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FAIR GAME

Arbitration, Litigation, Aggravation

By GRETCHEN MORGENSON
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WHEN investors file complaints against their brokers, the matters are almost always heard by an arbitration panel rather than by a judge or jury. Arbitration forums like those run by the [Financial Industry Regulatory Authority](#) typically adjudicate cases more quickly than the courts and less expensively, because costs associated with discovery and extensive legal filings are minimized if not eliminated.

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Helen Cohen lost \$700,000 on a REIT.

But a swift and inexpensive outcome is not always assured in Finra arbitrations, as an investor case under way in California shows. By cleverly circumventing Finra's rules, the financial firm that was sued by its former client has brought a related case in California state court, adding significantly to the investor's costs of seeking relief.

And to make matters even more exasperating, Finra's rules preclude it from investigating the firm and its tactic until after the damage is done.

The story begins in 2005, when Helen Cohen, an elderly widow, opened an investment account with the brokerage unit of what is now called the State Employees Credit Union, in Raleigh, N.C. Ms. Cohen, who died three years later, at the age of 86, was in poor health at the time she was dealing with S.E.C.U. Notes taken by an S.E.C.U. employee after meeting with Mrs. Cohen at her San Diego home stated that she "confuses easily."

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According to the complaint filed by a trust that Mrs. Cohen had set up to benefit her two children, the S.E.C.U. broker recommended a real estate investment known as NNN Sanctuary at Highland Oaks. The broker advised that by investing in that company, which owned an apartment complex in Tampa, Fla., Mrs. Cohen could make a tax-free exchange of an apartment building that she had owned for 30 years and defer capital gains on the sale, the complaint said.

Mrs. Cohen invested about \$1 million in the Sanctuary investment. Only later did a trustee overseeing her investment discover that the apartment complex was financed with a risky interest-only loan, that turnover among its renters was unusually high and that even a modest decline in real estate values could result in a significant loss.

In any case, the real estate investment trust cratered, and the Cohen trust lost \$700,000. The trust and its trustee, Nancy Thornton, filed an arbitration claim in 2009, seeking to recover those losses as well as \$2.6 million in damages for its claims of senior citizen financial abuse and for legal fees. A Finra arbitration panel was appointed to hear the case.

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IN response to the complaint, S.E.C.U. argued that Mrs. Cohen was a sophisticated real estate investor and had agreed to buy the Sanctuary REIT after receiving advice from her tax lawyer, accountant, friends and at least one of her children.

But in June 2010, as the arbitration was proceeding, S.E.C.U. came up with a creative legal tactic outside of the Finra process. It brought a counterclaim against Foster Thornton LLC, which employed Mrs. Cohen's trustee, in Superior Court in San Diego. S.E.C.U. contended that the company had advised the client about the real estate investment or had "expressed no concern or reservation" about it. Therefore, the complaint asked the court to determine whether the trustee was liable for any or all of Mrs. Cohen's investment losses.

To **Arthur S. Leider, president of Investors Arbitration Specialists in San Diego**, who represents the Cohen trust, the S.E.C.U. suit was a form of harassment that has increased his client's costs. S.E.C.U.'s court case has required the Cohen trust to pay additional expenses to hire a new trustee and cover her associated costs. An extra \$20,000 has been spent so far, he said.

Furthermore, the counterclaim by S.E.C.U. is odd, Mr. Leider said, because Ms. Thornton began working for the Cohen trust only in 2007, well after the investment was made. S.E.C.U. appears to have sued Foster Thornton, the company, rather than Ms. Thornton, the trustee, to keep the case alive in court. Because she is a plaintiff in the arbitration, naming Ms. Thornton in the counterclaim would probably have led the judge assigned to the court case to return the matter to the arbitrators already hearing the Cohen family claims.

Michael Weisel, a lawyer at Bailey & Dixon who represents S.E.C.U., declined to comment. But his court filings argue that because Foster Thornton is not a Finra member and subject to its arbitration agreements, S.E.C.U. is free to sue it.

Mr. Leider said the S.E.C.U. suit runs afoul of Finra rules barring parties in an arbitration from bringing related matters into a court. Finra Rule 12209 states: "During an arbitration, no party may bring any suit, legal action, or proceeding against any other party that concerns or that would resolve any of the matters raised in the arbitration."

When Mr. Leider contacted Finra to ask it to enforce its rule, he was told to request that the arbitrators hearing the matter refer the problem to Finra enforcement.

But there was a catch. The organization's rules let arbitrators refer matters to Finra enforcement only after arbitration ends.

"Investors bringing arbitration claims against Finra members have a right to believe that Finra will enforce their own rules," Mr. Leider said. "Allowing securities firms to financially intimidate investors who bring claims must not be permitted."

Mr. Leider said that Finra told him it was looking into the matter. He believes that because there has been a substantial increase in large arbitration awards, some brokerage firms are being more aggressive in litigation with investors.

A spokeswoman for Finra said it had proposed a new rule allowing arbitrators to refer complaints of egregious conduct to its enforcement division while arbitrations are in progress.

Claudia S. Powell, a professional fiduciary in La Mesa, Calif., and the new trustee responsible for the Cohen trust, said the court action brought by S.E.C.U. "certainly has complicated the Finra arbitration process. It has added a tremendous amount of cost to the whole process."

"To the extent the language of the rule was not specific enough to prevent this," she says of the Finra policy, "is too bad."

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