FINRA MEDIATION:

A CLOSE TO "NO LOSE" SITUATION

By: Peter Byer

To anyone who has handled securities arbitrations in the last 10 years, the mediation program administered by FINRA has helped clear or reduce arbitration caseloads. According to FINRA's website, since 1995 FINRA has administered approximately 17,500 mediations. Of this amount, close to 80% have resulted in settlements.

The growth of FINRA's mediation program has filled a void long existent in securities arbitration practice; that is to say, unlike civil litigation in state and federal courts, FINRA (which now conducts the arbitrations formerly administered by the NASD and NYSE) arbitration procedures do not provide for mandatory settlement conferences before the arbitrators, as is routinely done with judges/magistrates or assigned attorneys in civil litigation. Left on their own, recalcitrant or stubborn attorneys and/or parties have no (presumed) objective third party to suggest, cajole or otherwise incent them to engage in fruitful settlement negotiations of arbitration claims.

The success of the mediation program conducted through FINRA has led to the parallel growth of a cadre of professional mediators. Many current mediators were civil litigation and/or securities arbitration practitioners who represented claimants or securities firms in arbitrations. Now, there are a number of attorneys (and

some non-attorneys) who advertise that they practice exclusively as mediators.

This article will describe the procedural requirements of conducting mediation before FINRA and then delve into several practical considerations involved in successful mediations.[1]

I. PROCEDURAL OVERVIEW

- Mediation can be initiated with FINRA prior to the filing of an arbitration claim or during the pendency of a claim. If initiated while a claim is pending, the arbitration process and the mediation process run separately. The parties can choose to have FINRA suspend the arbitration while mediating the case. Alternatively, the parties can adjourn a scheduled hearing without incurring adjournment fees.

- The parties select a mediator from a roster of mediators maintained by FINRA. Alternatively (as of August 2012), the parties may select a mediator not on FINRA's approved list, subject to FINRA's approval. Lastly, parties can tell FINRA that they have agreed upon a mediator to conduct the mediation.

[1] Other organizations also provide mediation services. This article will focus on FINRA's mediation program. If you are in the middle of a FINRA arbitration, there are several benefits to conducting a mediation through the auspices of FINRA, such as the ability to adjourn scheduled hearings at no cost to the parties. However, much of what is discussed in this article could apply to mediations administered by other organizations.

- The parties must sign a mediation submission agreement in which they agree to follow FINRA's Mediation Ground Rules (discussed below) and pay applicable fees.

- Mediations can be conducted in person, by telephone or by video conference, as chosen by the parties (I believe most participants in FINRA mediations would agree that in person mediations are by far the most effective).

- Mediation Ground Rules:
    - Participation is completely voluntary;
    - The mediator is to act as an impartial facilitator;
    - The mediation is private and confidential. Offers, admissions, etc., are not admissible in any future proceedings;
    - The mediator will not convey any confidential information from one party to another without the permission of the disclosing party.

II. PRACTICAL CONSIDERATIONS

A. <u>To mediate or not to mediate – that is the question.</u>

There are several factors that play into a decision as whether it is advantageous for your client to submit to mediation:

- Is the case worth settling? Certainly, most cases are worth at least exploring settlement. Early settlement will certainly reduce legal fees/costs for all parties in

arbitration. The prospect of having a mediator point out to your adversary the weak points in her case and the strengths in your case can help reduce the settlement costs. Conversely, having the mediator demonstrate to your client the strength of his adversary's case and the weaknesses in his own case can assist you in obtaining an appropriate level of settlement authority.

- At the very least, you will get to actually observe the other parties in the mediation. You can see for yourself whether the claimants are as elderly and infirm as the claim alleges or whether the broker is a slick looking, sleazy salesman (wearing a Rolex watch/ expensive suit) as described by your customer clients. The mediator will also share with you his/her impression of the potential witnesses. While you will most likely not be able to directly question the parties as to the disputed portions of the claim, you may ask the mediator to do so. The mediator will then convey to you your adversary's position as to various issues raised in the arbitration claim and provide you with his/her assessment of the veracity (or not) of the parties. Indeed, in order to give a candid assessment of your own client, the mediator may ask to speak directly with your client (in your presence) to ask questions about the disputed facts. The mediator may also speak to you without the client present so as to convince you that your client may have

some problems convincing the arbitration panel of the client's version of events.

- In short, there is very little downside to participation in a mediation. At the very least, you will get to observe your adversary parties and have a third party (the mediator) highlight to you the strengths and weakness of your case, some of which you may have previously not considered very significant. If, however, your client is a claimant who adamantly insists upon receiving 100% of losses, plus attorneys' fees, interest and costs, you have to either lower your client's expectations or be prepared for a long and ultimately unsuccessful mediation. Conversely, if you are defending a six figure exposure claim and your business client refuses to consider a settlement no larger than "cost of defense," your fees might be better spent preparing for a hearing.

B. The selection of the mediator – friend or foe?

While participation in mediation is voluntary and non-binding, practitioners do not want to find themselves in a situation involving a biased and/or inexperienced mediator. Such a situation could result in being locked into an untenable settlement posture, both unacceptable to you and your client. Fortunately, as stated previously, there are a number of experienced, full-time mediators available to conduct mediations. Indeed, there are several mediators who have developed positive reputations among both

the claimants' bar and defense counsel. In my own practice, which is almost exclusively in defense of brokers/firms, I have agreed to mediate with experienced claimants' counsel, and we have easily come to a joint agreement as to a mediator with whom we are both comfortable (I suppose these mediators also tell claimant's counsel how much they enjoy working with them and what great attorneys they are). FINRA's roster of mediators now numbers approximately 230 and anyone desirous of arranging the mediation of a claim should be able to find a mediator with whom all parties involved can work.

I also note that when FINRA initiated its mediation program, the mediators would frequently describe their backgrounds and their personal mediation philosophy in an opening statement to the parties in an initial joint session. Mediators would often discuss the two types of mediation "styles" – "evaluative" (the mediator evaluates the claims of the individual parties and makes settlement recommendations based on the mediator's judgment as to who has a stronger case) and "facilitative" (the mediator does not evaluate the strengths and weaknesses of the claims but rather leads the parties to a common ground that will result in a resolution). Most mediators currently do not describe themselves in this fashion but rather point to their success rate as the reason to utilize their services.

C. Preparation for mediation – Prepare to skirmish, not battle

Prior to the agreed upon mediation, the mediator will expect to receive written materials from all parties. This can include pleadings, a profit and loss analysis and possibly some key documents, such as correspondence exchanged with a customer, notes of conversations with a broker, etc. Some attorneys will prepare a separate "mediation statement" outlining the respective strengths and weaknesses of the parties' claims. In instances in which significant documents, emails, phone records, etc., have been provided in discovery, to the extent such information is not discussed in the pleadings, a separate mediation statement may be in order.

While neither the attorneys and nor the mediator take testimony during mediation sessions, the mediator will frequently ask permission to question the client or broker and/or the branch manager in the presence of their attorney (adversaries are not present). Therefore, it is necessary to prepare your client to truthfully, accurately and concisely answer any questions which might be posed by a mediator. You should attempt to "sell" your client to the mediator. Rest assured, late in the afternoon when the mediator is pushing parties to raise or lower their settlement figures, his impression of the probable performance of your witness at arbitration, if settlement is not reached, may go a long way towards helping him convince the other side to reach a

settlement (or conversely, convincing you to tell your client how difficult it actually is to testify under oath).

Lastly, it is advisable to consult with your adversary prior to the mediation on the issue of damages. If the parties go into the mediation without an agreement as to the damage figure, much time and energy can be wasted at the outset agreeing on that number – without such an agreement settlement is highly unlikely. By that "number" I mean the net out of pocket loss, which, in most cases, is a simple mathematical calculation. Claimants can also calculate additional damages, such as "lost opportunity" or "well managed account" losses to present at the mediation, together with an attorneys' fees statement. Nevertheless, most mediators will insist to claimants' counsel that if the case is to be settled it will settle at some percentage of the net out of pocket loss.

D. <u>The conduct of the mediation – do you care to dance?</u>

When FINRA's mediation program began, the initial practice was for the parties and their counsel to meet in a large conference room. The mediator would begin the session by describing his background and objectivity and the mediation process, primarily directed at the claimants. He emphasized the uncertainty of arbitration outcomes and the ability to control the outcome of the case via mediation. The claimants' attorney then gave an opening statement, accusing the broker of various and sundry offenses against the claimants in violation of numerous state, federal and industry regulations. He linked in the brokerage firm, pointing to

the hapless and inept supervision efforts of the manager seated across the table. It was then the defense attorney's turn. Statements of Claim were full of inconsistencies, inaccuracies and outright fallacies. The husband and wife clients sitting in the room were actually quite sophisticated investors, evidenced by their past investment experience, and well aware of the activity ongoing in their account. Lastly, any damages were caused by market forces which no human being could control or foresee.

Then the mediator would say, "Ok folks, let's get to work and settle this case!"

It always seemed counterintuitive to me that while the purpose of the mediation was to bring parties together to amicably settle the claim, the mediation began with attorneys for the parties casting aspersions on each other's clients and their motivations for either filing a claim or being in the business of generating commissions.[2] Presently, it is not unusual for the parties to meet together at the outset so the arbitrator can briefly describe the process, forego opening statements and begin the separate conferences with the mediator. Indeed, there is one mediator, popular with both claimants and respondents, who starts mediations at 9 am and tells respondent's counsel to show up at 11 am. However, in instances

[2] Once when I was in-house and attending a mediation, my firm's outside counsel made a particularly blistering opening statement. He later said, "I want the claimants to know that if they don't settle, they will have to face ME at the hearing." The case ultimately settled but I wonder if it was in spite of his opening comments, rather than because of them.

in which counsel feels an opening statement is warranted, perhaps a better practice is to not attack an adversary party to the degree that it might instill some antagonism in that party, resulting in bitter feelings and intransience during the course of the mediation.

As the mediator conducts "shuttle diplomacy" throughout the course of the day, you should be prepared to provide him with factual support for your arguments supporting your case. It is wholly appropriate to show the mediator notes, correspondence, exception reports, etc., that you feel bolster your case. A good mediator will use effective evidence to present your position to your adversary (that is, with your permission). If you have evidence that rebuts the claims of your adversary, have that at the mediation to share and discuss with the mediator.

E. Settlement negotiations – who are you going to believe, me or your lyin' eyes?

Respondents should always have a person at the mediation with settlement authority – or at least have that settlement authority one phone call away. At some point in the mediation, the claimants and respondents will tell the mediator the least they will accept and the most they will pay, respectively. But is that really the final number?

The mediator may tell you to give him your final settlement figure and let him get the other side to accept that number (if the respondents' final settlement offer is higher than the claimants' final settlement demand, the mediator has an easy day; the

question is, will he tell you?). I suppose the practice of most attorneys is to never give anyone your final number in case you have to sweeten the deal by a few thousand dollars. We all engage in negotiations and know that when an adversary says $ xxx is the last dollar they will accept or pay, there probably is a little more out there. Presumably, in conveying that last dollar amount to the mediator, the mediator understands that there may be a little more in the kitty to close the deal. Therefore, be guided accordingly in talking final dollars with the mediator.

CONCLUSION

As you should be able to tell, I am a firm believer in the utility of securities mediation in FINRA arbitrations. I am aware of very few cases that did not result in a settlement. Those were multimillion-dollar cases with questionable liability. For most cases under $1 million in exposure, mediation can be a short cut to the successful resolution of disputes. Perhaps, the most effective skill an attorney can use in the context of mediation is managing a client's expectations towards settlement. As we all know, we often negotiate with our clients as much as we do with our adversaries. One of the main benefits of using a successful mediator to resolve a claim is that he or she can often assist you in managing your client and leading them to a settlement which they can accept.

****