

## ARTICLES

# THE IMPROBABLE BIRTH AND CONCEIVABLE DEATH OF THE SECURITIES ARBITRATION CLINIC

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### I. INTRODUCTION

Americans have unprecedented access to global debt and equity markets to purchase investment and income-producing products. While individual stock ownership peaked in the late 2000s with the 2008 financial crisis, at least half of Americans still own stocks.<sup>1</sup> The Revenue Act of 1978 created the 401(k) plan that, in turn, opened up the world of mutual fund investing to the average American employee.<sup>2</sup> According to the Investment Company Institute, as of September 2012, 401(k) plans held about \$3.5 trillion in assets, representing about 18% of the U.S. retirement market, “which includes employer-sponsored retirement plans, individual retirement accounts (IRAs), and annuities.”<sup>3</sup> Additionally, the

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<sup>1</sup> Hibah Yousuf, *Only Half of all Americans Invested in Stocks*, CNNMONEY (May 9, 2013, 2:49 PM), <http://money.cnn.com/2013/05/09/investing/american-stock-ownership/index.html> (“The percentage of overall Americans who own stocks has been falling steadily since the financial crisis. Ownership peaked at 65% in 2007. It has been below 60% since 2009, even as the broader market has bounced back from the March 2009 lows.”).

<sup>2</sup> See Bradley P. Rothman, *401(k) Plans in the Wake of the Enron Debacle*, 54 FLA. L. REV. 921, 931 (2002) (noting the exponential rise in popularity of the 401(k) plan from 1983–1999); Colleen E. Medill, *Stock Market Volatility and 401(k) Plans*, 34 U. MICH. J.L. REF. 469, 478 (2001); see also Anne Kates Smith, *Roads to Riches*, U.S. NEWS & WORLD REPORT, June 28, 1999, at 66, available at [http://www.usnews.com/usnews/biztech/articles/990628/archive\\_001341.htm](http://www.usnews.com/usnews/biztech/articles/990628/archive_001341.htm) (“But what really brought Wall Street to Main Street was the enactment of section 401(k) of the Revenue Act of 1978, which enabled employees to decide if and how much to contribute to retirement savings (sometimes with a partial match from the employer), to choose among investments, and to bear the risks or rewards of their decisions while their savings grow—tax free.”).

<sup>3</sup> *Frequently Asked Questions about 401(k) Plans*, INVESTMENT COMPANY INSTITUTE, [http://www.ici.org/policy/retirement/plan/401k/faqs\\_401k](http://www.ici.org/policy/retirement/plan/401k/faqs_401k) (last visited Oct. 7, 2013).

rapid expansion of online trading in the 1990s provided Americans with convenient access to brokerage accounts and the ability to implement self-directed trading strategies.<sup>4</sup> This increase in investing naturally has led to an explosion of disputes between investors on the one side and individual brokers<sup>5</sup> and their employer firms (broker-dealers)<sup>6</sup> on the other.<sup>7</sup>

For more than twenty-five years, arbitration in forums sponsored by the securities industry<sup>8</sup> has been the primary mechanism<sup>9</sup> for the resolution of disputes among investors, broker-dealers, and associated persons.<sup>10</sup> In the late 1980s, the U.S. Supreme Court overruled prior law<sup>11</sup> and held that brokerage firms could enforce pre-dispute arbitration agreements in customer agreements, thus forcing customers to arbitrate their federal securities law claims.<sup>12</sup> Virtually all broker-dealers—and many investment advisors—now include a pre-dispute arbitration clause in their retail customers'

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<sup>4</sup> Michael Schroeder & Rebecca Buckman, *SEC Chief Wants Online Trading Firms to Disclose the Risks of Internet Dealing*, WALL ST. J., May 4, 1999, at C23, available at <http://cyber.law.harvard.edu/rfi/press/tradingrisk.htm> (“The SEC and state regulators have become concerned about the sudden popularity of individuals buying and selling stocks on the Internet.”).

<sup>5</sup> An individual known in popular culture as a broker is more formally defined under the Securities Exchange Act as an “associated person of a broker or dealer.” 15 U.S.C. § 78c(18) (2012). Their employers give them varying titles such as “account executives,” “financial advisers,” or “financial consultants.”

<sup>6</sup> Section 3(a)(4)(A) of the Securities Exchange Act of 1934 defines “broker” as “any person engaged in the business of effecting transactions in securities for the account of others,” and Section 3(a)(5)(A) defines a “dealer” as “any person engaged in the business of buying and selling securities . . . for such person’s own account through a broker or otherwise.” 15 U.S.C. § 78c(a)(4)(A) (2012); 15 U.S.C. § 78c(a)(5)(A) (2012). Since most firms act as both brokers and dealers depending on the transaction, they are referred to as “broker-dealers.”

<sup>7</sup> Constantine N. Katsoris, *Roadmap to Securities ADR*, 11 FORDHAM J. CORP. & FIN. L. 413, 416 (2006); see also Constantine N. Katsoris, *The Arbitration Of A Public Securities Dispute*, 53 FORDHAM L. REV. 279, 279 (1984).

<sup>8</sup> “Securities arbitration” broadly refers to arbitration of disputes between investors (customers) and their individual brokers and broker-dealer firms, employment disputes between individual brokers and their employer firms, and intra-industry disputes among securities industry parties. Today, virtually all of these disputes are arbitrated at FINRA Dispute Resolution. This article focuses on the first type of securities arbitration—customer disputes.

<sup>9</sup> Mediation is also utilized if all parties consent. See Jill I. Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, 21 OHIO ST. J. ON DISP. RESOL. 329, 359 (2006).

<sup>10</sup> The securities industry has utilized arbitration as an alternative dispute resolution process since the late 1700s, when New York Stock Exchange (“NYSE”) clerks ruled on mismatched trades. See Gross, *supra* note 9, at 336–37.

<sup>11</sup> *Wilko v. Swan*, 346 U.S. 427 (1953).

<sup>12</sup> See *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 485 (1989) (holding that claims arising under the Securities Act of 1933 are arbitrable); *Shearson/Am. Express v. McMahon*, 482 U.S. 220, 242 (1987) (holding that claims arising under the Securities Exchange Act of 1934 are arbitrable).

account agreements.<sup>13</sup> Brokerage customers who allege, for example, that their broker recommended unsuitable investments or strategies, placed unauthorized trades, or committed fraud<sup>14</sup> must, because of the ubiquitous arbitration clause in their customer agreements,<sup>15</sup> arbitrate those claims in the FINRA arbitration forum. Moreover, even if the customer agreement does not contain a pre-dispute arbitration clause, FINRA rules require broker-dealers and their associated persons to submit to arbitration upon the demand of a customer.<sup>16</sup>

However, many investors, particularly if they are unsophisticated or of modest means, are unfamiliar with the arbitration process<sup>17</sup> and thus cannot navigate the forum without legal representation. Several studies show that disputants fare better in a dispute resolution process when represented by counsel.<sup>18</sup> Yet it is not economically feasible for those customers with low-dollar-

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<sup>13</sup> Luis A. Aguilar, U.S. Sec. & Exch. Comm'n, Outmanned and Outgunned: Fighting on Behalf of Investors Despite Efforts to Weaken Investor Protections, Remarks at the North American Securities Administrators Association, Annual NASAA/SEC 19(d) Conference, Washington, D.C. (Apr. 16, 2013), available at [http://www.sec.gov/News/Speech/Detail/Speech/1365171515400#P86\\_21374](http://www.sec.gov/News/Speech/Detail/Speech/1365171515400#P86_21374).

<sup>14</sup> For a description of the most common claims brought by customers against their brokers, see Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1008–12 (2002).

<sup>15</sup> N. Am. Sec. Adm'rs Ass'n ("NASAA"), *Mandatory Binding Arbitration: Is It Fair and Voluntary?*, (Sept. 15, 2009), <http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Arbitration-Statement-9.15.09.pdf>.

<sup>16</sup> FINRA Code of Arbitration Procedure for Customer Disputes Rule 12200. Until the mid-2000s, the National Association of Securities Dealers, Inc. ("NASD") and the NYSE ran separate arbitration forums that handled a combined 99% of all securities arbitrations in the country. On July 30, 2007, NASD and NYSE Member Regulation, including their respective arbitration forums, consolidated and formed FINRA. See Press Release, *NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority*, FINRA (July 30, 2007), <http://www.finra.org/Newsroom/NewsReleases/2007/P036329>.

<sup>17</sup> See Jill I. Gross & Barbara Black, *When Perception Changes Reality: An Empirical Study of Investors' Views of the Fairness of Securities Arbitration*, 2008 J. DISP. RESOL. 349, 387–89 (2008) (reporting results of a survey showing that customers lack knowledge about the securities arbitration process).

<sup>18</sup> See Howard Prossnitz, *Who Wins FINRA Cases and Why? An Empirical Analysis*, 19 PIABA BAR J. (2012) (statistics show *pro se* customers are far less likely to obtain an award in FINRA arbitration than those represented by counsel); U.S. Gen. Accounting Office, *Securities Arbitration: How Investors Fare 7-8*, GAO/GGD-92-74 (1992), available at <http://www.gao.gov/assets/160/151835.pdf>; Jane Bryant Quinn, *Odds Don't Favor Small Investors in Arbitration*, PITTSBURGH POST-GAZETTE (May, 1997), available at <http://news.google.com/newspapers?nid=1129&dat=19970519&id=Vs5aAAAAIABAJ&sjid=vm8DAAAAIABAJ&pg=5754,3897372>; see also *Investor Advocacy Clinic Program*, FINRA INVESTOR EDUCATION FOUNDATION, <http://www.finrafoundation.org/grants/advocacy/> (last visited Oct. 8, 2013) ("In the event that individual investors have a dispute with a securities professional, they often fare better if they are represented by an attorney with experience in securities arbitration.").

value claims to retain counsel because legal fees would dwarf any possible recovery. Similarly, investors with larger claims but with few remaining disposable assets (precisely because of the monetary losses stemming from the alleged misconduct) may not be able to afford to retain private counsel or pay for upfront costs such as filing fees, forum fees, and expert witness fees.

One means available to investors who have low-dollar-value disputes with their brokers to obtain assistance in the securities arbitration process is to retain the services of a law school securities arbitration clinic (SAC).<sup>19</sup> Generally, SAC is a clinical law program in which students, for academic credit and under the supervision of law faculty who act as supervising attorneys, provide free legal assistance to eligible investors who have disputes with their securities brokerage firms that must be resolved in arbitration, but who are unable to obtain private legal representation because of the low dollar value of their claims. While SACs did not exist at law schools until the late 1990s, as of early 2014, eighteen such programs are open in the United States.<sup>20</sup> Resort to a SAC may be the best option available to an investor seeking legal representation in low-dollar-value arbitration disputes. Indeed, SACs have helped many investors since the first clinic opened at Pace Law School in 1997.<sup>21</sup>

However, a few SACs recently have closed and several of the existing ones are currently in jeopardy of closing due to lack of funding.<sup>22</sup> Many law schools will not commit to support them long-term.<sup>23</sup> Other law schools have declined to open SACs because the faculty or the administration does not believe they are the type of clinic a law school should offer. Unless dollars flow in the general direction of law school clinics, and in particular to this type of clinic, the SAC may not make it to its twentieth anniversary.

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<sup>19</sup> These clinics bear several different names including Securities Arbitration Clinic, Investor Rights Clinic, Investor Protection Center; and Investor Advocacy Clinic. For the sake of simplicity, in this article, I will refer to them collectively as SACs, defined as law school clinics in which students represent customers of broker-dealers in arbitration and other alternative dispute resolution processes.

<sup>20</sup> See *infra* note 38 and accompanying text.

<sup>21</sup> Pace established its Securities Arbitration Clinic in 1997. It changed its name to the Pace Investor Rights Clinic (PIRC) in 2007 to more accurately reflect the broader scope of legal services it provided. PIRC has recovered more than \$500,000 for its clients since it opened.

<sup>22</sup> See *infra* note 101 and accompanying text.

<sup>23</sup> I have attended the annual National Securities Arbitration Clinic Roundtable at Fordham Law School for most of the past decade. At this Roundtable, I listen to SAC directors express their concerns about the ongoing viability of their clinic, and the uncertainty surrounding future funding.

This Article explores the birth, life, and possible death of SACs in the United States. Part II of this Article describes the history of the securities arbitration clinic in the United States. Part III describes how a SAC operates and how SAC students help investors. Part IV reviews the pedagogical advantages and disadvantages of a SAC, and addresses the reluctance of many law schools to embrace this type of clinic. Part V concludes by predicting whether these clinics have a future in light of the modern challenges to clinical legal education.

## II. THE BIRTH OF THE SECURITIES ARBITRATION CLINIC

Arthur Levitt, while serving as the 25th Chairman of the Securities and Exchange Commission (SEC) from 1993–2001, made investor protection one of his top priorities.<sup>24</sup> Among other initiatives, he conducted over forty “investor town meetings throughout the country to listen to the concerns of investors and to give them tips on safe and wise participation in the securities markets.”<sup>25</sup> At those town meetings, investors expressed frustration with their inability to obtain legal representation in securities arbitrations.<sup>26</sup>

In particular, investors of modest means often had claims that were too small to be cost-effective for a private lawyer to take.<sup>27</sup> Rather than proceed *pro se*, some investors did not pursue their claims because they were intimidated by the arbitration forum, were unfamiliar with the arbitration process, or did not know how to advance their claims without legal representation.<sup>28</sup> Levitt suggested a solution: create law school clinics to close the gap in access to justice by delivering free legal services to these unsophisticated investors. And so, in March 1997, Levitt reached out to law schools in the Northeastern United States to increase the accessi-

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<sup>24</sup> ARTHUR LEVITT, TAKE ON THE STREET: HOW TO FIGHT FOR YOUR FINANCIAL FUTURE 7–17 (2002) (describing how he developed his investor protection agenda at the SEC).

<sup>25</sup> SEC Biography: Chairman Arthur Levitt, SEC. & EXCH. COMM’N, <http://www.sec.gov/about/commissioner/levitt.htm> (last visited Feb. 14, 2014).

<sup>26</sup> Press Release, SEC. & EXCH. COMM’N 97–101, SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors – Levitt Responds To Concerns Voiced At Town Meetings (Nov. 12, 1997), available at <http://www.sec.gov/news/press/pressarchive/1997/97-101.txt>.

<sup>27</sup> For a discussion about the procedural difficulties faced by claimants with low dollar-value claims, see Jill Gross, *AT&T Mobility and the Future of Small Claims Arbitration*, 42 Sw. U. L. REV. 47 (2012).

<sup>28</sup> *What Every Investor Should Know*, CONN. DEP’T OF BANKING, <http://www.ct.gov/dob/cwp/view.asp?a=2235&q=297960> (last visited Oct. 10, 2013) (suggesting investors who are unfamiliar with securities arbitration would prefer having counsel).

bility of legal counsel to investors of modest means with small claims.

Pace Law School responded first to Chairman Levitt's overture and opened its Securities Arbitration Clinic in the fall of 1997.<sup>29</sup> The following year, both Fordham and Brooklyn Law Schools opened similar clinics, which were followed by Buffalo Law School in 1999.<sup>30</sup> The success of these four "first-generation" securities clinics led to the creation of additional clinics. Other clinics opened at Duquesne School of Law in 2001 ("Securities Arbitration Practicum"); at the University of San Francisco School of Law ("Investor Justice Clinic") in 2002; at Albany Law School, Cardozo Law School, Syracuse University College of Law, and St. John's University School of Law in 2004; and at Touro Law Center and New York Law School in 2005.<sup>31</sup> In 2005, although Albany closed its SAC, Northwestern University School of Law opened its Investor Protection Center, following a grant from the NASD Investor Education Foundation.<sup>32</sup> In the summer of 2006, Hofstra School of Law opened a clinic,<sup>33</sup> and in January 2008, following a

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<sup>29</sup> See Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35, 35 (2000); see also J. Samuel Tenenbaum & Thomas H. Morsch, *Guidelines for Establishing a Law School Investor Advocacy Clinic*, FINRA 1-2 (November 2012), <http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p118734.pdf>.

<sup>30</sup> For a more extensive description of the history and early years of Pace's clinic, see Black, *supra* note 29, at 37-48; see also Romaine L. Gardner, *The First Four Years: The Securities Arbitration Clinic at Brooklyn Law School*, in SECURITIES ARBITRATION 507-15 (David E. Robbins chair, 2002); Constantine N. Katsoris, *Securities Arbitration: A Clinical Experiment*, 25 FORDHAM URB. L.J. 193, 202-08 (1998) (documenting experiences at other "first generation" clinics).

<sup>31</sup> The 2004-05 explosion is due primarily to grants awarded by the New York State Attorney General stemming from settlements obtained from defendants in securities fraud enforcement cases brought by that office. See Press Release, *Former Telecom Executive Agrees to Turn Over IPO Profits*, OFFICE OF THE N.Y. STATE ATTORNEY GEN. (Dec. 4, 2003), available at <http://www.ag.ny.gov/press-release/former-telecom-executive-agrees-turn-over-ipo-profits> (last visited Oct. 10, 2013); Press Release, *Telecom Executive Agrees to Give Up IPO Profits*, OFFICE OF THE N.Y. STATE ATTORNEY GEN. (Oct. 9, 2003), available at <http://www.ag.ny.gov/press-release/telecom-executive-agrees-give-ipo-profits-0>; Press Release, *Telecom Executive Agrees to Give Up IPO Profits*, OFFICE OF THE N.Y. STATE ATTORNEY GEN. (May 13, 2003), available at <http://www.ag.ny.gov/press-release/telecom-executive-agrees-give-ipo-profits>.

<sup>32</sup> See *Investor Protection Center*, NORTHWESTERN LAW SCHOOL, <http://www.law.northwestern.edu/legalclinic/investorprotection/> (last visited Oct. 10, 2013). As part of its grant requirements, Northwestern Law School produced a guide for other law schools to use who are considering establishing an Investor Protection Clinic. See Tenenbaum & Morsch, *supra* note 29.

<sup>33</sup> See *Curtis Pew*, HOFSTRA LAW SCHOOL, <http://law.hofstra.edu/directory/faculty/visiting/pew/> (last visited Oct. 10, 2013).

new round of grants from the New York State Attorney General's Office, Cornell's Securities Law Clinic opened its doors.<sup>34</sup>

In 2009, FINRA's Investor Education Foundation, following a study demonstrating the need for these clinics in other parts of the country, initiated a program to provide three years of seed money to law schools that agreed to open a SAC and could show the ability to sustain the clinic with ongoing funding from other sources.<sup>35</sup> These grants were designed to expand the geographic reach of SACs because most existing programs were situated in the New York metropolitan area. As a result of these grants, clinics opened at other law schools such as Florida International University, Howard University, Suffolk University, and Pepperdine in 2009; at Seton Hall University and University of Miami in 2010; and at Georgia State and Michigan State in 2012.<sup>36</sup> In 2011, the clinic at Duquesne Law School closed, but the neighboring University of Pittsburgh School of Law opened one with partial funding from the Pennsylvania Securities Commission.<sup>37</sup>

Today, there are eighteen law school clinics across the country offering free or low cost legal services to investors with low-dollar-value disputes with their securities brokers.<sup>38</sup> Investors in at least eight states and the District of Columbia, covering fifteen different metropolitan areas, can reach out for legal assistance for their arbitrable securities disputes. SACs have garnered favorable media coverage for helping those in need and filling the gap in access to justice for investors.<sup>39</sup> The next section of this Article will describe in more detail exactly what SAC students do for their clients.

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<sup>34</sup> Thomas Adcock, *Cornell Establishes Securities Law Clinic*, N.Y. L.J. (Jan. 25, 2008), <http://www.newyorklawjournal.com/id=900005501572/Cornell-Establishes-Securities-Law-Clinic?slret urn=20140108170343> (reporting on \$490,000 grant). Equal amounts of grant money were distributed to existing SACs in New York State, including Pace, to fund ongoing operations.

<sup>35</sup> See News Release, *FINRA Foundation Announces \$1 Million in Grants to Fund Securities Advocacy Clinics*, FINRA INVESTOR EDUCATION FOUNDATION (Jan. 28, 2010), <http://www.finra.org/Newsroom/NewsReleases/2010/P120794> (last visited Feb. 23, 2014) (announcing \$250,000 in grants to law schools at Pepperdine, Suffolk, Howard, and Florida International).

<sup>36</sup> *Investor Advocacy Clinic Programs*, FINRA INVESTOR EDUCATION FOUNDATION, <http://www.finrafoundation.org/grants/awarded/advocacy/> (last visited Oct. 10, 2013).

<sup>37</sup> See Press Release, *Pitt Law School to Open Securities Arbitration Clinic*, UNIV. OF PITTSBURGH (May 2, 2011), <http://www.news.pitt.edu/news/pitt-law-school-open-securities-arbitration-clinic> (last visited Oct. 10, 2013). Brooklyn Law School closed its clinic in 2012 for a little over one year but reopened it in the fall of 2013.

<sup>38</sup> See *Find an Attorney or Other Legal Representation*, FINRA, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/OptionsforInvestors/FindanAttorney/index.htm> (last visited Feb. 23, 2014) (listing eighteen SACs).

<sup>39</sup> See John Golden, *Law School Gives Investors Their Day Out of Court*, WESTCHESTER CNTY. BUS. J. (Oct. 26, 2012), <http://westfaironline.com/49582/law-school-gives-investors-their->

## III. THE NUTS AND BOLTS OF A SAC

SAC clients are investors who have disputes with their brokerage firms and/or individual brokers and meet the individual clinic's eligibility standards. While standards vary from clinic to clinic, typically they require that the potential client:

- Have household income under \$100,000;
- Have a claim for damages of less than \$100,000;
- Have no major assets other than a primary residence and a car; and
- Exhaust other avenues for private legal representation.<sup>40</sup>

These criteria are designed to enable SACs to offer free legal services to clients who have suffered losses from disputed transactions that have had a significant impact on their financial condition and cannot afford or do not have access to private representation. SACs do not want to compete with the local, private bar; instead, they wish to fill an unmet need for legal services that the private bar cannot meet. In addition, depending on the law school's individual practice orders<sup>41</sup> or state ethical rules governing the unauthorized practice of law,<sup>42</sup> clients may need to be residents of the state in which the SAC operates.<sup>43</sup>

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day-out-of-court/; Art McFarland, *Free Advice for Those Who Lost Money*, WABC (Dec. 5, 2008), <http://abclocal.go.com/wabc/story?section=news/education&id=6540773>; Kathy M. Kristof, *Law Students to the Rescue*, L.A. TIMES (Oct. 8, 2006), <http://articles.latimes.com/2006/oct/08/business/fi-perfin8>; Janet Kidd Stewart, *Law Schools Help Small Investors In Battles Against Brokers*, CHI. TRIBUNE (June 19, 2005), [http://articles.chicagotribune.com/2005-06-19/business/0506180261\\_1\\_small-investors-law-school-programs-daniel-sweeney](http://articles.chicagotribune.com/2005-06-19/business/0506180261_1_small-investors-law-school-programs-daniel-sweeney); Colleen Debaise, *Arbitration Clinics Offer Service for Small Investors*, WALL ST. J. (Apr. 20, 2005), available at <http://online.wsj.com/news/articles/SB111396025500611571>; Susan Harrigan, *When the Gamble Goes Bad*, NEWSDAY, Sept. 18, 2005, at A72; Leonard Post, *Help for 'Churned and Burned'*, NAT'L L. J., Feb. 10, 2003, at A6; David Andelman, *Places To Turn When At A Loss*, DAILY NEWS, Aug. 6, 2001, at 25; Penny Singer, *Pace Securities Clinic Aids Small Investors*, N.Y. TIMES, Oct. 18, 1998, at 8WE.

<sup>40</sup> For example, Pace's clinic informs potential clients that it may ask them to consult a private lawyer or lawyer referral service before considering them eligible for representation. See *Pace Investor Rights Clinic Client Eligibility Standards*, PACE LAW SCHOOL, <http://www.law.pace.edu/investor-rights-clinic-client-eligibility-standard> (last visited Oct. 21, 2013).

<sup>41</sup> These student practice orders typically are issued by the court in the state that has jurisdiction to regulate the admission of attorneys to practice in courts of that state. In New York, for example, it is the Appellate Division. See N.Y. Jud. Law §§ 478, 484 (2013).

<sup>42</sup> See MODEL RULES OF PROF'L CONDUCT R. 5.5 (2013).

<sup>43</sup> PIRC's eligibility guidelines state, "You should be a resident of New York State now or have been a resident of New York State when the disputed transactions occurred." See *Pace Investor Rights Clinic Client Eligibility Standards*, *supra* note 40.

Once students determine that a potential client has met the eligibility criteria for representation, they initiate a detailed investigation of the client's claim of wrongdoing to evaluate its legal viability and evidentiary strength. This investigation typically includes:

- Telephonic and in-person interviews of clients;
- Examination of client's financial background including tax returns, previous investment experience and other indicators of investment objectives and risk tolerance;
- Factual research into the firms, brokers, securities and products at issue;
- Legal research into whether the disputed transactions give rise to a valid and provable legal claim for relief;
- Review of all account documentation including account opening profiles, customer agreements, periodic account statements and transaction confirmations;
- Interviews of any third-party witnesses; and
- Where appropriate, consultation with financial and damages experts.

The typical claims that customers allege revolve around violations of FINRA sales practice rules, such as the recommendation of the purchase of unsuitable securities,<sup>44</sup> churning,<sup>45</sup> unauthorized trading<sup>46</sup> and misrepresentations.<sup>47</sup> Other claims that SACs inves-

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<sup>44</sup> Recommending unsuitable securities purchases, sales or strategies violates FINRA Rule 2111, formerly NASD Conduct Rule 2310, and could give rise to a cause of action for breach of duty, fraud, or negligence. *See, e.g.,* Clark v. John Lamula Investors, Inc., 583 F.2d 594, 601 (2d Cir. 1978) (an investment is "unsuitable" and constitutes federal securities fraud if (1) the investment was incompatible with a plaintiff's investment objectives; and (2) the broker recommended the investment; although (3) the broker knew or reasonably believed the investment was inappropriate); Scalp & Blade, Inc. v. Advest, Inc., 722 N.Y.S.2d 639 (N.Y. App. Div. 2001) (an unsuitable recommendation can constitute a breach of a fiduciary duty owed by a broker to a customer); Tonzi v. Nichols, 899 N.Y.S.2d 63, 65 (N.Y. Sup. Ct. 2009), *aff'd*, 907 N.Y.S.2d 903 (N.Y. App. Div. 2010) (an unsuitable recommendation can give rise to a claim for negligence). For general guidance on the scope of the suitability rule, *see Suitability*, FINRA, <http://www.finra.org/industry/issues/suitability/> (last visited Oct. 21, 2013).

<sup>45</sup> Churning occurs when a broker excessively trades a customer's account over which he has control for the purpose of generating commissions without regard to the client's investment objective(s). *See* Frankel v. Sardis, 76 A.D.3d 136, 138 (N.Y. App. Div. 2010); *see also* Saxe v. E.F. Hutton & Co., Inc., 789 F.2d 105 (2d Cir. 1986). SEC and FINRA rules forbid a broker from churning a customer's account. *See* SEC Rule 15c(1)-(7), 17 C.F.R. § 240.15c(1)-(7) (2001); FINRA Rule 2111.

<sup>46</sup> A broker engages in unauthorized trading when he intentionally executes a trade without obtaining the customer's approval. *Caiola v. Citibank, N.A.*, 295 F.3d 312, 323-24 (2d Cir. 2002).

<sup>47</sup> Broker-dealers owe their customers duties of full and accurate disclosure. *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 537 (2d Cir. 1999) (determining that a broker owes a duty to disclose all material information relevant to an investment); *see also* *United States v. Santoro*,

tigate include wrongful withholding of interest, failure to execute a customer's order, improper margin liquidation, and mishandling of customer funds. When evaluating these claims, students must consider common defenses that brokers and their firms raise such as ratification,<sup>48</sup> failure to mitigate damages,<sup>49</sup> and lack of justifiable reliance.<sup>50</sup>

If the clinic determines that the claim has merit (i.e., it has a reasonable chance of resulting in some financial recovery through arbitration), and if the client accepts the clinic's offer of representation, students then counsel the client so she can determine which method of dispute resolution to pursue. Clients may choose to initiate settlement negotiations, request mediation of the dispute, or file an arbitration claim with FINRA Dispute Resolution, which is the primary dispute resolution forum for customer-broker disputes in the securities industry.<sup>51</sup> No matter which dispute resolution process the client elects to pursue first, clinic students, under close faculty supervision, represent the client throughout that process and any subsequent process.

If the client elects to negotiate, student interns typically send a "demand letter" to opposing counsel informally describing the client's allegations and legal claims. The demand letter seeks to initiate a dialogue aimed at achieving a negotiated resolution. If the client elects mediation, because it is a voluntary, non-binding

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302 F.3d 76 (2d Cir. 2002) (customers who rely on investment recommendations reasonably trust their brokers to fully disclose all information pertinent to the recommendation and quality of the investment). For a more complete description of these common claims customers bring against their brokers, see Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 *CARDOZO L. REV.* 991, 1008–12 (2002); see also *INVESTOR'S GUIDE TO SECURITIES INDUSTRY DISPUTES: HOW TO PREVENT AND RESOLVE DISPUTES WITH YOUR BROKER* (Jill Gross, Ed Pekarek, Alice Oshins eds., 2013), available at <http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p119054.pdf>.

<sup>48</sup> The affirmative defense of ratification is available to a respondent who can prove that, even though its customer did not approve of the transaction when it occurred, the customer adopted and ratified the trade as his or her own through subsequent conduct. See *Modern Settings, Inc. v. Prudential-Bache Secs., Inc.*, 936 F.2d 640, 645–46 (2d Cir. 1991).

<sup>49</sup> Generally, claimants must reasonably attempt to mitigate damages before seeking a remedy at law or in equity. *Air Et Chaleur, S.A. v. Janeway*, 757 F.2d 489, 494 (2d Cir. 1985).

<sup>50</sup> This defense precludes recovery for misrepresentation(s) if, "through minimal diligence, the investor should have discovered the truth." *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1032 (2d Cir. 1993).

<sup>51</sup> FINRA operates the largest dispute resolution forum in the securities industry. See *Arbitration and Mediation*, FINRA, <http://www.finra.org/ArbitrationAndMediation/index.htm> (last visited Oct. 21, 2013).

method of dispute resolution, the student intern might need to persuade reluctant opposing parties to agree to it.<sup>52</sup>

If the client elects arbitration, student interns draft and file a Statement of Claim, which is a short narrative of the relevant facts and remedies sought, and should specify the amount of money the client is seeking in damages.<sup>53</sup> Pursuant to the FINRA Customer Code, respondents then have a limited time period in which to file an Answer to the Statement of Claim.<sup>54</sup> The arbitration process then continues with pre-hearing discovery, a process typically limited to the exchange of relevant documentation,<sup>55</sup> and the selection of arbitrators.<sup>56</sup> If the damages claim is \$50,000 or less, a single arbitrator decides the claim based solely on paper submissions (“Simplified Arbitration”), unless the Claimant requests an in-person hearing.<sup>57</sup> For all other cases, the parties present their evidence at a hearing.<sup>58</sup> Arbitration hearings can last one or more days and involve presentation of witness testimony and documentary evidence, as well as legal argument. The case concludes after the panel issues its decision in an arbitration award.<sup>59</sup>

By representing clients in these dispute resolution processes, SAC students have the opportunity to secure meaningful financial recoveries for their clients. The monies that might otherwise have been lost to private representation might have been the client’s nest egg, retirement savings, children’s college education funds, or small savings account funds. To an investor of modest means, the loss of these funds is devastating. Even for those investors that the clinic declines to represent, the clinic still performs a critical education function of informing investors of the lawfulness of the broker’s conduct. Even if they do not “win” an arbitration claim, student interns still listen to investors’ stories.

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<sup>52</sup> For more information about FINRA’s mediation program, see Jill Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, 21 OHIO ST. J. ON DISP. RESOL. 329 (2006). FINRA recently established a pilot program to administer telephonic mediations of claims of \$50,000 or less in order to make mediation more cost-effective in small claim cases. See News Release, *FINRA Launches Small Claims Telephonic Mediation Pilot Program*, FINRA (Jan. 16, 2013), <http://www.finra.org/Newsroom/NewsReleases/2013/P197693>.

<sup>53</sup> See FINRA Code of Arbitration Procedure for Customer Disputes (Customer Code), Rule 12302 (2014).

<sup>54</sup> See *Id.* at Rule 12303.

<sup>55</sup> See *Id.* at Rules 12505–12513.

<sup>56</sup> See *Id.* at Rules 12400–12403.

<sup>57</sup> See *Id.* at Rule 12800.

<sup>58</sup> See *Id.* at Rule 12600.

<sup>59</sup> See FINRA Code of Arbitration Procedure for Customer Disputes, Rule 12904 (2014).

During an academic year, Pace's SAC (PIRC) handles between twenty-five and fifty preliminary inquiries, investigates more than twenty cases in depth, and offers formal representation to approximately five to ten clients. PIRC does not charge legal fees for its services,<sup>60</sup> but investors are directly responsible to the arbitration forum for all costs other than legal fees, such as filing and hearing fees, incurred in the arbitration. All other costs, such as overhead and administrative salaries, are borne by the clinical program.

SAC students learn critical lawyering skills including interviewing, counseling, negotiating, claim evaluation, written and oral advocacy, conducting discovery, problem-solving, and managing ethical dilemmas. The seminar component of SAC teaches students the substantive law governing the obligations of broker-dealers to their customers, and the procedural framework of mediation and arbitration, and also gives students an opportunity to discuss their cases with the other students and supervisors as part of "case rounds."<sup>61</sup> Students also practice lawyering skills during seminars through simulated telephone and in-person interviews, counseling sessions, negotiations, mediations, and arbitrations. At the conclusion of the academic program, SAC students are better equipped to represent clients in any field and more confident in their ability to be competent and ethical lawyers.

#### IV. THE PEDAGOGY OF THE SECURITIES ARBITRATION CLINIC

The academic literature is replete with articles extolling the benefits of clinical legal education in general, especially more recently given the renewed focus on preparing students to be "practice-ready."<sup>62</sup> Indeed, most current research strongly suggests experientially-based teaching is more effective for student learning outcomes than traditional methods of law school teaching (i.e., the

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<sup>60</sup> See *infra* note 99–100 and accompanying text for a discussion of whether the clinic could charge its clients "low bono" fees.

<sup>61</sup> For a detailed discussion of the value of case rounds in clinics, see Susan Bryant & Elliott S. Milstein, *Rounds: A "Signature Pedagogy" for Clinical Education?*, 14 *CLINICAL L. REV.* 195 (2007).

<sup>62</sup> See generally Scott Fruehwald, *Legal Education Reform Scholarship*, <http://sfruehwald.com/lers.htm> (last visited Aug. 20, 2013).

Socratic Method).<sup>63</sup> Clinics are considered the most intensive form of experiential learning.

What the literature does not address is the pedagogical advantages of this particular kind of clinic. Below, I discuss some of the ways in which a SAC contributes to the law school curriculum and fills a niche in clinical legal education.

### A. *Pedagogical Advantages*

First, a SAC permits students to interact with individual clients—average people—who have suffered a loss and need help asserting their legal rights. While SACs are not different from many other types of clinics, except those that have primarily institutional clients such as environmental groups, in my experience SAC clients typically come to the clinic feeling victimized or exploited, but unsure as to how. They also do not know whether their victimization gives rise to a valid legal claim or how to pursue a claim. They know that their account statements reflect a lower value than what they started with, but they often do not know what that means. This is different from clients in other types of clinics, such as those who have been accused of wrongdoing and need representation to challenge the accusations (e.g., defendants in criminal defense or immigration clinics), those who seek assistance in completing a specific transaction (e.g., a not-for-profit community organization needs to incorporate, buy, or lease space, and seeks help from a community lawyering clinic), or those who have been denied a specific benefit and seek to challenge that denial (e.g., the disabled who have been denied social security benefits who get help from a disability rights clinic). In these examples, the client knows the problem and seeks legal assistance to solve it. In contrast, SAC clients may not even know there is a problem or what caused it. They just know they lost money.

Indeed, some clients, particularly the elderly, often believe they have done something wrong, or their own ignorance led to the harm, and thus are reluctant to assert known or unknown legal

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<sup>63</sup> See e.g., Scott Fruehwald, *General Education Research Supports CLEA's Petition to Require 15 Credits of Experiential Credits*, LEGAL SKILLS PROF BLOG (July 8, 2013), [http://lawprofessors.typepad.com/legal\\_skills/2013/07/general-education-research-supports-cleas-petition-to-require-15-credits-of-experiential-credits.html](http://lawprofessors.typepad.com/legal_skills/2013/07/general-education-research-supports-cleas-petition-to-require-15-credits-of-experiential-credits.html); Margaret Martin Barry, Jon C. Dubin & Peter A. Joy, *Clinical Education for this Millennium: The Third Wave*, 7 CLINICAL L. REV. 1, 13–14 (2000).

rights.<sup>64</sup> By listening to these individuals, assuring them that the broker in fact did something wrong (if appropriate), and identifying a potential wrongdoer and a legal wrong, students provide much-needed relief and compassion. Even if the students ultimately inform potential clients that they do not have enough evidence to prove a claim or the law does not provide a remedy for the provable misconduct, potential clients often feel better that someone is finally listening to their story, and gain some knowledge about what actually happened.<sup>65</sup> Of course, if the students offer them representation, they are pleased that someone else will be advocating on their behalf. Students who provide concrete legal assistance to an individual while they are still in law school taste the experience of a practicing lawyer who diagnoses and solves clients' problems.<sup>66</sup>

Second, representation in SAC can often begin and end in one academic year, if not in one semester. By handling a client's problem from intake to resolution, a student gains experience managing the various stages of client representation. Students can investigate the facts of a dispute by interviewing the client, reviewing account documentation, researching any securities products or public companies, tracing the flow of money through transactions, and researching legal theories—all in a few weeks. If the client has not retained copies of relevant account documents, SEC regulations require broker-dealers to provide customers, upon their request, with their account-related agreements.<sup>67</sup> This enables students to obtain at least account agreements, and many other relevant documents are publicly available or can be obtained from legal or business databases to which law school libraries have access. If the client authorizes the clinic to attempt to negotiate a settlement of the

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<sup>64</sup> Lydie Nadia Cabrera Pierre-Louis, *Nowhere to Run, Nowhere to Hide: The Impact of Sarbanes-Oxley on Securities Arbitration*, 81 *ST. JOHN'S L. REV.* 307, 332 (2007) ("Like most victims of fraud, embarrassment and betrayal are emotions that keep many defrauded investors from moving forward to assert their rights.").

<sup>65</sup> Barbara Black, *Establishing a Securities Arbitration Clinic: The Experience at Pace*, 50 *J. LEGAL EDUC.* 35, 49 (2000) (reporting that, while customers may be disappointed that the law does not provide a remedy for their loss, many have thanked the students for taking the time to investigate and explain the situation to them).

<sup>66</sup> Pearl Goldman & Leslie Larkin Cooney, *Beyond Core Skills and Values Integrating Therapeutic Jurisprudence and Preventive Law into the Law School Curriculum*, 5 *PSYCHOL. PUB. POL'Y & L.* 1123, 1140–41 (1999) (in clinics, students can, on top of providing legal advice, also play the role of "counselors" where they treat the client not only like a legal problem, but as a person who is distraught and needs help).

<sup>67</sup> 17 C.F.R. § 240.17a-3(a)(17)(iii) (2012) (requiring broker-dealer to provide any requesting customer with copy of an agreement relating to his/her account); FINRA Conduct R. 2268.

claim without filing an arbitration, then the negotiation can be completed within a few weeks of sending a demand letter. Alternatively, if the client chooses to pursue mediation in lieu of arbitration, a mediation session can be scheduled and completed within a few weeks. Only if the client chooses to pursue arbitration, and the case does not settle quickly, will the students not be able to resolve the case within one academic year.

Third, securities clinics fill a gap in the access to justice and provide free legal services to investors of modest means who otherwise would not be able to obtain legal representation. While disputes between investors and their brokers do not neatly fit within the range of traditional client matters handled by law school clinics, these clients are people who have suffered a real loss, often under circumstances that are life-changing and devastating to them, and often leaving them with virtually no other assets. Their inability to obtain affordable legal assistance renders them unable to assert and pursue their legal rights. But they are entitled to justice, too.

Fourth, this type of clinic appeals to business-oriented students who have shied away from more traditional law school clinics because the subject matter (e.g., criminal law, poverty law, street law) is not the kind of law they plan to practice. SAC students learn about investing, the stock market, the bond market, public company filings, mutual funds, and portfolio allocation theory, all business-oriented topics that typically are not covered in any other law school class. They work with spreadsheets, calculate losses with mathematical formulae, and trace money in and out of accounts. Students interested in practicing securities or corporate law can bring valuable experiences to subsequent employment.

Fifth, SACs teach critical lawyering skills not often covered in more conventional clinics, such as mediation and arbitration advocacy. As alternative dispute resolution (ADR) processes grow exponentially in importance in our legal system, students must be equipped to practice in those processes, counsel clients as to the various processes, and learn the advocacy skills unique to those processes.<sup>68</sup> The MacCrate Report recognizes the importance of ADR, as demonstrated by the Report's ranking negotiation as

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<sup>68</sup> See John Lande & Jean R. Sternlight, *The Potential Contribution of ADR to an Integrated Curriculum: Preparing Law Students for Real World Lawyering*, 25 OHIO ST. J. ON DISP. RESOL. 247, 251–52 (2010); Michael C. Bryce, *ADR Education from a Litigator/Educator Perspective*, 81 ST. JOHN'S L. REV. 337, 340 (2007) (noting that law schools are not teaching ADR sufficiently to students because many of them are still mostly focused on the adversarial aspects of law, instead of focusing on “teamwork, cooperation, conciliation, mutual problem-solving, and peacemaking.”).

lawyering skill number seven and “Litigation and ADR Procedures” as lawyering skill number eight.<sup>69</sup> By counseling clients as to the pros and cons of ADR processes, strategically recommending the use of one over the other and preparing to mediate or arbitrate rather than litigate a dispute, students learn real-world uses of these processes and see how they can be helpful in resolving disputes. By teaching ADR skills through these clinics, law schools have another vehicle to train students to be practice-ready.

Sixth, SACs provide students with the opportunity to collaborate with both consulting and testifying experts. Learning how to work with experts, mastering the relevant rules of ethics, and understanding the limits of privilege and discovery obligations with respect to experts are all important skills for students to learn.<sup>70</sup> Financial consultants are needed for SAC cases to render suitability opinions, analyze account statements, calculate damages, identify broker misconduct, and spot supervisory failures. At some point in the evolution of the case, SAC students will decide whether they need to present testifying experts. Gaining experience in making this decision is intrinsically valuable to student lawyers. Working with a testifying expert, preparing him for testimony, and shaping the presentation of the case through the expert are also valuable learning experiences.

Pace’s SAC has collaborated with Pace University’s Lubin School of Business on both formal and informal bases over the years.<sup>71</sup> For several years in the mid-2000s, the law school’s formal interdisciplinary partnership with the finance department in the business school provided unique learning environments for both law and finance students. Graduate finance students enrolled in a

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<sup>69</sup> The Report states: “In order to effectively employ, or to advise a client about, the options of litigation or alternative dispute resolution, a lawyer should have an understanding of the potential functions and consequences of these course of action in relation to the client’s situation and objectives. . .and should have a working knowledge of the fundamentals of . . . [inter alia] alternative dispute resolution.” *Report of The Task Force on Law Schools and the Profession: Narrowing the Gap*, A.B.A. 191 (1992), available at [http://www.americanbar.org/content/dam/aba/publications/misc/legal\\_education/2013\\_legal\\_education\\_and\\_professional\\_development\\_maccrate\\_report\).authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/misc/legal_education/2013_legal_education_and_professional_development_maccrate_report).authcheckdam.pdf) [hereinafter *MacCrate Report*].

<sup>70</sup> Anthony J. Luppino, *Minding More Than Our Own Business: Educating Entrepreneurial Lawyers Through Law School-Business School Collaborations*, 30 W. NEW ENG. L. REV. 151, 179–86 (2007) (advocating the use of interdisciplinary collaborations, such as clinical law-business programs, to improve the substantive knowledge, the grasp of underlying theory and policy, and the skills training of students seeking to become business lawyers).

<sup>71</sup> For a more complete description of this collaboration, see Jill I. Gross & Ronald W. Filante, *Developing A Law/Business Collaboration through Pace’s Securities Arbitration Clinic*, 11 FORDHAM J. CORP. & FIN. L. 57 (2005).

guided supervision course taught by a finance professor and, under his supervision, provided consulting expertise to SAC students. The business students ran account analyses, explained complex investment products to SAC students, calculated damages, provided opinions as to whether a broker recommended unsuitable transactions, and detected churning in an account. Law students learned how financial professionals look at account activity and gained a better understanding of how and why recommendations are made. This formal interdisciplinary collaboration enhanced the educational opportunities for Pace University students and made it possible to represent investors in more complex cases without incurring expert witness fees that the clients likely could not have afforded.<sup>72</sup>

While the formal partnership ended after three years, it continued on an informal basis with the same finance professor offering, case-by-case, consulting and expert witness services *pro bono* to clinic students. He also guest-lectures each year in the clinic seminar to teach students about working with financial experts and describes securities arbitration from the vantage point of a financial expert. Having access to this unique perspective has provided an invaluable learning opportunity for law students who are likely to work with all kinds of consulting and testifying experts in actual practice.

### B. *Pedagogical Challenges*

While these significant benefits of teaching a SAC provide ample justification for a law school to offer the program, it is not without its pedagogical challenges. Indeed, these challenges have led several law schools to decline to open a SAC when presented with the opportunity, or to shut down an existing one.

First, broker-dealer liability to customers is a highly specialized area of practice. It is challenging to teach SAC students, in just a few classes early in the semester, the substantive law they need to know to competently represent a client.<sup>73</sup> The securities industry is highly regulated, with numerous layers of regulatory bodies at both the state and federal levels, all with the authority to

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<sup>72</sup> Of course, several other models of interdisciplinary clinical collaboration exist and a law school should explore each one to determine which model is the best fit for a SAC at a particular law school.

<sup>73</sup> One might make the same observation for clinics practicing in other highly regulated areas such as immigration or environmental law.

promulgate applicable regulations, all of which an attorney must master to adequately assess potential wrongdoing. At the federal level, in addition to the federal securities laws, the SEC issues administrative rules and regulations for both broker-dealers and investment advisers.<sup>74</sup> FINRA is the self-regulatory organization to which the SEC has delegated additional regulatory authority over broker-dealers.<sup>75</sup> Pursuant to that authority, FINRA has enacted its own conduct rules governing all broker-dealers.<sup>76</sup> At the state level, state securities commissioners or attorneys general enforce state Blue Sky laws.<sup>77</sup> In addition to remedies provided by some state securities laws, investors can pursue private rights of action arising under the common law.<sup>78</sup> Students must navigate these overlapping layers of securities laws to understand fully whether an investor's losses stemmed from actionable misconduct.

In addition to complicated substantive law, students must quickly learn the FINRA mediation and arbitration processes, the latter of which is different from most other commercial arbitration providers. Both FINRA arbitration and mediation are likely to be unfamiliar to many students. Counseling a client on the pros and cons of proceeding in FINRA arbitration instead of mediation, or even litigation, if that is an option, is difficult for even the most experienced lawyers. Asking students to do so while they are learning the substantive law is an additional challenge.

Moreover, finding a clinical law professor sufficiently experienced in this specialized practice area or willing to learn it before the students do can pose an obstacle to the launch of a SAC. Even if the faculty supervisor has the requisite expertise, it can be argued that it is beyond the capability of law students to represent a client in a complex matter, and for students to do so could violate the ethical duty of competency.<sup>79</sup> Indeed, several times during the

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<sup>74</sup> 15 U.S.C. §78d(a) (2011).

<sup>75</sup> 15 U.S.C. §78o-4 (2010).

<sup>76</sup> See *FINRA Rules*, FINRA, [http://finra.complinet.com/en/display/display.html?rbid=2403&element\\_id=607](http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=607) (last visited Oct. 22, 2013).

<sup>77</sup> "Blue sky" laws refer to a state's statutes regulating the offer and sale of securities to protect the investing public from fraud. Justice McKenna of the U.S. Supreme Court used the term "blue sky" in an opinion upholding the validity of Ohio's securities laws: "The name that is given to the law indicates the evil at which it is aimed, that is, to use the language of a cited case, 'speculative schemes which have no more basis than so many feet of 'blue sky.'" *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917) (citing an unnamed source).

<sup>78</sup> See Black & Gross, *supra* note 14, at 1007-08.

<sup>79</sup> ABA Model Rules of Professional Conduct Rule 1.1 provides "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." MODEL CODE

fourteen years I have supervised SAC students, I have wondered whether the clinic cases were just too complex for law students to handle. Even the brightest and most sophisticated students in the area of finance have had difficulty understanding products such as leveraged exchange-traded funds (ETFs), real estate investment trusts (REITs), inverse floaters, mortgage-backed securities, and other esoteric products that even many financial professionals admit that they do not understand, even when selling them to retail customers.<sup>80</sup> However, while the underlying subject matter of many legal problems can be complex, lawyers are not excused from the task of learning enough about the underlying industry in order to solve their clients' legal problems. Moreover, the subject matter of some other clinics, such as environmental and immigration law, is equally complex, yet those clinics thrive.

A second pedagogical disadvantage is that the cases sometimes drag on for more than one academic year, thereby precluding students from seeing a case from start to finish. Instead, they might work on only various bits and pieces of several different matters. Students can be left without a sense of closure or the opportunity to see how the dispute resolution processes function over the

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OF PROF'L RESPONSIBILITY R. 1.1. The Comments to Rule 1.1 explain that "the relative complexity and specialized nature of the matter," among other factors, contributes to a determination that the lawyer has the requisite legal knowledge and skill, and that "[e]xpertise in a particular field of law may be required in some circumstances." MODEL CODE OF PROF'L RESPONSIBILITY R. 1.1 cmt. 1. On the other hand, a lawyer can obtain the requisite knowledge and skill in a "novel field through necessary study" or "through the association of a lawyer of established competence in the field in question." MODEL CODE OF PROF'L RESPONSIBILITY R. 1.1 cmt. 2. Comment 4 adds that a "lawyer may accept representation where the requisite level of competence can be achieved by reasonable preparation." MODEL CODE OF PROF'L RESPONSIBILITY R. 1.1 cmt. 4. Thus, expertise in the field may be necessary for a SAC faculty supervisor, and students must spend a lot of time at the beginning of the semester mastering the relevant law.

<sup>80</sup> Nathaniel Popper, *State Regulator Opens Inquiry Into Products Sold to Older Investors*, N.Y. TIMES (July 10, 2013, 1:38 PM), <http://dealbook.nytimes.com/2013/07/10/state-regulator-subpoenas-brokers-over-investments-sold-to-elderly/> ("In the course of his office's investigation of those REITs, Mr. Galvin said that his staff noticed that many brokers were selling a number of other complex financial products that even they did not understand, with little oversight from their parent companies."); News Release, *FINRA Sanctions Four Firms \$9.1 Million for Sales of Leveraged and Inverse Exchange-Traded Funds*, FINRA (May 1, 2012), <http://www.finra.org/Newsroom/NewsReleases/2012/P126123> (reporting on disciplinary action against four brokerage firms for, *inter alia*, not ensuring that their representatives had an understanding of the products they were selling; firms admitted their brokers "did not have an adequate understanding of Non-Traditional ETFs before recommending these products to retail brokerage customers."); see also Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CALIF. L. REV. 627, 663 (1996) ("An individual broker may not fully understand the risk associated with the securities he or she pushes, even though others within the firm do.").

life of a case. However, this is not a challenge unique to SACs: environmental clinics and other civil litigation clinics handle cases that can be active for several years.

Third, the flipside of having the opportunity to work with financial experts is that almost every case actually requires expert consulting and perhaps testimony for suitability opinions, identification of sales practice violations, damages calculations, and explanation of sophisticated securities products. This complicated mix of subject matter can present an overly complex, rather than a simple and straightforward, learning opportunity to students. The goal of the clinical experience is to teach students transferable lawyering skills such as interviewing, counseling, negotiating, and advocacy. Such narrow pedagogical objectives are harder for clinical supervisors to reach if they also must help students master complex financial products, securities regulations, and the arbitration process, as well as work with experts.

Fourth, under current FINRA arbitration rules, claims of damages of \$50,000 or less are resolved solely on the papers via FINRA's Simplified Arbitration process.<sup>81</sup> Thus, students handling those matters—which often comprise a large majority of SAC cases—do not get an opportunity to conduct an in-person hearing and practice their live advocacy skills. These students also do not get much interaction with a neutral decision-maker, because oral or even telephonic appearances before an arbitrator are rare in a simplified case.<sup>82</sup> On the other hand, students get substantial practice in written advocacy skills and boiling down a complex claim and evidence into a short Statement of Claim simple enough for non-lawyer arbitrators to understand.

Fifth, the case load varies and sometimes it can be difficult for a SAC to find new cases. In fact, the case load is directly related to the performance of the stock market. Needless to say, if the market is performing well, investors are generally not losing money and thus are not complaining about their brokers. In contrast, in a down market, investors notice losses and suspect broker misconduct as a possible cause of those losses. Maintaining a sufficient docket of cases in a bull market can be a challenge to SAC direc-

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<sup>81</sup> FINRA Code of Arbitration Procedure for Customer Disputes, Rule 12800 (2014).

<sup>82</sup> *Id.* at Rule 12800(c). They do get to practice their written advocacy skills, however, as they must persuade an arbitrator through written submissions that their client is entitled to recover damages and other relief.

tors.<sup>83</sup> However, over the course of its fifteen years, Pace's clinic has never had zero matters to assign to its students.

A related concern is generating a pipeline of new matters for students to investigate. When new SACs have opened and the clinicians designing the clinic have called me for suggestions and advice, one of the first questions they ask is "where do you get your cases from?" My answer usually involves a hodgepodge of suggestions: add your clinic's contact information to the list maintained on the FINRA website,<sup>84</sup> sign up for the Public Investors Arbitration Bar Association (PIABA) lawyer referral web function,<sup>85</sup> contact your state's securities administrator,<sup>86</sup> or network with local securities arbitration practitioners who might receive inquiries from potential clients who ultimately cannot afford to retain them.

Finally, perhaps the biggest challenge to SACs is the maintenance of ongoing funding. Generally, funding of clinical legal education is considered more expensive than classroom education, given the faculty time required for one-on-one supervision and the relatively small number of students who can enroll in a clinic in a semester.<sup>87</sup> Indeed, it is generally viewed as desirable for a law school to have permanent faculty teaching clinics who have a status equal to that of faculty teaching doctrinal classes. However, in an era of declining law school enrollment and thus tuition revenue, law schools are reluctant to hire a permanent, full-time clinical professor to teach a new clinic. Instead, some law schools staff one or more of their clinics with supervising attorneys who are not full-time tenured or tenure-track professors, but adjunct, visiting, or contract professors, who are not on permanent salary budget lines

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<sup>83</sup> It is in bull markets that some clinics increase the public policy and legislative advocacy work of students. For example, students can draft comment letters on SEC or FINRA rule filings, file amicus briefs in investor protection-related cases, and research ways to advocate for legislative change in consumer or investor protection laws.

<sup>84</sup> See *Find an Attorney or Other Legal Representation*, FINRA, <http://www.finra.org/arbitrationandmediation/finradisputeresolution/optionsforinvestors/findanattorney/> (last visited Oct. 22, 2013).

<sup>85</sup> "PIABA is an international bar association whose members represent investors in disputes with the securities industry." See *About PIABA*, PIABA, <http://piaba.org/about-piaba> (last visited Oct. 22, 2013).

<sup>86</sup> All 50 states' securities regulators are members of the National Association of State Securities Administrators (NASAA) and investor protection is part of their mission. See *Our Role*, NASAA, <http://www.nasaa.org/about-us/our-role/> (last visited Oct. 22, 2013).

<sup>87</sup> For a more nuanced analysis of the costs of clinical legal education, see Robert Kuehn, *Pricing Clinical Legal Education*, 20–22, available at <http://ssrn.com/abstract=2318042> (last visited Oct. 22, 2013). Professor Kuehn notes that the conventional wisdom that clinical legal education is more expensive than doctrinal instruction has been challenged recently, and his article demonstrates that adding more clinics should not result in an increase in law school tuition. *Id.*

(i.e., “hard” money) and thus require supplemental salaries or stipends that must be funded year-to-year (i.e., “soft” money).<sup>88</sup>

Additionally, as discussed above,<sup>89</sup> very few existing faculty members are qualified to teach a SAC, as they are unlikely to have practiced privately in this particularized subject matter area with a small private bar. Most schools have hired local practitioners to teach SACs, causing the school to incur additional expense. Some law schools have found it hard to justify the added expense of a SAC, when other clinics considered part of a core curriculum, such as criminal defense, general civil legal services, and immigration law clinics, can be offered and staffed with permanent faculty.<sup>90</sup>

As detailed above,<sup>91</sup> most law school SACs opened their doors as a result of their law schools’ raising of “soft” money, primarily with grants from state securities administrators or the FINRA Investor Education Foundation (FINRA IEF).<sup>92</sup> Because both state and federal governments have pursued investor protection policies—albeit with varying degrees of vigor depending on the administration’s political agenda—funding these clinics is one way of furthering those policies. Law school clinics sponsored by government regulators meet the needs of members of the public with whom the regulated industries interact. For example, the Internal Revenue Service funds taxpayer assistance clinics to enable taxpayers to properly understand and fulfill their tax obligations.

However, SACs cannot bank on these grantors as steady sources of funding. First, most of the clinics are located in New York State because, when Eliot Spitzer was Attorney General of New York,<sup>93</sup> he brought several high-profile securities enforcement actions and negotiated with the defendants to designate part of the funds recovered by the state through penalties and disgorgement to

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<sup>88</sup> These arguments speak to the broader debate within the legal academy about the tension between the cost of clinical legal education and the need to produce practice-ready graduates. While I certainly am not advocating a model of legal education in which clinicians have second-class faculty status, it is beyond the scope of this paper to tackle these issues and do them justice.

<sup>89</sup> See *supra* note 79 and accompanying text.

<sup>90</sup> See *The 2010-11 Survey of Applied Legal Education*, CTR. FOR THE STUDY OF APPLIED LEGAL EDUC., <http://www.csale.org/files/CSALE.Report.on.2010-11.Survey.5.16.12.Revised.pdf> (last visited Oct. 22, 2013) (listing civil/criminal/general litigation, criminal defense, immigration, and children and the law as the most common types of clinics at reporting law schools).

<sup>91</sup> See *supra* notes 31–37 and accompanying text.

<sup>92</sup> PIRC has been the recipient of a generous grant from FINRA IEF to produce and distribute the *Investor’s Guide to Securities Industry Disputes* in 2009 as well as supplemental grants to revise and update the Guide in 2011 and 2013.

<sup>93</sup> In New York, the Attorney General is the state’s top securities administrator.

law school SACs.<sup>94</sup> Since Spitzer resigned as governor in 2008, New York's new Attorney Generals have not followed his lead. Second, securities administrators in other states do not regularly obtain windfall enforcement settlement monies. In fact, the grants for SACs from securities administrators in states other than New York have resulted primarily from the billion-dollar Global Analyst Research Settlement in 2003.<sup>95</sup> Most of those funds have been distributed, with a small portion going to SACs in a handful of states. To my knowledge, no other enforcement actions in the past ten years have resulted in monies set aside for investor education through SACs, and it seems unlikely to expect any future monies from this channel.

Moreover, despite FINRA's investor protection mission, FINRA IEF has established a policy that it will not fund the ongoing operations of existing clinics. Instead, it will provide only three years of seed money to any law school that expresses an interest in opening a new SAC, completes a complex grant application, and demonstrates the ability to secure other funding to sustain the clinics after the three-year seed money runs out.<sup>96</sup> Directors of existing SACs have lobbied FINRA IEF to reconsider its rigid policy stance; thus far it has declined to do so, despite the existence of millions of unspent dollars in the Foundation (some of it still unspent as vestiges of the Global Analyst Research Settlement funds) and despite public criticism of its operations and fiscal management.<sup>97</sup> In addition, because FINRA's membership is entirely broker-dealer firms across the country, it seems unlikely that FINRA will generously fund SACs whose mission is—at least as some cynics see it—to sue its members. Thus, external funding has dried up for the existing SACs.<sup>98</sup> Without this external funding, existing

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<sup>94</sup> See *supra* note 31 and accompanying text.

<sup>95</sup> See *SEC Fact Sheet on Global Analyst Research Settlements*, SEC. & EXCH. COMM'N (Apr. 28, 2003), <http://www.sec.gov/news/speech/factsheet.htm> (describing the payments of \$80 million from the settling defendants to create investor education funds, out of approximately \$1 billion dollars in total payments).

<sup>96</sup> See *Investor Advocacy Clinic Program*, FINRA INVESTOR EDUCATION FOUNDATION, <http://www.finrafoundation.org/grants/advocacy/> (last visited Oct. 22, 2013).

<sup>97</sup> See *Securities and Exchange Commission v. Bear Stearns & Co., Inc.*, 879 F. Supp.2d 404 (S.D.N.Y. 2012) (criticizing performance and grant-funded programs of FINRA IEF as well as its financial management).

<sup>98</sup> One other possible source of external funding is a judge-made *cy pres* award. *Cy pres* awards, which are quite rare, stem from funds remaining in a class action settlement fund where no further plaintiffs file a claim for the monies. For example, in the fall of 2011, Judge Deborah Batts of the United States District Court for the Southern District of New York issued a *cy pres* award of \$64,445.37 to the Pace Investor Rights Clinic from unclaimed settlement funds. See

SACs not funded by law school “hard” money or endowments have had to either cut back on personnel, or even close their doors.

One possible funding option would be to charge its clients sliding-scale fees (sometimes known as “low bono”), in which the clinic could charge an increasing percentage of the recovery as the dollar value of the dispute increases.<sup>99</sup> It is widely known that private claimants’ lawyers typically charge clients one-third of the recovery. A SAC theoretically could charge its clients 10% or even 20% and still offer more affordable legal services. The downside of this model is that recoveries are far from certain, and the clinic would have to develop a track record of collecting a minimum amount before it could hire employees who would rely on this money for their salaries. Moreover, the amount of money in dispute likely will not result in a large enough recovery to generate sufficient fees to fund the operations of a law school clinic. For example, if the Pace clinic had charged 15% of its recoveries throughout its existence, it would have generated approximately \$75,000 in revenue over fifteen years, or an average of \$5,000 per year. This amount of money could not fund ongoing operations of a clinic, which can cost at least \$100,000 to operate annually.<sup>100</sup>

As external funding for SACs has dried up, and law schools have dwindling resources to self-fund, law schools are faced with the difficult choice of jettisoning specialty clinics such as SACs, or cutting other non-core programs. Several schools have already chosen to close their SACs, such as Suffolk University Law School, Duquesne School of Law, and Albany Law School.<sup>101</sup> Despite the many pedagogical benefits of a SAC, I fear that more schools will follow that path.

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Order Authorizing *Cy Pres* donation of the Unclaimed Balance of Class Action Settlement Fund to Charity, *In re American Express Financial Advisors Litig.*, Master File No. 04 Civ. 1773 (DAB) (Nov. 16, 2011). This is the only *cy pres* award to a SAC of which I am aware. Thus, it is not likely to be a viable source of ongoing funding.

<sup>99</sup> See Sam Glover, *The Reality of Low Bono Practice*, LAWYERIST BLOG (July 27, 2013), <http://lawyerist.com/the-reality-of-low-bono-law-practice/>.

<sup>100</sup> Of course, if Pace’s SAC had accepted cases with a larger dollar amount in dispute, then recoveries might have been larger.

<sup>101</sup> Brooklyn closed its SAC in January 2012 and reopened it under a different model in the fall of 2013.

## V. CONCLUSION: THE CONCEIVABLE DEATH OF THE SAC?

When Arthur Levitt's office first dreamed up the idea of a SAC as a solution to the problem of inadequate legal representation for investors in arbitration, it seemed improbable that law schools would be willing to experiment with a type of clinic that didn't serve the traditional clinic client. Yet the early adopters—Pace, Fordham, Brooklyn and Buffalo law schools—were able to imagine the potential for an enriching educational experience for more business-oriented students and boldly innovate beyond the core, traditional curriculum. In the early 2000s, a time of ever-increasing law school enrollments and adequate funding from securities regulators, the SAC community thought only of expansion, not contraction. Discussions at the annual SAC Roundtable focused on facilitating the opening of new SACs at more law schools. The idea that SACs could cease to exist would have seemed far-fetched only a few years ago.

Today, in light of declining law school enrollments nationwide and thus declining revenue,<sup>102</sup> law schools are generally reevaluating their models of education. Law schools are considering cutting expensive programs, especially those outside the core curriculum. It remains to be seen whether specialty clinics such as SACs will survive a new regime. Yet specialty clinics serve an important function in a law school's overall curriculum. Students who have graduated from Pace's SAC continue to rave about the program as among the best learning experiences from law school. Furthermore, most of the pedagogical drawbacks I identified above apply equally to other kinds of clinics and so cannot justify the closing of SACs in particular.

Because SACs have provided valuable legal education and *pro bono* legal services to deserving investors who have nowhere else to turn, I am concerned that some law schools will close their SAC. Absent a shift in policy by the one funder awash in tens of millions of dollars slated for investor education and protection programs—FINRA IEF—to permit grant-funding of the operations of existing SACs, permanent closure is no longer inconceivable at many schools, even though it is well known that current investor protection programs are insufficient.

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<sup>102</sup> See, e.g., Ashby Jones & Jennifer Smith, *Amid Falling Enrollment, Law Schools are Cutting Faculty*, WALL ST. J. (July 15, 2013), <http://online.wsj.com/article/SB10001424127887323664204578607810292433272>.

These SACs—despite their improbable beginning—offer a win-win-win: modest investors gain access to otherwise inaccessible legal services, law students become more qualified and ready to practice securities law and represent clients in alternative dispute resolution processes, and the securities industry gains immeasurable good will through the investor protection function that SACs offer to countless Americans. I urge FINRA's Investor Education Foundation to relax its strenuous stance against funding the ongoing operations of existing SACs and prevent their not-so-inconceivable death.