[29] *See, e.g.*, GAO, PROCEDURES FOR UPDATING ARBITRATOR DISCLOSURE INFORMATION, Rep. No. GAO-01-162R (Nov. 9, 2000).

[30] GAO, FOLLOW-UP REPORT ON MATTERS RELATING TO SECURITIES ARBITRATION, Rep. No. GAO-03-162R (April 11, 2003) (evaluating, among other things, NASD procedures for removing arbitrators from cases and use of motions to dismiss and for summary judgment in arbitrations).

success.[31] The acceptability of arbitral awards is strongly correlated with parties' perceptions of whether fair and unbiased procedures were used to reach an outcome.[32] Systemic procedural inequities would likely increase the costs of the arbitration system as more dissatisfied parties attempted to overturn arbitration awards. The presence of systemic conflicts or other procedural inequities might cause legislators to seek to overhaul arbitration structures or might invite closer judicial scrutiny of arbitration awards, yielding more successful challenges and therefore less finality.[33]

This combination of oversight and rational self-interest has made the SROs quite responsive to groups that have advocated for revisions of the SROs' arbitration procedures. Indeed, the SROs have regularly revised their procedures over the last fifteen years.[34] The SROs formed the Securities Industry Conference on Arbitration (SICA), a cooperative venture consisting of representatives of the SROs, the Securities Industry Association, and members of the public to establish a Uniform Arbitration Code

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[31] *See* SICA, THE ARBITRATOR'S MANUAL 3 (January 2001) ("Since arbitration is the primary means of resolving disputes in the securities industry, the public perception of its fairness is of paramount importance.").

[32] TOM R. TYLER, WHY PEOPLE OBEY THE LAW 115-24 (1990); E. Allan Lind, et al., *Individual and Corporate Dispute Resolution: Using Procedural Fairness as a Decision Heuristic*, 38 ADMIN. SCI. Q. 224 (1993).

[33] *See* Penn v. Ryan's Family Steak Houses, Inc., 269 F.3d 753, 758 (7th Cir. 2001); Hooters of America, Inc. v. Phillips, 173 F.3d 933, 941 (4th Cir. 1999); Cole v. Burns Int'l Security Servs., Inc., 105 F.3d 1465, 1482–83 (D.C. Cir. 1997); Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 697–98; Carrie Menkel-Meadow, *Do the "Haves" Come Out Ahead in Alternative Judicial Systems?: Repeat Players in ADR*, 15 OHIO ST. J. ON DISP. RESOL. 19, 52 (1999) (noting that securities and other industries favor arbitration "so much that they are willing to undertake potentially substantial internal reforms to avoid judicial nullification").

[34] *See* Constantine N. Katsoris, *The Resolution of Securities Disputes*, 6 FORDHAM J. CORP. & FIN. L. 307 (2001); Constantine N. Katsoris, *SICA: The First Twenty Years*, 23 FORDHAM URB. L.J. 483 (1996).

and to otherwise monitor and revise securities arbitration procedures.[35] NASD established a standing committee of its board, the National Arbitration and Mediation Committee (NAMC), to recommend improvements to its dispute resolution systems.[36] The NAMC is composed of a majority of non-securities industry members. Lawyers representing investors have formed their own association, the Public Investor Arbitration Bar Association (PIABA). Among other functions, PIABA advocates the interests of public investors and serves as a clearinghouse for information on SRO arbitrations and arbitrators.

The SROs have sponsored independent evaluations of their arbitration procedures as well. For example, in 1994 the NASD appointed an Arbitration Policy Task Force chaired by former SEC Chairman David S. Ruder to evaluate the need for securities arbitration reform. The resulting task force report, commonly referred to as the Ruder Report, served as the basis for substantial changes intended to enhance the fairness of the arbitration system.[37]

The SROs actions after the release of my report to the SEC on the adequacy of their arbitrator conflict disclosure requirements provides a more recent example of the SROs' responsiveness to proposed changes. In my report, I concluded that: "While the current SRO conflict disclosure requirements generally appear adequate, some minor enhancements to disclosure and other related rules may provide additional assurance to

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[35] *See* X LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4577-78 (rev'd 3d ed. 1996); Constantine N. Katsoris, *The Level Playing Field*, 17 FORDHAM URB. L.J. 419 (1989).

[36] *See* SEC REPORT, *supra* note 1, at 10.

[37] *See supra* note 3.

investors that arbitrators are in fact neutral and impartial."[38] In particular, my report made the following four recommendations: (1) amend arbitration rules to emphasize that all conflict disclosures are mandatory; (2) re-examine the definitions of public and non-public arbitrators; (3) provide greater transparency with respect to challenges for cause by including the cause standard in the arbitration rules; and (4) sponsor independent research to evaluate the fairness of SRO arbitrations.[39] The SROs promptly adopted these recommendations.[40] Indeed, the NASD went beyond those recommendations and further narrowed the definition of public arbitrator. NASD expressed a preference for an overly restrictive rather than overly permissive definition of public arbitrator because it wanted "to protect the integrity of the NASD forum[] and investors' confidence in the integrity of the forum..."[41]

In sum, the SEC, Congress, and the SROs appear to have worked consistently and diligently to ensure SRO-sponsored securities arbitration provides a fair dispute resolution system.

II. AVAILABLE EVIDENCE DOES NOT SUPPORT THE EXISTENCE OF SYSTEMIC PROBLEMS IN THE SECURITIES ARBITRATION SYSTEM

Public confidence in the fairness of the securities arbitration system is crucial to its success. But, imposing additional procedural requirements on the system should not in any way be viewed as a costless way to achieve that goal. As I noted in my SEC

[38] SEC REPORT, *supra* note 1, at 4.

[39] SEC REPORT, *supra* note 1, at 4-5.

[40] SEC Rel. No. 34-49573, 69 FED. REG. 21871 (Apr. 22, 2004).

Report, for example, imposing additional arbitrator conflict disclosure rules "may deter well-qualified arbitrators from serving or may disqualify those with significant expertise from hearing a case. The net result may well be less accurate case resolutions and more judicial challenges to arbitral awards."[42] It is for this reason that the SEC has long taken the position that proposed changes must "balance the need to strengthen investor confidence in the [SROs'] arbitration system with the need to maintain arbitration as a form of dispute resolution that provides for the equitable and efficient administration of justice."[43] In addition, significant unintended consequences often accompany regulatory shifts,[44] suggesting that such changes should not be undertaken based on sporadic anecdotal accounts of perceived problems in individual cases. Consequently, those seeking to revamp the securities arbitration system should have the burden of identifying through thorough and well-documented empirical evidence that actual problems in fact exist.

To date, there is little empirical evidence to suggest systemic problems in the securities arbitration system. While it remains important to study the system further, available empirical evidence on outcomes in SRO arbitrations and on investors'

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[41] 69 FED. REG. at 21872.

[42] SEC REPORT, *supra* note 1, at 48, *see also* HOW INVESTORS FARE, *supra* note 26, at 61 (noting SEC's concern that imposing additional qualification and training requirements on arbitrators "risks increasing significantly the costs of securities arbitration and reducing the pool of qualified arbitrators without materially improving the general quality of the arbitrator pool or increasing assurances of the independence or capability of individual arbitrators.").

[43] SEC Rel. No. 30153, 57 FED. REG. 1292 (Jan. 6, 1992).

[44] *See, e.g.*, Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913.

perceptions of the arbitration process suggest that the current system addresses customer disputes fairly and impartially.

A. Arbitration Outcomes

The most comprehensive study of investor outcomes in securities arbitrations is the GAO's 1992 report, *Securities Arbitration: How Investors Fare*.[45] That report examined results in arbitrations over an eighteen-month period from January 1989 to June 1990 and found no evidence of a systemic pro-industry bias.

For example, some critics suggest that investors tend to fare worse in SRO-sponsored arbitrations versus arbitrations in non-SRO forums. As shown in Figure 2, the GAO found no statistically significant difference between the results in SRO-sponsored arbitrations versus securities arbitrations at the American Arbitration Association (AAA).[46] In SRO arbitrations, the arbitrators found for investors in about 59% of the cases versus 60% of AAA cases. In cases in which investors prevailed, they recovered on average about 61% of the damages they claimed in SRO arbitrations versus 57% in AAA arbitrations.[47] In addition, about 44% of SRO cases and 33% of AAA cases settled.[48]

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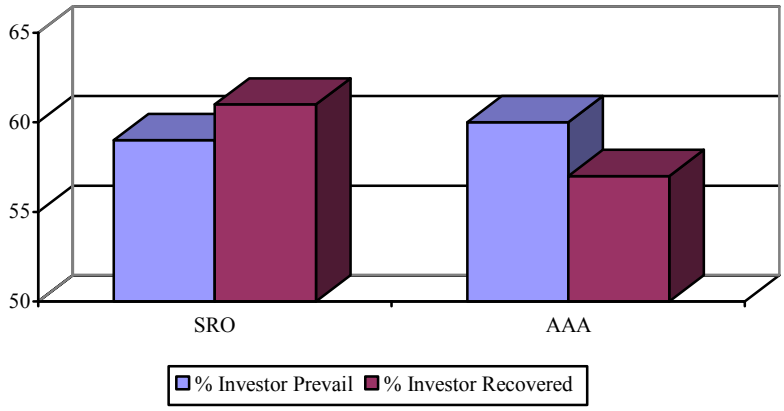
[45] *See supra* note 26.

[46] HOW INVESTORS FARE, *supra* note 26, at 38-39. The GAO was unable to evaluate arbitration versus litigation results because of the limited number of litigated cases. HOW INVESTORS FARE, *supra* note 26, at 6.

[47] HOW INVESTORS FARE, *supra* note 26. This finding is consistent with empirical studies from other arbitration contexts and with conventional views of arbitration that suggest that arbitrators tend to make compromise awards between the parties' positions. *See* David E. Bloom, *Empirical Models of Arbitrator Behavior Under Conventional Analysis*, 68 REV. ECON. & STATS. 578, 585 (1986); Henry S. Farber, *Splitting-the-Difference in Interest Arbitration*, 35 INDUS. & LAB. REL. REV. 70 (1981).

[48] HOW INVESTORS FARE, *supra* note 26, at 48.

Figure 2
Investor Outcomes in SRO vs. AAA Arbitrations
(January 1989-June 1990)



The GAO updated these findings in 2000.[49] It found that in the period 1992-1998 both the percentage of investor favorable outcomes and the proportion of awards to amounts claimed declined over the previous study period.[50] The GAO Report suggested, however, that an increase in settled claims during the second study period,[51] rather than the rise of a pro-industry bias, might explain these apparent declines to the extent that the settlements substantially altered the mix of cases that went to a final arbitration decision. In other words, industry members may have settled more of the stronger cases, leaving more of the weaker cases for resolution through arbitration decisions. Although the GAO

[49] PROBLEM OF UNPAID AWARDS, *supra* note 26.

[50] In its initial study, investors won about 59% of the time. The annual win rate in the later study ranged from 49% to 57%. From 1992 to 1996, the rate averaged 51%, but climbed to 56% in 1997 and 57% in 1998. PROBLEM OF UNPAID AWARDS, *supra* note 26, at 23-24. Awards during the second study period ranged from 46% to 57% of the amount claimed, averaging about 51% from 1992 to 1998. By contrast, in the first study period awards averaged 61% of the amount claimed. PROBLEM OF UNPAID AWARDS, *supra* note 26.

[51] Less than 50% of claims settled from 1989 to 1992, while settlements ranged from 50% to 60% of the cases from 1993 to 1998. PROBLEM OF UNPAID AWARDS, *supra* note 26, at 7.

did not analyze arbitration settlements, it did report, "the declining win rate could indicate little or no change in the fairness of the arbitration process."[52]

Indeed, if one examines SICA's data on arbitration outcomes over the period from 1980 through 2001 (represented in Figure 3), one finds some annual variation, but no evidence of systemic advantages for industry members. From 1980 to 2002, SRO arbitrators decided 32,732 public customer cases. Of that total, 17,211 (52.58%) resulted in customer awards. These findings are consistent with empirical studies involving other arbitration contexts in which repeat players are present. Most of the work in this area involves labor disputes in which employers and unions are the repeat players. Although the repeat players on the claimants' side are different (plaintiff's lawyers instead of unions) a similar pattern emerges—each side wins about half the time.[53]

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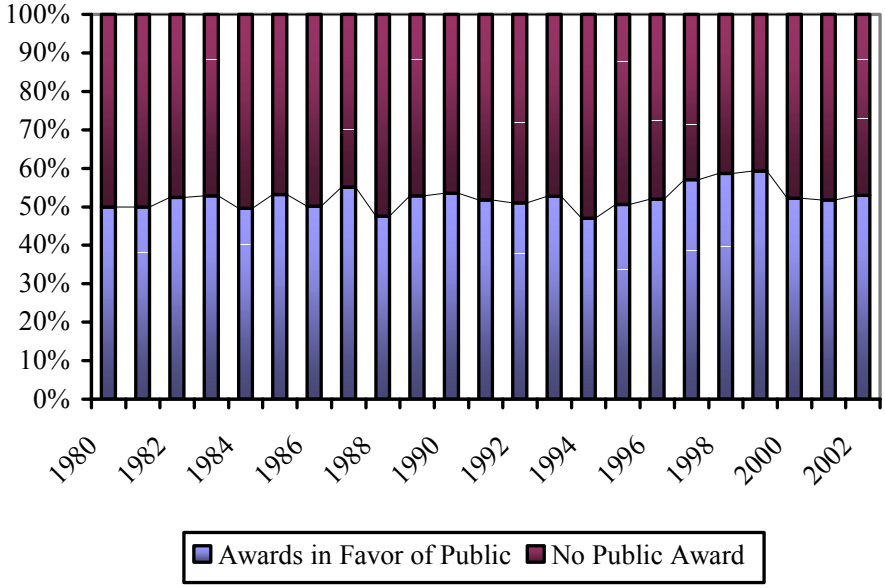
[52] PROBLEM OF UNPAID AWARDS, *supra* note 26, at 5.

[53] *See* Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMPL. RTS. & EMPLOY. POL'Y J. 189, 202 (1997) (reviewing studies).

Figure 3
SRO Cases With Awards to Public vs. No Public Award



In 2000, the GAO could not reach a conclusion on the fairness of the process based on the same analysis of case outcomes it had used in the 1992 study. Very few cases were handled outside the SRO forums, and so the GAO had insufficient data to compare SRO arbitration outcomes to AAA or litigation outcomes.[54] The GAO suggested that there were fewer cases at non-SRO forums because more pre-dispute arbitration agreements required arbitration in an SRO forum.[55] Critics of SRO arbitrations suggest that giving investors the opportunity to select non-industry forums would help maintain the integrity of securities arbitration.[56] But, it is not entirely clear

[54] PROBLEM OF UNPAID AWARDS, *supra* note 26, at 7.

[55] PROBLEM OF UNPAID AWARDS, *supra* note 26, at 31.

[56] Joel Seligman, *The Quiet Revolution: Securities Arbitration Confronts the Hard Questions*, 33 HOUS. L. REV. 327, 344-46 (1996).

that if given such a choice investors would select non-SRO forums. In January 2000, SICA initiated a two-year pilot program whereby investors could elect to arbitrate their claims in selected non-SRO forums. Of the 277 cases eligible for the program, only eight were submitted. Among the reasons participants gave for not selecting the alternative forums was the lower cost of SRO arbitrations, a preference for more familiar SRO procedures, and the possibility of delays in non-SRO forums.[57] If SRO arbitrations were significantly biased in favor of the industry, it is reasonable to predict that the suggested speed and cost advantages would not be compelling.

Of course, win rates are only part of the story—the amount recovered is important as well. Here too the GAO's empirical evidence, which demonstrates that claimants recover 40 to 60 percent of the amounts claimed, is hardly unexpected. There is a widespread popular perception that arbitrators tend to split the difference,[58] a phenomenon that has been observed in a wide variety of arbitration contexts. In other words, recoveries in securities arbitration are similar to recoveries in other arbitrations and do not suggest any special pro-industry bias.[59]

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[57] *See* SICA, FINAL REPORT SECURITIES INDUSTRY CONFERENCE ON ARBITRATION PILOT PROGRAM FOR NON-SRO SPONSORED ARBITRATION ALTERNATIVE (2002).

[58] Bloom, *supra* note 47, at 578.

[59] In fact, claimants may do better in arbitration than they would in litigation. Although the cases are quite different in many obvious respects, it is worth noting that recoveries in securities fraud class actions tend to be substantially lower on a percentage basis than recoveries in securities arbitrations. One recent study found that the median settlement in recent securities class actions was 4.4% of the estimated damages. *See* Laura E. Simmons, *Post-Reform Act Securities Lawsuits: Settlements Reported Through December 2003* at 5 (2004) (available at http://www.cornerstone.com/fram_res.html) (studying cases filed after passage of Private Securities Litigation Reform Act).

In sum, the available evidence demonstrates that claimants in securities arbitration do at least as well as claimants in similar arbitration contexts. There is thus nothing in the outcomes data to suggest that the securities arbitration system has any apparent pro-industry bias.

B. Survey Data on Perceptions of the Fairness of SRO Arbitrations

The most recent and comprehensive study of investor perceptions of the fairness of SRO arbitrations reveals a substantial level of satisfaction among parties and representatives.[60] The study reviewed the evaluations submitted in NASD arbitrations over a fifteen-month period between December 1, 1997 and April 1, 1999.

Two limitations of the study suggest that its findings must be interpreted with caution. First, few arbitration participants completed the surveys; the authors concluded that the evaluation response rate was only between 10%-20%. Second, these responses may reflect selection bias problems. The authors performed some tests to detect possible problems and found none, but it is still possible that individuals that were more satisfied with the fairness of the process or that achieved favorable outcomes were more likely to complete the surveys.

Despite these limitations, the authors concluded that participants in NASD arbitrations overwhelmingly believed that their cases were handled fairly and without

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[60] GARY TIDWELL, KEVIN FOSTER & MICHAEL HUMMEL, PARTY EVALUATION OF ARBITRATORS: AN ANALYSIS OF DATA COLLECTED FROM NASD REGULATION ARBITRATIONS (1999), *available at* http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_009528.pdf [hereinafter TIDWELL STUDY]. Mr. Tidwell was the Director of Neutral Training and Development for NASD Regulation at the time this study was prepared.

bias.[61] Two aspects of the survey are particularly relevant. First, as shown in Table 1 an overwhelming majority (93.49%) strongly agreed or agreed that their cases were handled fairly and without bias. Only 3.8% of respondents strongly disagreed with this statement.[62]

Table 1
Evaluation of Whether Claim Was Handled Fairly and Without Bias[63]

	Frequency	Percent	Cumulative
Strongly Agree	573	57.36%	57.36%
Agree	361	36.14%	93.49%
Disagree	27	2.70%	96.20%
Strongly Disagree	38	3.80%	100.00%
Total	999	100.00%	

The data suggest that claimants (who tend to be customers) have a stronger opinion of the fairness of arbitration proceedings than respondents. Table 2 demonstrates that a significantly higher percentage of claimants or attorneys representing claimants (61%) strongly agreed that their case had been handled fairly and without bias, as opposed to only 53% of respondents or those representing respondents.[64]

[61] TIDWELL STUDY, *supra* note 60, at 3.

[62] In 2001, NASD-DR conducted a follow-up study. While the response rate remained low (34%) and the sample size (n=61) was small, the results were generally consistent. Eighty-five percent of the survey respondents strongly agreed (62%) or agreed (23%) that their cases were handled fairly and without bias. Twelve percent disagreed, while none strongly disagreed. The remaining 2% were neutral. NASD-DR, *Customer Satisfaction Survey Results* 1 (May 2001).

[63] TIDWELL STUDY, *supra* note 60, at 20.

[64] The p-value for the chi-square analysis of these responses is 0.003, which reflects a statistically significant difference in the way that claimants and respondents answered these questions. TIDWELL STUDY, *supra* note 60, at 17.

Table 2
Respondents' and Claimants' Evaluation of
Whether Claim Was Handled Fairly and Without Bias[65]

	Strongly Agree	Agree	Disagree	Strongly Disagree	Total
Respondent	245	196	9	13	463
	52.92%	42.33%	1.94%	2.81%	100.00%
Claimant	321	165	18	22	526
	61.03%	31.37%	3.42%	4.18%	100.00%
Total	566	361	27	35	989
	57.23%	36.50%	2.73%	3.54%	100.00%

Arbitration participants were also asked to evaluate whether the arbitrators displayed fairness and the appearance of fairness. As the data in Table 3 demonstrate, 91.67% of the respondents rated the arbitrators as either excellent or good. The percentage of respondents and claimants rating the arbitrators as excellent was virtually identical (76.86% v. 76.74%).[66] Thus, the available data indicate that arbitration participants believe that their arbitrations were fair and impartial.

[65] TIDWELL STUDY, *supra* note 60, at 20. The upper number is the frequency of the response. The lower number is the percentage of the response.

[66] TIDWELL STUDY, *supra* note 60, at 38. In evaluating the structural bias claim, it would have been useful if the study evaluated whether claimants tended to give lower evaluations to non-public arbitrators, but the study does not break down the data in this manner.

Table 3
Evaluation of Whether Arbitrator Displayed Fairness and Appearance of Fairness[67]

	Frequency	Percent	Cumulative
Excellent	774	76.71%	76.71%
Good	151	14.97%	91.67%
Fair	48	4.76%	96.43%
Poor	36	3.57%	100.00%
Total	1009	100.00%	

CONCLUSION

The available evidence does not suggest that the heavily regulated securities arbitration system has any apparent pro-industry bias. This is not to say, however, that more work need not be done and that we can safely ignore securities arbitrations for the foreseeable future. In my SEC Report, I wrote that "[g]iven the unquestioned significance of securities arbitrations, it is crucial that the SROs resolve any lingering concerns about pro-industry bias."[68] Due to the limited nature of existing evidence of investors' perceptions of the arbitration process, I recommended that the SROs sponsor additional independent studies to further evaluate the impartiality of the SRO arbitration process. It is my understanding that such a study is about to commence and that its findings will be published before the end of the year. If that or other studies reveal systemic problems, then those problems should and must be addressed. But, until persuasive evidence of such problems exists, it would be imprudent to substantially alter a system that appears to serve investors well.

[67] TIDWELL STUDY, *supra* note 60, at 38.

[68] SEC REPORT, *supra* note 1, at 5.

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SCHOLARLY INTERESTS

Securities Regulation and Litigation, Corporations, Complex Litigation

EMPLOYMENT

St. John's University School of Law: Professor

Assistant Professor (June 1998-August 2001)

Promoted to Associate Professor December 2000 (Effective September 2001)

Granted tenure and promoted to Professor December 2002

Subjects: Securities Regulation, Securities Litigation Seminar, Securities Regulation Seminar; Business Organizations

Columbia University School of Law: Justin W. D'Atri Visiting Professor of Law, Business and Society (Fall 2002); **Adjunct Professor** (Spring 2003)

Subjects: Corporations, Securities Regulation & Capital Markets

Stanford Law School: Lecturer (January 1997 to June 1998); **Co-Director, Roberts Program in Law, Business, and Corporate Governance** (November 1995 to June 1998).

Subjects: Advanced Topics in Securities Litigation, Securities Litigation

Cadwalader, Wickersham & Taft: **Associate** (September 1988 to August 1994; June 1995 to October 1995).

PUBLICATIONS

Books

SECURITIES LITIGATION AFTER THE REFORM ACT (CCH 2000) (Updated semi-annually).

Articles

SEC Enforcement of Attorney Up-the-Ladder Reporting Rules: An Analysis of Institutional Constraints, Norms and Biases, 49 VILL. L. REV. 851 (2004).

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Securities Law for the Next Millennium: A Forward-Looking Statement, 75 ST. JOHN'S L. REV. 1 (2001).

Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action, 50 STAN. L. REV. 273 (1998).

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Securities Litigation Reform: The First Year's Experience (A Statistical and Legal Analysis of Class Action Securities Fraud Litigation Under the Private Securities Litigation Reform Act of 1995), Working Paper No. 140, John M. Olin Program in Law and Economics Working Paper Series, Stanford Law School (February 1997) (with Joseph A. Grundfest).

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The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation, 38 ARIZ. L. REV. 559 (1996) (with Joseph A. Grundfest).

Drafting Mediation Privileges: Lessons From the Civil Justice Reform Act, 26 SETON HALL L. REV. 1 (1995).

Not Just A Private Club: Self-Regulatory Organizations as State Actors, 1995 COLUM. BUS. L. REV. 453 (with Richard A. Stone).

Comment, *Justice Scalia: Standing, Environmental Law and the Supreme Court*, 15 B.C. ENVTL. AFF. L. REV. 135 (1987).

WORKING PAPERS

Strategic Decision Making in Federal District Courts: Evidence from Securities Fraud Actions

OTHER WRITINGS

REPORT TO THE SECURITIES AND EXCHANGE COMMISSION REGARDING ARBITRATOR CONFLICT DISCLOSURE REQUIREMENTS IN NASD AND NYSE SECURITIES ARBITRATIONS (Nov. 4, 2002) (available at http://www.sec.gov/pdf/arbconflict.pdf).

SECURITIES CLASS ACTION LITIGATION IN Q1 1998: A REPORT TO NASDAQ FROM THE STANFORD LAW SCHOOL CLASS ACTION CLEARINGHOUSE (June 1998).

What We Know and Don't Know About the Private Securities Litigation Reform Act of 1995, Written Testimony of Michael A. Perino Before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs, United States Senate (Oct. 29, 1997).

What We Know and Don't Know About the Private Securities Litigation Reform Act of 1995, Written Testimony of Michael A. Perino Before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, United States House of Representatives (Oct. 21, 1997).

A Census of Securities Class Action Litigation After the Private Securities Litigation Reform Act of 1995, Written Testimony of Michael A. Perino Before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs, United States Senate (July 24, 1997).

Ten Things We Know and Ten Things We Don't Know About the Private Securities Litigation Reform Act of 1995, Joint Written Testimony of Joseph A. Grundfest and Michael A. Perino Before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs, United States Senate (July 24, 1997).

EDUCATION

Columbia University School of Law: LL.M., 1995
- Valedictorian

Boston College Law School: J.D., 1988, *Cum Laude*
- Executive Editor, *Boston College Environmental Affairs Law Review*

Rutgers College: B.A., 1985
- *High Honors* (Top 5%)

HONORS, AWARDS, AND FELLOWSHIPS

Dean's Teaching Award, St. John's University School of Law (2001): Given for excellence in teaching for Business Organizations course.

Finalist, Computerworld-Smithsonian Award (1997): Developed Internet site (securities.stanford.edu) that was recognized as one of the five most important applications of information technology created by an educational institution.

Walter Gellhorn Prize (1995): Awarded by Columbia University School of Law for outstanding proficiency in legal studies.

James Kent Scholar (1995): Highest honor awarded by Columbia University School of Law in recognition of outstanding academic achievement.

Order of the Coif (1988): Boston College Law School.

National Trial Competition (1988): New England Regional Champion and National Finalist.

CONFERENCES ORGANIZED

Enron and Its Aftermath, St. John's University School of Law (September 2002).

Securities Law for the Next Millennium: A Forward-Looking Statement, St. John's University School of Law (September 2000).

PAPER PRESENTATIONS AND SELECTED SPEAKING ENGAGEMENTS

Securities Litigation Reform: Did the Plaintiffs' Lawyers Win the War?, Bloomberg News (Sept. 30, 2004).

Are Shareholder Lawsuits Useful or Frivolous, American Enterprise Institute (Mar. 18, 2004).

How Vigorously Will the SEC Enforce Attorney Up-the-Ladder Reporting Rules? An Analysis of Institutional Constraints, Norms, and Biases, Up the Ladder & Beyond: The New Professional Standards for Lawyers under the Sarbanes-Oxley Act, Villanova Law Review Symposium (Nov. 8, 2003).

Litigation and Shareholder Actions, CPE Corporate Governance Seminar (June 2003).

Investors in Arbitration: Leveling the Playing Field, North American Securities Administrators Association's 18th Annual Public Policy Conference (April 2003).

Action or Reaction? Congress Responds to Enron, ABA 2002 Annual Meeting (August 2002).

Don't be the Test Case! How to Avoid Liability Under Reg FD, ABA-CLE VideoConference and TeleConference (February 2002).

PLUS IPO Laddering Litigation Seminar (September 2001).

Don't be the Test Case! How to Avoid Liability Under Reg FD, ABA 2001 Annual Meeting (August 2001).

The Reform Act at 5 Years: A Look Backward and A Peek Forward, PLUS D&O Liability & Insurance Issues Symposium (February 2001).

Corporate and Securities Litigation Today, ALI-ABA Annual Corporate Governance Institute (November 2000).

Current Issues and Recent Developments in Securities Litigation, National Association of Public Pension Attorneys Legal Education Conference (June 2000).

Moderator, *Securities Law for the Next Millennium: A Forward-Looking Statement*, St. John's University School of Law (September 2000).

The Role of Public and Private Enforcement in Setting Future Normative Standards, Securities Law for the Next Millennium: A Forward-Looking Statement, St. John's University School of Law (September 2000).

Trends in Securities Litigation, Northern District of California Judicial Conference (April 1999).

Private Securities Litigation Reform Act of 1995: Where are We Four Years Later, 1999 Institute for Corporate Counsel, USC School of Law (March 1999).

Securities Class Actions in State Courts: A Way Around the Federal Securities Litigation Reform Act, American Bar Association Annual Meeting (August 1998).

Securities Litigation Reform: The First Year's Experience, John M. Olin Program in Law and Economics Lecture Series, Stanford Law School (May 1997).

New Research Tools in an Electronic Age, Conference on Markets and Information Gathering in an Electronic Age: Securities Regulation in the 21st Century, Washington University School of Law (March 1997).

The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation, Securities Litigation Legislation Conference, University of Arizona (December 1995).

Securities in the Electronic Age, Glasser Legal Works (March 1998).

Securities Litigation, American Corporate Counsel Association (October 1997).

Advanced Securities Law Workshop, Practicing Law Institute (August 1997; August 1998).

Nasdaq Directors' Day, Stanford Law School and the Nasdaq Stock Market (June 1997).

Disclosure Tools for the New Safe Harbor, Nasdaq Regional Forums (June 1997).

Private Securities Litigation Reform Act of 1995, Biotechnology Industry Organization 1997 Annual Conference (June 1997).

Directors' Roundtable, National Conference for Corporate Counsel (May 1997).

Biotechnology Law and Policy, Stanford Law School (March 1997).

Directors' College, Stanford Law School (March 1997; March 1999).

The Silicon Valley Venture Forum, Center for Economic Policy Research, Stanford University (March 1997).

Corporate Practice Conference 1997, American Bar Association (January 1997).

Securities Litigation, Practicing Law Institute (October 1996; September 1997).

Institutional Investors' Forum, Stanford Law School (March 1996; October 1996; June 1997).

TESTIMONY

Legislative Hearing on S. 1260, the Securities Litigation Uniform Standards Act of 1997, Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs, United States Senate (October 29, 1997).

Oversight Hearings on the Private Securities Litigation Reform Act, Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, United States House of Representatives (October 21, 1997).

EXPERT ENGAGEMENTS AND CONSULTANCIES

U.S. Securities and Exchange Commission; New York Stock Exchange; Morgan Stanley Dean Witter; UBS PaineWebber, Inc.; U.S. Bancorp Piper Jaffray; National Union Fire Insurance Company; New York State Common Retirement Fund, Inc.; Public Employees Retirement Association of Colorado; Minnesota State Board of Investment; New York Life Insurance Co.; American Electronics Association; National Venture Capital Association; BankAmerica Corporation

MEMBERSHIPS AND COMMITTEES

New York County Bar Association Ad Hoc Task Force on Corporate Responsibility

Commissioner's Advisory Committee on Securities Regulation and Capital Formation, California Department of Corporations (1997-1998)

New York State Bar

United States District Courts for the Southern and Eastern Districts of New York

Association of American Law Schools—Securities Regulation and Corporations Sections

American Bar Association

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Michael A. Perino	

3. Business Address and telephone number:

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4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2004 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2004 related to the subject on which you have been invited to testify?
☐ Yes ☒ No	☐ Yes ☒ No

6. If you answered "yes" to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.

Michael A. Perino

7. Signature:

Please attach a copy of this form to your written testimony.