

*A Menace to Investors:  
Non-Attorney Representatives in FINRA Arbitration*

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## **INTRODUCTION**

When investors sue their broker or brokerage firm, they can hire an attorney who is licensed to practice law in a particular state. Alternatively, in many states investors have the option of hiring someone who is not licensed to practice law if the claim is filed through FINRA, the Financial Industry Regulatory Authority.

FINRA Rule 12208 generally allows non-attorney representatives (“NARs”) to represent investors in its arbitration forum, provided that the investor’s state permits such representation. NARs often do not maintain malpractice insurance, have no ethical code or constraints like attorneys do, and do not face potential sanctions from any regulatory or licensing body like a state bar association. Essentially, this system exposes

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the investor who was victimized by her broker to potential further victimization, with little chance of recovering damages caused by an unscrupulous or negligent NAR.

This report will examine the representation of investors in FINRA arbitration proceedings by NARs, particularly those who represent investors for compensation. It will discuss the applicable FINRA rules that govern this practice, the pitfalls of NAR representation, and some of the particular NAR firms that often represent investors in FINRA arbitration. After detailing the status of the NAR problem, the report will identify what FINRA should do to better protect investors' interests.

## **BACKGROUND**

FINRA (the Financial Industry Regulatory Authority) is a not-for-profit organization that, through powers delegated from the Securities and Exchange Commission ("SEC"), regulates the securities brokerage industry. FINRA's stated mission is to protect investors "by making sure that the broker-dealer industry operates fairly and honestly".<sup>3</sup> FINRA also touts itself as being "dedicated to investor protection and market integrity through effective and efficient regulation of broker-dealers".<sup>4</sup>

FINRA counts among its members several thousand securities brokerage firms.<sup>5</sup> FINRA member firms almost universally require their customers sign account agreements containing arbitration clauses, stating that the customer can seek redress against the brokerage firm or its brokers only through binding arbitration, administered through FINRA Dispute Resolution, a department of FINRA.

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<sup>3</sup> See FINRA, at <http://www.finra.org/about> (last visited Nov. 9, 2017).

<sup>4</sup> *Id.*

<sup>5</sup> See *Statistics*, FINRA, <https://www.finra.org/newsroom/statistics#currentmonth> (last visited Nov. 9, 2017) (stating that as of October 2017, there were 3,756 member firms and 635,073 registered representatives under FINRA).

FINRA Dispute Resolution promulgates rules for its Code of Arbitration Procedure, which rules govern the administration of claims between investors and FINRA member firms and brokers.<sup>6</sup> These rules govern all aspects of the arbitration procedure, including the filing and answering of complaints, the exchange of documents and information through discovery, and proceeding with an evidentiary hearing to ultimately determine liability.

The FINRA Code of Arbitration Procedure Rule 12208 governs who may represent parties within the forum. That rule provides that parties, including investors, can be represented by almost anyone. Unfortunately, investors who get victimized by their broker or brokerage firm sometimes find themselves victimized for a second time when an NAR provides substandard and ineffective representation in their FINRA arbitration claim. While all licensed attorneys are not created equal, at least they have licenses, standards and ethical rules that set a high standard of care. NARs, who increasingly represent investors in FINRA arbitration, have no such rules, duties or standards. Further they are not trained in advocacy as attorneys are, and as a result, often do a poor job of aggressively advocating for their clients.

Investors deserve better. FINRA has issued a Regulatory Notice, 17-34, seeking comment on the efficacy of allowing compensated NARs to represent parties in arbitration.<sup>7</sup> PIABA is supportive of FINRA's initial efforts to address this issue, and requests that FINRA adopt rules which would prohibit NARs from representing investors in arbitration, with limited exceptions.

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<sup>6</sup> See FINRA, RULE 12100 *et seq.*

<sup>7</sup> See FINRA, NOTICE TO MEMBERS 17-34 (2017), *available at* <http://www.finra.org/industry/notices/17-34>.

## **FINRA'S RULES PERMITTING NARS IN ARBITRATION**

FINRA Rule 12208 governs the representation of parties in arbitration claims involving customers. Rule 12208(a) provides that a party may represent themselves, and Rule 12208(b) provides that parties may be represented by an attorney in good standing and admitted to practice to the highest court of any state, unless state law prohibits such representation.<sup>8</sup>

Rule 12208's sections (c) and (d) provides that non-attorneys may also represent parties, with certain restrictions:

### **(c) Representation by Others**

Parties may be represented in an arbitration by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or
- the person is currently suspended from the practice of law or disbarred.

### **(d) Qualifications of Representative**

Issues regarding the qualifications of a person to represent a party in arbitration are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.<sup>9</sup>

FINRA Rule 12208 explicitly permits NARs to represent parties, with very limited exceptions. The exceptions in the rule are not sufficient to adequately protect investors.

## **HISTORY OF FINRA RULE 12208**

FINRA's predecessor, the NASD (National Association of Securities Dealer) enacted NASD Code of Arbitration Procedure Rule 27. In 1996, the NASD recodified these rules under a new numbering system and converted Rule 27 to Rule 10316. That rule simply stated that "All parties shall have the right to representation by counsel at

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<sup>8</sup> See FINRA, RULE 12208(a) and (b).

<sup>9</sup> See FINRA, RULE 12208(c) and (d).

any stage of the proceedings.”<sup>10</sup> No other guidance on this rule was provided at the time.

Then in 2005, the NASD proposed amending its representation rule.<sup>11</sup> The NASD ultimately withdrew that proposal, and filed a new representation rule proposal in 2006.<sup>12</sup> In 2007, FINRA adopted Rule 12208.<sup>13</sup>

NASD’s representation rule was originally written to address the multi-jurisdictional practice of law. Many states permit an attorney licensed in at least one state to represent clients in arbitration in states in which he or she is not licensed.<sup>14</sup> At the time of the initial proposed amendments, commenters raised concerns about NARs.<sup>15</sup> The NASD’s 2006 proposal attempted to address those concerns.

The NASD considered that it may be difficult for investors to obtain representation if they had relatively small claims, such as those under \$100,000 in losses.<sup>16</sup> However, the NASD was concerned about allowing NARs who had been punished by regulatory bodies (such as state bar associations or securities regulators) to represent individuals. The NASD concluded:

While NASD remains concerned about some aspects of non-attorney representation, NASD does not wish to prohibit investors from retaining a non-attorney representative if that person is the only affordable representation available, and the requirements of the proposed rule are met.<sup>17</sup>

Thus, the NASD thought it was prudent to allow NARs to represent investors, to ensure investors with smaller claims would not be denied representation, so long as the NAR

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<sup>10</sup> See NASD, RULE 10316.

<sup>11</sup> See SR-NASD-2005-023.

<sup>12</sup> See SR – NASD-2006-109.

<sup>13</sup> See Order Approving Proposed Rule Change Relating to Representation of Parties in Arbitration, Exchange Act Release No. 34-56540 [SR-NASD-2006-109], 72 Fed. Reg. 56410 (Sept. 26, 2007).

<sup>14</sup> See SR-NASD-2006-109 at 7-9 (addressing the ABA Model Rule 5.5).

<sup>15</sup> *Id.* at 10.

<sup>16</sup> *Id.* at 12.

<sup>17</sup> *Id.* at 12-13.

had not been punished by a regulator – it prohibited representation by any NAR that had been suspended or barred from the securities industry. After the NASD merged with NYSE Member Regulation in 2007 to form FINRA, FINRA enacted Rule 12208 in its present form.

## **PROBLEMS WITH NARS**

Although FINRA rules have permitted NARs to represent investors, certain NARs have compounded the damages investors have suffered. For example, NARs have been alleged to have charged investors \$25,000 in non-refundable deposits for representation; taken settlement money that the investors were not aware of; and represented some investors without their consent.<sup>18</sup> FINRA is fully aware of these issues. In October 2017, FINRA Director of Dispute Resolution, Richard Berry, discussed these allegations in a public forum.<sup>19</sup> FINRA is not alone in recognizing the problems associated with NARs - the SEC<sup>20</sup> and NASAA (the North American Securities Administrators Association)<sup>21</sup> have also warned the public about “recovery companies” that charge a fee to assist individuals to recover money from investment scams.

There have been various articles and published research discussing the issues with NARs in FINRA arbitration.<sup>22</sup> Most recently, in October 2017, FINRA published

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<sup>18</sup> See Rita Raagas de Ramos, *FINRA Warns Against Rogue Non-Lawyer Reps*, FINANCIAL ADVISOR IQ (Oct. 13, 2017), [https://financialadvisoriq.com/c/1764013/205263/finra\\_warns\\_against\\_rogue\\_lawyer\\_reps?referrer\\_module=mostPopularSaved&module\\_order=3](https://financialadvisoriq.com/c/1764013/205263/finra_warns_against_rogue_lawyer_reps?referrer_module=mostPopularSaved&module_order=3).

<sup>19</sup> *Id.*

<sup>20</sup> See *What You Should Know About Asset Recovery Companies*, SEC (Aug. 9, 2016), [https://www.sec.gov/oiea/investor-alerts-bulletins/ia\\_assetrecovery.html](https://www.sec.gov/oiea/investor-alerts-bulletins/ia_assetrecovery.html) (last visited Nov. 9, 2017).

<sup>21</sup> See *Informed Investor Advisory: Third-Party Asset Recovery Companies*, NASAA (Dec. 2015), <http://www.nasaa.org/38322/informed-investor-advisory-third-party-asset-recovery-firms/>.

<sup>22</sup> See Securities Industry Conference on Arbitration, *Report on Representation of Parties in Arbitration by Non-attorneys*, 22 FORDHAM URB. L.J. 507, 512 (1995); Ariel Kaminer, *Swatting at Wall Street from a Bunker in Brooklyn*, N.Y. TIMES (May 21, 2010) (quoting one defense lawyer as stating that dealing with a particular NAR “is one of the most frustrating experiences I’ve ever dealt with...It’s like hondling at a flea market with these guys”); Adam J. Gana, *Should Non-Attorneys Represent Parties in FINRA Arbitration*

Regulatory Notice 17-34, in which FINRA asked for feedback as to whether FINRA should allow NARs to continue to represent investors in its forum.<sup>23</sup> As of December 11, 2017, fourteen people or firms had commented on Regulatory Notice 17-34, with nine of the commenters being opposed to allowing NARs, three commenters in support of allowing NARs, and two commenters pointing out the purported positives and negatives of NARs. Both attorneys representing parties in FINRA arbitration, and arbitrators who presided over them, have commented on the notice. One of the arbitrators who commented on this Notice mentioned that she would no longer agree to serve as an arbitrator where a party is represented by an NAR.<sup>24</sup>

There are a number of reasons why representation by NARs is problematic. Several states do not permit NARs to represent parties in arbitration, however NARs may still be operating in those states, with little protection for investors. Moreover, parties are deprived of many of the basic attorney-client protections that would be available if the investor was represented by an attorney. NARs have no ethical code or constraints like attorneys do, and do not face potential sanctions from any regulatory or licensing body like a state bar association. It is unlikely that the NARs will have malpractice insurance, and there may be no meaningful way to obtain information about problems others have had with the NAR.

*Representation by NARs May be the Unauthorized Practice of Law*

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*for Compensation?*, NYSBA JOURNAL (Jan. 2015); Aegis J. Frumento & Stephanie Korenman, *Rethinking Non-Lawyer Advocacy in FINRA Customer Arbitrations*, SECURITIES ARBITRATION COMMENTATOR Vol. 16, No. 8 (Mar. 2017).

<sup>23</sup> See FINRA, NOTICE TO MEMBERS 17-34 (2017), available at <http://www.finra.org/industry/notices/17-34>.

<sup>24</sup> See Micalyn S. Harris, *Comments on Efficacy of Allowing Compensated Non-Attorneys to Represent Parties in Arbitration*, FINRA (Nov. 6, 2017) [http://www.finra.org/sites/default/files/notice\\_comment\\_file\\_ref/17-34\\_harris\\_comment.pdf](http://www.finra.org/sites/default/files/notice_comment_file_ref/17-34_harris_comment.pdf).

FINRA Rule 12208(c) allows non-attorneys to represent clients in its arbitration forum, unless “state law prohibits such representation”. Because of the extent of what NARs do in the context of representing investors in a FINRA arbitration, many states consider the conduct of NARs to be the practice of law. NARs interview clients, draft pleadings, develop litigation strategy, engage in discovery, negotiate settlements, engage experts, and conduct examination of witnesses at the arbitration hearing, all of which involves legal skill and knowledge. This unauthorized practice of law by non-attorneys in arbitration is illegal in some states.

Several states’ highest courts have ruled that representation by a non-attorney in arbitration constitutes the unauthorized practice of law, including Arkansas<sup>25</sup>, Arizona<sup>26</sup>, and Ohio<sup>27</sup>. Other states have instead provided guidance regarding the unauthorized practice of law in arbitration through bar rules and advisory opinions, like Alabama<sup>28</sup>, Florida<sup>29</sup>, Illinois<sup>30</sup>, Kansas<sup>31</sup>, Louisiana<sup>32</sup>, and Washington<sup>33</sup>. Yet other

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<sup>25</sup> See *NISHA, LLC v. TriBuilt Const. Group, LLC*, 388 S.W.3d 444, 451 (Ark. 2012) (holding that “a nonlawyer’s representation of a corporation in arbitration proceedings constitutes the unauthorized practice of law”).

<sup>26</sup> See *In re of Creasy*, 12 P.3d 214 (Ariz. 2000) (concluding that a disbarred attorney violated an order of disbarment because he engaged in the practice of law by representing party at private arbitration proceeding).

<sup>27</sup> See *Disciplinary Counsel v. Alexicole, Inc.*, 822 N.E.3d 348, 350 (Ohio 2004) (finding that the representation of parties in securities arbitration by non-attorneys constituted the unauthorized practice of law).

<sup>28</sup> See Ala. State Bar Office of Gen. Counsel Disciplinary Comm’n, Formal Op. R0 2014-01, at 1 (2014), available at <https://www.alabar.org/assets/uploads/2014/08/2014-01.pdf> (finding that a non-lawyer cannot represent a party in court-ordered arbitration, as such would constitute the unauthorized practice of law).

<sup>29</sup> See *Fla. Bar re Advisory Op. on Nonlawyer Representation in Sec. Arbitration*, 696 So. 2d 1178 (Fla. 1997) (finding that the representation of parties by a non-attorney in securities arbitration violates the State’s bar rules, including the unauthorized practice of law).

<sup>30</sup> See Illinois State Bar Ass’n, ISBA Professional Conduct Advisory Opinion 13-03 (Jan. 2013) (stating that “[A] nonlawyer’s representation of parties to a FINRA arbitration generally constitutes the unauthorized practice of law”). The opinion even suggested that FINRA arbitrators notify FINRA and the Illinois ARDC (Attorney Registration and Disciplinary Committee) if a non-attorney represents a party in FINRA arbitration.

<sup>31</sup> See Kansas Attorney Gen. Opinion No. 93-100 (July 26, 1993) (stating that “a non-attorney representative may not engage in the unauthorized practice of law, and therefore may not examine

states, like New York, have found that NARs are allowed to represent investors, as long as the forum's (FINRA's) rules allow it.<sup>34</sup> However, most states have been silent on the issue of whether the appearance of NARs in an arbitration forum constitutes the unauthorized practice of law.

Some states require out-of-state attorneys to file an application or affiliate with local counsel to represent in-state clients in arbitration, but there are no such similar rules for NARs. California requires that certain procedures be followed if an out-of-state attorney is representing a client in an arbitration in the state. An attorney not licensed to practice in California must affiliate with an attorney licensed in California and submit an Out of State Attorney Arbitration Counsel form.<sup>35</sup> With respect to California, FINRA procedures require the out-of-state attorney to submit this form to FINRA, gain approval from FINRA, and then submit the approved form to the State Bar of California, along with a \$50 processing fee.<sup>36</sup> FINRA procedures also require that out-of-state attorneys affiliate with local counsel for several other states (including Florida, Michigan, and Ohio) before serving a customer's claim on a respondent.

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witnesses, file pleadings, make legal arguments, or perform any functions deemed to be the practice of law").

<sup>32</sup> See La. R. Prof. Conduct, Rule 5.5(e)(3)(iii) (stating that appearing on behalf of a client in any hearing or proceeding, including in front of an arbitrator, is deemed the practice of law).

<sup>33</sup> See Washington Gen. Rule 24(a)(3) (defining the practice of law to include representation of another person or entity in a "formal administrative adjudicative proceeding or other formal dispute resolution process or in an administrative adjudicative proceeding in which legal pleadings are filed or a record is established as the basis for judicial review").

<sup>34</sup> See *DePalo v. Lapin*, Index No. 114656/2008 (Sup. Ct. NY June 30, 2009) (stating that "New York has no prohibition which would have prevented Lapin from representing an individual in a FINRA arbitration") (citing *Williamson v. John D. Quinn Construction*, 537 F.Supp. 613, 616 (S.D.N.Y. 1982) (noting that under New York law representation of a party in an arbitration proceeding by a non-lawyer does not constitute the unauthorized practice of law)).

<sup>35</sup> The form can be found on the State Bar of California website at <http://www.calbar.ca.gov/About-Us/Forms#osaac> (last visited Nov. 9, 2017).

<sup>36</sup> See FINRA OFFICE OF DISPUTE RESOLUTION, PARTY'S REFERENCE GUIDE 48-50 (April 2017), available at <https://www.finra.org/sites/default/files/Partys-Reference-Guide.pdf>.

NARs are not required to comply with the same procedures as licensed attorneys under FINRA's rules. FINRA, and some states, therefore require additional steps for attorneys in the FINRA arbitration forum, but the same is not required of NARs.

*Investors Lack Basic Protections when Represented by an NAR*

Unlike licensed attorneys, NARs are not bound by codes of conduct. Licensed attorneys are bound by an ethical code of conduct, including state conduct rules, primarily modeled on the American Bar Association's Model Rules of Professional Conduct.<sup>37</sup> Licensed attorneys who violate these ethical codes subject themselves to discipline, such as fines, suspensions, or even expulsion from the practice of law. The state bar associations report instances of attorney misconduct. Additionally, investors receive additional protections when working with attorneys, such as the attorney-client privilege. NARs, however, are not subject to any such rules or guidelines, leaving investors vulnerable when an NAR represents them.

*Lack of Ethical Guidelines*

Attorneys are bound by rules of professional conduct. Such rules often prohibit attorneys from soliciting clients by initiating contact with prospective clients in-person, via telephone, or real-time electronic contact (such as instant messaging), with limited exceptions.<sup>38</sup> The commentary to ABA Model Rule 7.3 discuss the concerns with directly contacting prospective clients:

There is a potential for abuse when a solicitation involves direct in-person, live telephone or real-time electronic contact by a lawyer with someone known to need legal services. These forms of contact subject a person to the private

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<sup>37</sup> A complete list of the ABA Model Rules of Professional Conduct can be found on the ABA's website at [https://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct.html](https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct.html) (last visited Nov. 9, 2017).

<sup>38</sup> See MODEL RULES OF PROF'L CONDUCT R. 7.3(a) (2016).

importuning of the trained advocate in a direct interpersonal encounter. The person, who may already feel overwhelmed by the circumstances giving rise to the need for legal services, may find it difficult fully to evaluate all available alternatives with reasoned judgment and appropriate self-interest in the face of the lawyer's presence and insistence upon being retained immediately. The situation is fraught with the possibility of undue influence, intimidation, and over-reaching.<sup>39</sup>

However, some NARs (through their affiliates or “consultants”) have admitted to cold-calling prospective clients and soliciting them to initiate FINRA arbitration proceedings.<sup>40</sup> Unfortunately, NARs’ potential use of these tactics, which are impermissible for licensed attorneys, are not governed by any regulator (like a state’s bar association) and subjects the investor to potential abuse.

### *Lack of Disciplinary History Available*

Many state bars, like California<sup>41</sup>, Florida<sup>42</sup>, Iowa<sup>43</sup>, and Texas<sup>44</sup>, provide the general public with disciplinary information about attorneys licensed in their states, which can be found by searching the states’ websites. Like FINRA’s rationale behind

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<sup>39</sup> See MODEL RULES OF PROF’L CONDUCT R. 7.3 cmt. 2 (2016).

<sup>40</sup> See Affidavit of Louis Ottimo, *National Securities Corp. v. Cold Spring Advisory Group LLC et al.*, Index No. 653483/14 (Sup. Ct. NY, Feb. 29, 2016).

<sup>41</sup> The State Bar of California’s disciplinary information can be found after searching for an attorney at <http://members.calbar.ca.gov/fal/membersearch/quicksearch> (last visited Nov. 9, 2017).

<sup>42</sup> The same can be found on the Florida Bar’s website at <https://www.floridabar.org/directories/find-mbr/> (last visited Nov. 9, 2017).

<sup>43</sup> The Iowa Judicial Branch Office of Professional Regulation carries a similar search function at <https://www.iacourtcommissions.org/SearchLawyer.do> (last visited Nov. 9, 2017).

<sup>44</sup> The State Bar of Texas also provides a similar function at [https://www.texasbar.com/AM/Template.cfm?Section=Find\\_A\\_Lawyer&Template=/CustomSource/MemberDirectory/Search\\_Form\\_Client\\_Main.cfm](https://www.texasbar.com/AM/Template.cfm?Section=Find_A_Lawyer&Template=/CustomSource/MemberDirectory/Search_Form_Client_Main.cfm) (last visited Nov. 9, 2017).

BrokerCheck, potential clients can review whether a particular attorney they're considering hiring to represent them in their dispute with their broker has been previously sanctioned or punished for violating ethical rules. Such information is not readily available for an NAR, if it exists at all. Because they are neither regulated nor supervised, it is difficult for an investor to determine if a particular NAR has any disciplinary history.<sup>45</sup>

#### *Lack of Malpractice Insurance*

NARs generally do not have insurance to cover potential misconduct. While attorneys are not required to have professional malpractice insurance in most states, many do for practical reasons. Some state bars that do not require attorneys to carry insurance often require the attorney to disclose whether he or she has insurance, which is then disclosed on the state bar's website or directory (such as Illinois<sup>46</sup> and Colorado's<sup>47</sup> state bar websites), so that investors are aware of their uninsured status.

Many legal malpractice insurance carriers will not extend coverage to anyone who is not licensed to practice law, meaning that it may be difficult for NARs to obtain meaningful legal malpractice insurance. If the NAR is negligent or commits malpractice while representing an investor and does not have insurance, it is unlikely the investor will be able to be compensated for the NAR's misconduct, especially if the NAR is thinly capitalized.

#### *Lack of Attorney-Client Privilege*

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<sup>45</sup> As discussed above, because NARs are not governed by bar associations, it is unlikely there is even an entity available to record misconduct of NARs.

<sup>46</sup> The attorney search function on the Illinois Attorney Registration and Disciplinary Commission is located at <https://www.iardc.org/lawyersearch.asp> (last visited Nov. 9, 2017).

<sup>47</sup> The Colorado Supreme Court Office of Attorney Regulation Counsel's attorney search function can be found at <http://www.coloradosupremecourt.com/Search/AttSearch.asp> (last visited Nov. 9, 2017).

When an attorney represents a client, communications between the attorney and client are almost always subject to the attorney-client privilege. Under such privilege, the attorney cannot disclose any confidential communications without the client's consent, and those communications are not discoverable by the opposing side. The comments to ABA Model Rule 1.6 describe the rationale for this:

A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation. See Rule 1.0(e) for the definition of informed consent. This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct.<sup>48</sup>

For the privilege to apply, there must be a relationship with an attorney. For example, under New York law, “no attorney-client privilege arises unless an attorney-client relationship has been established”.<sup>49</sup> But there is no privilege where an NAR is representing an investor. Communications between the investor and the NAR are not privileged and therefore discoverable, meaning the opposing side could request production of all communications between an NAR and the client. This could be particularly harmful to the client, who may be disclosing legally damaging information to the NAR without any idea that those communications can be obtained by the opposing side.

### **ISSUES WITH PARTICULAR NARS**

There are a number of NARs that currently solicit and represent customers in FINRA arbitrations. While this is not an exhaustive list, the background and conduct of

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<sup>48</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.6, cmt. 2 (2016).

<sup>49</sup> See *Priest v. Hennessy*, 409 N.E.2d 983 (NY 1980).

these NARs are illustrative of the issues facing FINRA and investors who hire NARs to represent them in arbitration.

### **Cold Spring Advisory Group**

#### *Background*

Cold Spring Advisory Group (“CSAG”) is an NAR firm that has appeared in a number of FINRA arbitrations. CSAG is a firm based in New York City and owned by Michelle Ottimo. There are a number of “consultants” who work for the firm, and CSAG also sometimes refers cases to attorneys.<sup>50</sup>

It is believed that Michelle Ottimo is not licensed to practice law in any state. Michelle Ottimo’s husband, Louis Ottimo, is a consultant for CSAG. Frederick Amato is another consultant for CSAG. Both Louis Ottimo and Frederick Amato are former brokers, and it is believed that neither is licensed to practice law in any state. Pursuant to FINRA Rule 12208, Louis Ottimo would be prohibited from representing an investor on behalf of CSAG. Accordingly, CSAG avoids this prohibition by having another employee, Jennifer Tarr, appear on its behalf in all of the arbitrations in which CSAG has appeared. Ms. Tarr is not licensed to practice law in New York or any other state.<sup>51</sup>

#### *Louis Ottimo*

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<sup>50</sup> See *About Us*, COLD SPRING ADVISORY GROUP, <https://www.coldspringadvisory.com/about-cold-spring-advisory-group> (last visited Nov. 27, 2017). This also raises a question as to whether an attorney who takes on referred cases from CSAG can legally share fees with a non-attorney. See MODEL RULES OF PROF’L CONDUCT R. 5.4 (2016) (prohibiting attorneys from sharing fees with a nonlawyer, with exceptions). However, the purpose of this report is not to examine the propriety of those attorneys accepting cases from an NAR and whether any fees are shared.

<sup>51</sup> A search on New York State’s Unified Court System website (<http://iapps.courts.state.ny.us/attorney/AttorneySearch>) reveals that a Jennifer Elyse Tarr is a licensed attorney in Illinois and New York and works at Proskauer Rose’s New York City office. However, it is believed that this is not the same Jennifer Tarr affiliated with CSAG.

In an affidavit filed in a state court action in 2016, Louis Ottimo admitted that he was a “consultant” and “manager” of CSAG.<sup>52</sup> Louis Ottimo has quite the troubled regulatory and legal history. According to FINRA’s BrokerCheck, Louis Ottimo (CRD number 2606438) was affiliated with seven different brokerage firms between 1995 and 2014.<sup>53</sup> Four out of those seven brokerage firms have been expelled from the securities industry.

BrokerCheck also discloses that in August 2013, FINRA brought a regulatory action against Louis Ottimo<sup>54</sup> related to his affiliation with EKN Financial Services, which was owned in part by his father, Anthony Ottimo, Sr.,<sup>55</sup> and for which Ottimo was a representative. FINRA alleged that Louis Ottimo failed to timely disclose numerous liens and judgments against him, as well as a 2010 bankruptcy filing. FINRA also alleged that he made material misrepresentations and omissions in connection with the sale of a private placement that he and EKN created. FINRA further alleged that Louis Ottimo failed to disclose significant negative information concerning his prior business experience and that his misconduct resulted in personal monetary gain. In July 2015, FINRA barred Louis Ottimo from the securities industry.<sup>56</sup> After Louis appealed this decision to the National Adjudicatory Council (“NAC”), but after a hearing on the merits, the NAC upheld Ottimo’s lifetime bar in March 2017.<sup>57</sup>

BrokerCheck further discloses that Louis Ottimo was the subject of at least two customer complaints. In 1999, Louis Ottimo was ordered to pay \$20,061 regarding

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<sup>52</sup> See Affidavit of Louis Ottimo, *National Securities Corp. v. Cold Spring Advisory Group LLC et al.*, Index No. 653483/14 (Sup. Ct. NY, Feb. 29, 2016).

<sup>53</sup> See FINRA, BROKERCHECK REPORT: LOUIS OTTIMO (2017).

<sup>54</sup> See *FINRA Department of Enforcement v. Louis Ottimo*, FINRA No. 2009017440201 (Mar. 15, 2017).

<sup>55</sup> See FINRA, BROKERCHECK REPORT: EKN FINANCIAL SERVICES, INC. 3-5 (2017).

<sup>56</sup> See *FINRA Dept. of Enforcement v. Louis Ottimo*, FINRA No. 2009017440201 (Jul. 10, 2015).

<sup>57</sup> See *FINRA Dept. of Enforcement v. Louis Ottimo*, FINRA No. 2009017440201 (Mar. 15, 2017).

allegations of unauthorized trading. In 2010, he was the subject of a second customer complaint alleging unauthorized trading, but the claim was denied and not pursued further by the customer.

Louis Ottimo also filed a Chapter 7 bankruptcy in the Eastern District of New York on October 25, 2016.<sup>58</sup> According to the bankruptcy petition, Louis Ottimo disclosed that he had only \$9,000 in assets (consisting of just furniture, household furnishings, and clothing) but over \$4.52 million in liabilities.<sup>59</sup> The largest debt owed by Louis Ottimo was a \$1 million mortgage on his primary residence in Syosset, New York<sup>60</sup>. He owed over \$150,000 in federal taxes from 2006 to 2010, as well as over \$34,000 in taxes owed to the State of New York.<sup>61</sup> He had several other large debts:

- a) \$875,000 pursuant to a judgment from an action to collect a debt arising from a promissory note;
- b) \$185,631 pursuant to a judgment related to EKN Financial Services;
- c) \$933,500 arising from a personal loan;
- d) \$150,000 to FINRA for fines and penalties;
- e) \$60,921 for a deficiency on a repossessed boat;
- f) \$525,060 pursuant to a judgment against Ottimo as the guarantor of debt due for unpaid commercial rent;
- g) Another judgment against Ottimo for unpaid commercial rent for \$138,803;
- h) \$330,791 pursuant to a judgment arising from a breach of contract; and
- i) \$4,800 to a company for boat repairs and storage.<sup>62</sup>

Interestingly, in his bankruptcy petition which was filed eight months after he admitted to “consulting” and “managing” CSAG, Louis Ottimo claimed that he was unemployed and had zero income.<sup>63</sup> Rather he disclosed that his wife gets monthly “interest and

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<sup>58</sup> See Louis Ottimo Chapter 7 Bankruptcy Petition, *In re Louis Ottimo*, Case No. 8-16-75005-reg (E.D.N.Y. Oct. 25, 2016).

<sup>59</sup> *Id.* at 8, 15.

<sup>60</sup> *Id.* at 16.

<sup>61</sup> *Id.* at 17-18.

<sup>62</sup> *Id.* at 18-26.

<sup>63</sup> *Id.* at 31.

dividends” as a “member” of CSAG.<sup>64</sup> In his Statement of Financial Affairs, Louis Ottimo also claimed that he had not received any income from employment for the previous two years.<sup>65</sup> While his 2016 affidavit indicates he “consults” and “manages” for CSAG, he is apparently doing so for free.

#### *Frederick Amato*

Frederick Amato is another CSAG representative. A review of FINRA’s BrokerCheck reveals that a Frederick Amato (CRD number 2288663) worked for five different brokerage firms between October 2000 and May 2011. According to FINRA’s BrokerCheck, Amato was charged with one count of bookmaking in Florida in 1999. He was convicted for one count of gambling, a misdemeanor, and was sentenced to one-year probation.

#### *Complaints against CSAG*

CSAG itself has also been the subject of several complaints. National Securities Corp., a FINRA member firm, brought a complaint against CSAG, Louis Ottimo, Anthony Ottimo, Sr., Fred Amato, and a number of other individuals, in state court in New York.<sup>66</sup> National Securities Corp. alleged that employees of CSAG contacted numerous customers in Tennessee and solicited them to initiate arbitration claims against National Securities Corp.<sup>67</sup> National Securities Corp. further alleged that CSAG employees may have unlawfully obtained its proprietary roster of customers in order to solicit these potential arbitration claimants.<sup>68</sup>

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<sup>64</sup> *Id.* at 31-32.

<sup>65</sup> *Id.* at 36.

<sup>66</sup> See Memorandum of Law In Support of Motion for Expedited Discovery, *National Securities Corp. v. Cold Spring Advisory Group LLC et al.*, Index No. 653483/14 (Sup. Ct. NY, Nov. 12, 2014).

<sup>67</sup> *Id.* at 1-2.

<sup>68</sup> *Id.*

Louis Ottimo's affidavit filed in the National Securities Corp case, referenced above, helps illustrate CSAG's business practices. He states that CSAG "obtains its customers from recommendations, cold calls, email blasts, fax blasts, and mailings".<sup>69</sup> CSAG also "purchases lists and data basis from various services including InfoUSA, Dun and Bradstreet, and lists from the internet".<sup>70</sup> Ottimo also described the cold-calling practices of CSAG, stating that "when calls are made by a representative of Cold Spring, the caller asks whether the person has sustained a loss in the stock market and, if so, advises such person of the nature of the services that Cold Spring offers".<sup>71</sup> CSAG's cold-calling practices would likely be prohibited by state bar associations, yet, as an NAR, CSAG appears to be able to engage in this conduct.

CSAG was also the subject of at least one complaint by one of the attorneys, Hilton Wiener, to whom it "referred" cases. Wiener sued CSAG and a number of other individuals who worked or "consulted" with CSAG, alleging that that he had been retained by CSAG to represent an aggrieved couple in Florida, but he was never paid.<sup>72</sup> A mediation to try to settle the case was eventually set, but the harmed investors terminated their relationship with Wiener just prior to the mediation.<sup>73</sup> Wiener alleged that CSAG then settled the case on behalf of the couple at the mediation, without paying Wiener for his services.<sup>74</sup> It was alleged that Louis Ottimo and Jennifer Tarr represented the investors at the mediation.<sup>75</sup>

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<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> See Complaint, *Wiener v. Mulligan et al.*, Index No. 602501/17 (Sup. Ct. NY Apr. 18, 2017).

<sup>73</sup> *Id.* at ¶¶ 25-26.

<sup>74</sup> *Id.* at ¶¶ 29-35.

<sup>75</sup> *Id.* at ¶ 30.

Wiener's complaint also makes allegations about how CSAG's business model works. Wiener alleged that CSAG "requires that its clients pay a substantial amount of money for what it describes as a forensic evaluation of the accounts that suffered the alleged losses", and that CSAG charges "10-\$25,000 for the forensics evaluation."<sup>76</sup> Wiener further alleged that CSAG may "offer its clients...a referral to an attorney for the purpose of representing the client in a FINRA arbitration proceeding."<sup>77</sup>

### *CSAG's Awards*

The FINRA award search reveals that CSAG has been involved in at least 27 arbitration cases.<sup>78</sup> Jennifer Tarr represented the claimants on behalf of CSAG in each of those cases. In the 27 cases found, CSAG sought a total of \$2,352,274 on behalf of its clients. CSAG's clients were awarded a zero in 19 out of those 27 cases, resulting in investors receiving a positive award in only 29.63% of CSAG's cases, compared to the national average, which was most recently 41-42%.<sup>79</sup> In the eight cases where CSAG was successful, CSAG delivered the following results:

- a) In Case No. 15-03002, CSAG's client was awarded \$50,000 (100% of the amount requested) against three associated persons, none of whom were represented by counsel;
- b) In Case No. 16-00351, CSAG's client was awarded \$50,000 (100% of the amount requested) against four associated persons, one of whom was not represented by counsel and three of whom did not even file a response to the complaint;
- c) In Case No. 15-02851, CSAG's client was awarded \$44,734 (100% of the amount requested) against an associated person who defended the claim;
- d) In Case No. 16-00673, CSAG's client was awarded \$46,500 (93% of the amount requested) against two associated persons who did not file a response to the complaint;

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<sup>76</sup> *Id.* at ¶¶ 16-18.

<sup>77</sup> *Id.* at ¶ 19.

<sup>78</sup> As the award database does not record settlements unless there was a corresponding request for expungement by the firm or broker, it is highly likely that CSAG represented investors in a larger number of cases than captured in the database.

<sup>79</sup> See *Dispute Resolution Statistics*, FINRA, <http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics> (last visited Nov. 27, 2017).

- e) In Case No. 16-00441, CSAG's client was awarded \$32,517 (72.7% of the amount requested) against a terminated FINRA member firm (which did not file a response) and an associated person who did not file a response to the complaint;
- f) In Case No. 16-00350, CSAG's client was awarded \$298,737 (101.5% of the amount requested) against three associated persons, including one who was not represented by counsel and another who did not file a response to the complaint;
- g) In Case No. 16-00402, CSAG's client was awarded \$233,703 (75.7% of the amount requested) against an associated person who did not respond to the complaint; and,
- h) In Case No. 15-01911, CSAG's client was awarded \$41,482 (100% of the amount requested) against a FINRA member firm that defended the claim.

Out of the \$2,352,274 in damages sought by CSAG on behalf of its clients, its clients were awarded a total of \$752,673, or roughly 31.99% of the damages sought. However, nearly all of those "wins" by CSAG were against brokers, many of whom did not respond to the complaint or were not represented by counsel. The collectability of these awards is highly questionable (which is, of course, an entirely different problem). Indeed, only one out of the thirteen associated persons from the cases referenced above is still in the securities industry, as the rest have been kicked out for failing to pay an arbitration award.<sup>80</sup> Considering arbitration awards that were decided against a FINRA member firm (not its associated persons) that was still in business, and associated persons who are still in the securities industry after the award was rendered, CSAG's clients were likely only awarded a total of \$86,216, or 3.66% of the damages sought for all of its 27 cases.

Incredibly, there are some CSAG clients who did even worse than getting a zero. One such customer was ordered to pay the respondent firm and one of its associated

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<sup>80</sup> In *Kabat v. Rappa*, FINRA No. 15-02851, Pasquale Rappa was ordered to pay \$44,734. Rappa is still in the securities industry, so it is likely that this award was paid.

persons \$45,000 (consisting of \$37,500 in damages and \$7,500 in discovery sanctions).<sup>81</sup>

CSAG's detrimental impact on some investors' claims is not merely potential or hypothetical. In two of the 27 cases identified for this report, investors' cases were dismissed primarily because CSAG's representation of the investor violated the particular state's rules related to the unauthorized practice of law. In *Simon v. Aegis Capital Corp. et al.*, FINRA Case No. 15-02865, the arbitrator dismissed the investor's claims because CSAG and Jennifer Tarr were engaging in the unauthorized practice of law. The arbitrator in *Simon* discussed this issue at length in the October 2016 award, stating:

Rule 12208(c) of the FINRA Code of Arbitration Procedure provides that “[p]arties may be represented in an arbitration by a person who is not an attorney, **unless ... state law prohibits such representation.**” (Emphasis added). “The Arizona Supreme Court has exclusive jurisdiction over the regulation of the practice of law in Arizona.” *State v. Eazy Bail Bonds*, 224 Ariz. 227, 229, ¶ 9, 229 P.3d 239, 241 (App. 2010). Under the Arizona Supreme Court's rules, the representation of a party in an arbitration by another person constitutes the “practice of law.” Ariz. Sup. Ct. R. 31(a)(2)(A)(3). By this rule, the Arizona Supreme Court prohibits the representation of a party in an arbitration conducted in Arizona by anyone who is not admitted to practice law in Arizona. *See* Ariz. Sup. Ct. R. 31(b). The Arizona Supreme Court provides an exception under its rules that allows a lawyer (such as Respondents' representatives who are admitted to practice law in a state other than Arizona, to represent a party in an arbitration when that arbitration is conducted in Arizona and involves federal law. *See* Ariz. Sup. Ct. R. 31(d)(27) and Ariz. Sup. Ct. R. 42, E.R. 5.5(c)(2 and 3) and (d). However, CSAG and its representative, Jennifer Tarr, have admitted that they are not licensed to practice law in Arizona or any other State.<sup>82</sup>

During the course of the arbitration, Ms. Tarr withdrew from representation of the investor, and Hilton Wiener, the same attorney referenced above who later sued CSAG, entered an appearance. Wiener failed to file a new, amended complaint and sought only

<sup>81</sup> *See Hessong v. Cape Securities, Inc.*, FINRA Case No. 15-01225 (Jan 6, 2017).

<sup>82</sup> *See Simon v. Aegis Capital Corp.*, FINRA No. 15-02865 (Oct. 13, 2016).

to “adopt” all previous pleadings filed by CSAG and Tarr. However, the arbitrator found that this was insufficient and dismissed the investor’s claims.

Unfortunately, this is not the only instance where a CSAG client’s claims were dismissed because CSAG’s representation violated state law. In *Halling v. Cape Securities et al.*, FINRA No. 16-00519, the arbitrator found that CSAG’s representation of the Kansas investor violated Kansas law:

The Kansas Supreme Court and the Rules of Professional Conduct have consistently and firmly held non-attorney representatives are not authorized to practice law in its jurisdiction and individuals can only be represented by a lawyer, if they are not representing themselves...

\* \* \*

Under FINRA Code of Arbitration Procedure, and as limited by Kansas law, the pleadings are stricken, as neither Cold Spring Advisory Group nor non-attorney Jennifer Tarr can represent Claimant in this arbitration, and even if we were to address the merits, Claimant has not met his burden of proof on any count, so all awards are in favor of Respondents.<sup>83</sup>

The attorney for the Respondent raised this issue several times prior to and during the evidentiary hearing, and Ms. Tarr provided no authority that her representation of the investor was in compliance with Kansas law.<sup>84</sup> Because this ruling was entered as the final arbitration award, the investor did not get an opportunity to seek other representation.

## **Stock Market Recovery Consultants**

### *Background*

Stock Market Recovery Consultants (“SMRC”) is a firm based out of Brooklyn, New York. SMRC was co-founded by Benjamin Lapin and Mitchell Markowitz.<sup>85</sup>

Neither Lapin nor Markowitz have been licensed to practice law in New York, and it is believed that they are not licensed to practice law anywhere else.

<sup>83</sup> See *Halling v. Cape Securities, Inc.*, FINRA No. 16-00519 (Mar. 1, 2017).

<sup>84</sup> *Id.*

<sup>85</sup> See *About Us*, SMRC, <http://1800stockloss.com/about-us/> (last visited Nov. 9, 2017).

An investor seeking help recovering losses would not find anything negative about Markowitz's background on the SMRC web site. Conspicuously absent from his glowing background described on the web site is the fact that he pled guilty in 2004 to fraud in a nearly one-million-dollar scheme involving jewelry.<sup>86</sup> As part of his guilty plea, Markowitz was required to give up his public adjuster's license and paid a \$10,000 fine.<sup>87</sup> Markowitz and co-defendants allegedly "conspired to purchase 20,000 pieces of inexpensive costume jewelry, grossly over-insure the inventory, produce phony purchase receipts reflecting a greater value than the jewelry's worth,...and purposely damage the jewelry in order to file a phony insurance claims".<sup>88</sup> Markowitz allegedly submitted an inflated insurance claim totaling \$973,638.<sup>89</sup> It seems this misconduct does not squarely fit within the restrictions contained in FINRA Rule 12208, allowing Markowitz to appear as an NAR in the FINRA forum.

#### *SMRC's Awards*

A review of FINRA's arbitration award database shows that SMRC has been involved in 61 cases between January 2013 and August 2016 (as SMRC has not been identified in an arbitration award since then).<sup>90</sup> However, about a third of those cases (19 out of 61) were referred and lateralled to a licensed attorney at some point in the arbitration process.<sup>91</sup> It is not clear how much of the representations in those cases were handled by SMRC before the referrals.

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<sup>86</sup> See Ariel Kaminer, *Swatting at Wall Street from a Bunker in Brooklyn*, N.Y. TIMES, May 21, 2010.

<sup>87</sup> See *Four Others Plead Guilty to Million Dollar Scam*, N.Y. INSURANCE ADJUSTER (April 28, 2004) <https://www.insurancejournal.com/news/east/2004/04/28/41627.htm>.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> Again, it is likely SMRC represented additional investors whose claims may have been settled and no award issued.

<sup>91</sup> Again, the purpose of this report is not to examine whether an attorney who takes on referred cases from NARs can properly share fees with a non-attorney, which is a separate issue. See MODEL RULES OF

Out of the 42 remaining cases, Lapin handled 37 of the cases by himself as the NAR. Out of those 37 cases, 28 cases settled.<sup>92</sup> In one case, Lapin represented the investor in a request for expungement by a broker.<sup>93</sup> Out of the eight remaining cases, not one penny was awarded to an investor represented by SMRC through Lapin. A review of these eight remaining awards demonstrates a disturbing trend:

- a) In Case No. 11-03706, the customer's case was dismissed for discovery sanctions;
- b) In Case No. 12-00525, the customer's claims were denied, and Lapin withdrew from representation one day before the first day of the arbitration hearing;
- c) In Case No. 11-02571, the claims were withdrawn without any settlement to the customer;
- d) In Case No. 13-00723, the claims were withdrawn without any settlement to the customer. The award stated that "Claimants never review[ed] the claims...before they were filed and never intended to make the claims";
- e) In Case No. 10-03658, the claims were withdrawn after discovery without any settlement to the customer;
- f) In Case No 11-00600, the claims were dismissed without prejudice after the customer died; and,
- g) In Case Nos. 13-00099 and 13-00043, the customers' claims were denied.

Lapin and Markowitz co-represented investors in the five remaining cases reviewed. Out of those five cases, the customers' claims were dismissed in four of the cases. In the fifth case, SMRC sought damages of \$100,000 against a *pro se* broker while withdrawing claims against the brokerage firm on the first day of the arbitration hearing.<sup>94</sup> The customer was awarded \$34,407, although only against this *pro se* broker, and as such, the collectability of this award is questionable.

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PROF'L CONDUCT R. 5.4 (2016) (prohibiting attorneys from sharing fees with a nonlawyer, with exceptions).

<sup>92</sup> In a vast majority of the cases that settled, the broker sought expungement of the complaint from his or her record. In one particular case, Lapin represented a customer who sought \$1,000,000 in compensatory damages. The broker in that case sought expungement, and the award stated that the "amount of settlement was only a small fraction of the amount requested". See *Goldstein v. UBS Financial Services, Inc.*, FINRA No. 12-01361 (Jan. 2, 2014).

<sup>93</sup> See *Stern v. Rivetna*, FINRA No. 13-01785 (Oct. 2, 2013).

<sup>94</sup> See *Garrett v. Emerald Investments, Inc.*, FINRA No. 10-01289 (June 28, 2013). The award does not mention whether a settlement was reached exchange for this "withdrawal".

In the 13 cases where the claims were considered on the merits, SMRC sought total compensatory damages of over \$2.8 million on behalf of customers. SMRC was only able to get a favorable award in one case, resulting in a “win” rate of 7.69%.<sup>95</sup> Moreover, SMRC’s customers were only awarded an average of 1.23% of the damages they were seeking,<sup>96</sup> and that award’s collectability was questionable.

## **Investors Arbitration Specialists**

### *Background*

Investors Arbitration Specialists (“IAS”) is a firm based in San Diego, California, and it is operated by Arthur S. Leider. Leider has operated IAS since 1993,<sup>97</sup> but it has been registered as an LLC since 2009. Leider is not licensed to practice law in the State of California, and it is believed that he is not licensed to practice law in any jurisdiction.

Leider (CRD number 860215) was previously registered in the securities industry. He worked for 14 different brokerage firms between December 1978 and August 2000, two of which were later expelled from the securities industry.

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<sup>95</sup> By comparison, FINRA’s website contains statistics on how often investors are awarded at least some damages pursuant to an arbitration award. According to FINRA’s website as of November 27, 2017, investors received at least some damages in 42% of cases in 2013; 38% of cases in 2014; 42% of cases in 2015; 41% of cases in 2016; and 41% of cases in 2017. *See Dispute Resolution Statistics*, FINRA, <http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics> (last visited Nov. 27, 2017).

<sup>96</sup> As a comparison, a study by Edward O’Neal and Daniel Solin of NASD arbitration awards from 1995 to 2004 showed that, on average, the amount an investor can expect to recover in an arbitration hearing varied from 38% of the requested damages, as a high in 1998, to a low of 22% in 2004. *See EDWARD S. O’NEAL & DANIEL R. SOLIN, MANDATORY ARBITRATION OF SECURITIES DISPUTES: A STATISTICAL ANALYSIS OF HOW CLAIMANTS FARE.*

<sup>97</sup> *See About Us*, INVESTORS ARBITRATION SPECIALISTS, <http://www.investorsarbitration.com/about.htm> (last visited Nov. 9, 2017).

In 1994, Leider worked for a brokerage firm called Lam Wagner, Inc. In November 1995, a customer of Lam Wagner, Inc. brought a civil complaint against Leider and John Winnick, alleging fraud in the offering and sale of stock, debentures, and warrants of Altus International Telecommunications, Inc. (“Altus”), which were unregistered securities.<sup>98</sup> Leider was also on the Board of Directors of Altus.

Leider and Winnick were found jointly and severally liable to the customer for \$217,500, interest, and costs. The court also found that Leider and Winnick “converted [investor’s] money from the escrow account for their own personal use.”<sup>99</sup> In 1996, Leider was also punished by the Wisconsin Commissioner of Securities for this conduct.

According to his BrokerCheck report, Leider was also ordered to pay \$150,000 to a customer while he worked with Prudential in the late 1980s.<sup>100</sup> The customer alleged unsuitable investments and excessive trading.

### *IAS Awards*

Leider, working for IAS, represented at least eight investors (three of whom were in California) in FINRA arbitration between 2013 and the present.<sup>101</sup> Three of the cases settled. In the remaining five cases, Leider represented four investors and one broker.

IAS’s clients requested a total of \$6,488,068 in compensatory damages in these five cases. In four cases (including the case where IAS represented a broker claimant in an industry case), the claims were dismissed. In one of these cases, all of the forum fees were assessed against the customer claimant,<sup>102</sup> and in another case, nearly all of the forum fees were assessed against the customer claimant (\$14,450 in this particular

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<sup>98</sup> See FINRA, BROKERCHECK REPORT: ARTHUR STEVEN LEIDER (Nov. 8, 2017).

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> As with CSAG and SMRC, it is likely IAS handled more cases on behalf of investors than was captured by the award database.

<sup>102</sup> See *Nigohosian v. Charles Schwab & Co., Inc.*, FINRA No. 11-03358 (Feb. 12, 2014).

case).<sup>103</sup> In IAS's lone victory, the investor requested \$86,358, and was awarded \$70,333<sup>104</sup>. Thus, Leider and IAS's "win" rate in FINRA arbitration was 20%, while their average recovery out of these five cases was 1.084%.

## **Investors Recovery Service**

### *Background*

Investors Recovery Service ("IRS") is a firm based out of Novato, California. IRS is operated by Richard Sacks,<sup>105</sup> and it was also previously co-operated by Irwin Stein (although it is unclear whether Mr. Stein still is affiliated with IRS). Irwin Stein was a licensed attorney in the State of New York who first became licensed in 1975, but as of October 2017, his status is "delinquent."<sup>106</sup>

IRS's website indicates the following:

**At Investors Recovery Service, our objective is to provide professional, affordable representation for abused investors through negotiation and securities arbitration.** *Investors Recovery Service* provides investors with knowledge and expertise in the securities industry equal to that possessed by the brokerage firms to help you recover stock market losses due to investment fraud or stock broker fraud or misconduct.<sup>107</sup>

Sacks previously owned and operated a brokerage firm called Sacks Investment Company, Inc., also based in Novato, California. Sacks and his company were fined \$101,891.20 back in January 1991 by the NASD, regarding allegations that Sacks charged unfair prices to customers with markups ranging from 5.4% to 100% above

<sup>103</sup> See *Mapes v. Bowers*, FINRA No. 15-03485 (June 5, 2017).

<sup>104</sup> See *Wagner v. FSC Securities Corp.*, FINRA No. 15-00193 (Feb. 25, 2016).

<sup>105</sup> See *About Investors Recovery Service*, INVESTORS RECOVERY SERVICE, <http://www.investorsrecovery.com/aboutus.html> (last visited Nov. 9, 2017).

<sup>106</sup> See *Attorney Search*, N.Y. STATE UNIFIED COURT SYSTEM, <http://iapps.courts.state.ny.us/attorney/AttorneySearch> (last visited Nov. 9, 2017). Irwin Stein was not licensed to practice law in California.

<sup>107</sup> See INVESTOR'S RECOVERY SERVICE, <http://www.investorsrecovery.com/> (last visited Nov. 9, 2017) (emphasis in original).

contemporaneous costs.<sup>108</sup> Sacks was also alleged to have guaranteed a customer against a loss, used a customer's account for a second inventory account for the firm, executed fictitious trades to facilitate a loan, and operated the firm without a financial and operations principal.<sup>109</sup> Sacks was also suspended for 60 days and required to requalify as a principal. Moreover, the firm was prohibited from engaging in principal transactions for two years.

Sacks and Sacks Investment Company appealed the decision to the SEC. The sanctions were modified, with the fines being raised to \$159,956.42, and Sacks was barred from the securities industry in any capacity.<sup>110</sup> Sacks Investment Company was also the subject of at least a half-dozen other regulatory actions.<sup>111</sup>

### *IRS Awards*

From January 2013 to October 2017, IRS has represented customer claimants through eight awards. Out of those awards, customers were represented by Irwin Stein four times, and Richard Sacks four times. Out of Sacks' four cases, each case settled for undisclosed amounts, and as such, the arbitrators did not render any final awards on behalf of IRS's clients.<sup>112</sup> Pursuant to FINRA Rule 12208, Sacks should have been prohibited from representing investors because he had been barred from the industry.

## **Vindication Recovery Services**

### *Background*

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<sup>108</sup> See *Disciplinary Actions (January 1991)*, FINRA, [http://www.complinet.com/qfcra/display/display\\_plain.html?record\\_id=&rbid=1159&element\\_id=4633](http://www.complinet.com/qfcra/display/display_plain.html?record_id=&rbid=1159&element_id=4633) (last visited Nov. 9, 2017).

<sup>109</sup> *Id.*

<sup>110</sup> See SEC News Digest, Issue 93-114 (June 16, 1993).

<sup>111</sup> See FINRA, BROKERCHECK REPORT: SACKS INVESTMENT COMPANY, INC. (Nov. 9, 2017).

<sup>112</sup> This report did not analyze the cases of Irwin Stein, because he is a licensed attorney.

Vindication Recovery Services (“VRS”) claims through its website that it “supports injured investors through portfolio analysis and potential recovery of lost market assets through arbitration.”<sup>113</sup> A public records search indicates that VRS has its headquarters in Mount Sinai, New York, and was incorporated in October 2010.

VSR is run by Paul Shechter, a former broker (CRD #2589423), who worked for eleven different brokerage firms. Six of those firms were kicked out of the securities industry by FINRA or the NASD.<sup>114</sup>

Shechter has also been disciplined by various securities regulators. In September 2013, FINRA brought a regulatory action against Shechter.<sup>115</sup> FINRA alleged that between January 2007 and April 2010 (while Shechter was with iTradeDirect.com Corp.), that he engaged in abusive sales practices. FINRA’s allegations included instances of unauthorized trading, unsuitable recommendations, falsifying firm records regarding customers’ suitability factors, and engaging in excessive trading/churning with turnover ratios ranging from 16 to 58 and cost-to-equity ratios from 57% to 235%. In April 2014, “without admitting or denying” the allegations against him, Shechter was fined \$25,000 and suspended from the securities industry for two years.<sup>116</sup>

The Illinois Securities Department also brought a complaint against Shechter in December 2007.<sup>117</sup> Illinois alleged that Shechter “cold-called” an Illinois resident, he misrepresented the customer’s risk tolerance and investment experience on an account application, and then traded his account, on margin, with the primary purpose of

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<sup>113</sup> See VINDICATION RECOVERY SERVICES, [www.marketvindication.com/home](http://www.marketvindication.com/home) (last visited Oct. 25, 2017).

<sup>114</sup> See FINRA, BROKERCHECK REPORT: PAUL SHECHTER (Nov. 9, 2017).

<sup>115</sup> See FINRA Dept. of Enforcement v. Shechter, FINRA No. 2009016159107 (Sept. 26, 2013).

<sup>116</sup> See FINRA Dept. of Enforcement v. Shechter, FINRA No. 2009016159107 (Apr. 28, 2014).

<sup>117</sup> See *In the Matter of Paul S. Shechter*, File No. 0700550, Ill. Sec. Dept. (Dec. 10, 2007).

increasing commissions at the detriment of the investor<sup>118</sup>. After Illinois initiated its investigation, Shechter allegedly called and texted the investor in an attempt to harass and intimidate him.<sup>119</sup> Illinois alleged that the investor lost \$230,000 in his account.<sup>120</sup>

The Illinois Securities Department brought another complaint against Shechter in May 2009, also naming iTradeDirect.com Corp., Eric Alt (the President and CEO of iTradeDirect at the time) and Brian Sanders (the Chief Compliance Officer at iTradeDirect.com). Illinois made similar allegations as it had done in its December 2007 complaint. Illinois also alleged that Alt and Sanders failed to adequately supervise Shechter. These claims were eventually settled by Shechter in January 2010, who was ordered to pay \$150,000, and he was also put on heightened supervision for one year.<sup>121</sup>

Moreover, Shechter has also been the subject of five customer complaints.<sup>122</sup> The complaints allege unauthorized trading, misuse of margin, and excessive commissions.

#### *VRS Awards*

A review of FINRA's award database shows no arbitration awards where VRS or Shechter has represented a claimant or any other party.

## **SOLUTIONS**

FINRA has requested comment on whether it should amend the Codes to restrict NAR firm activities in some way, or to prohibit entirely NAR firms from representing clients at the forum. FINRA should bar representation of investors by NARs, with a few notable, limited exceptions. Rule 12208 leaves a massive loophole for NARs to conduct the unauthorized practice of law, to the detriment of investors throughout the country

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<sup>118</sup> *Id.* at ¶¶ 6-10, 21-24.

<sup>119</sup> *Id.* at ¶¶ 53-56.

<sup>120</sup> *Id.* at ¶ 62.

<sup>121</sup> See FINRA, BROKERCHECK REPORT: PAUL SHECHTER (Nov. 9, 2017).

<sup>122</sup> *Id.*

who have already been victimized by their financial advisor or brokerage firm. In its current form, FINRA Rule 12208 allows NARs with questionable backgrounds to represent investors. More generally, investors who have already suffered from misconduct by a firm and broker, should be ensured that they will not suffer harm a second time by unregulated NARs.

As reflected above, the rule, as currently formed, still permits representation by NARs who have been found to be bad actors, including recidivist brokers. While the current rule makes an effort to weed out attorneys who have been disbarred and those persons expelled from the securities industry, the rule is not working. There are multiple individuals operating as NARs, sometimes taking advantage of loopholes in the existing rule by operating through other people who then act as the “representative” for purposes of Rule 12208. Moreover, Mitchell Markowitz, who lost his license as a public insurance adjuster for running a million-dollar insurance scam but was never barred from the securities industry, is still permitted to represent investors as an NAR under the current rule.

Investors may not fully understand the repercussions of being represented by an NAR. Several investors have had their claims dismissed because the NAR was engaged in the unauthorized practice of law. Others have been sanctioned because of misconduct in the arbitration process. When an investor has his or her claim dismissed because of an NAR’s misconduct, that investor will likely have no other recourse for recovery.

Likewise, the success rate of these NARs has been sub-par. While that by itself may not necessarily require elimination of NARs, if one considered all of the other issues discussed above (expulsion from the securities industry, customer complaints

while they were in the securities industry, bankruptcies, bookmaking charges, insurance fraud, etc.), the comparatively low success and amount-of-recovery rates are considerable problems. The fact that some investors got a zero primarily because their NAR's representation violated state law is a serious concern.

Accordingly, FINRA should bar the practice of allowing NARs to represent investors in FINRA arbitration, with very limited exceptions. First, immediate family members (spouses, siblings, children, or parents) should be allowed to represent their family members in a FINRA proceeding. Many elderly investors may need to rely on children or grandchildren to assist them through the process, and spouses should also be able to assist, if necessary.

Second, there are many law schools that have established securities arbitration clinics and allow law students to represent customers in FINRA cases. Several of these clinics have received some funding from FINRA.<sup>123</sup> The clinics provide a valuable resource, in that they typically represent customer claimants with relatively small claims, often too small for many attorneys to be able to take. These customers get representation from the clinics through the law students, often without any cost or at little cost to the customer. The students provide help under the supervision of the clinic directors, who are attorneys, typically well-experienced in the arena. While the client enjoys the assistance provided by well-supervised law students, those students gain valuable, practical experience in representing a client through a legal proceeding. Any change to the NAR rule by FINRA should include an exception to continue to allow law students from securities arbitration clinics to represent investors in FINRA arbitrations.

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<sup>123</sup> See Press Release, FINRA, *FINRA Foundation Announces \$1 Million in Grants to Fund Securities Advocacy Clinics* (Jan. 28, 2010), available at <http://www.finra.org/newsroom/2010/finra-foundation-announces-1-million-grants-fund-securities-advocacy-clinics>.

FINRA has the ability to bar NARs from representing clients in its arbitration forum. FINRA is generally granted authority to issue rules, pursuant to Section 15A of the Securities and Exchange Act of 1934. FINRA already creates its Code of Arbitration Procedure that governs how Statements of Claim and Answers are filed, how parties exchange documents and information through discovery, how arbitrators are selected and empaneled, where arbitration hearings are held, etc. FINRA also has the ability to limit NARs' representation of investors in its arbitration forum, and it should severely limit such representation in the manner proposed in this report.

FINRA has already promulgated rules as to what qualifications an arbitrator must have to be in FINRA's pool of arbitrators.<sup>124</sup> FINRA requires "arbitrator applicants must have a minimum of five years of paid business and/or professional experience and at least two years of college-level credits."<sup>125</sup> If FINRA can control which persons it deems to be qualified enough to preside over these cases, it should also make rules that govern who can represent parties in its forum too. With the noted exceptions above, FINRA should bar NARs from representing customers in FINRA arbitration.

It is clear investors have already been harmed through the representation by NARs. FINRA has the ability to restrict the appearance of NARs in its forum, and it should do so, as outlined above.

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<sup>124</sup> See FINRA, RULE 12100(y); *Apply Now*, FINRA, <http://www.finra.org/arbitration-and-mediation/apply-now> (last visited Nov. 9, 2017).

<sup>125</sup> See *Apply Now*, FINRA, <http://www.finra.org/arbitration-and-mediation/apply-now> (last visited Nov. 9, 2017).