Breaking LOOSE

Fix the system? Or toss it entirely? Either way, a handful of plaintiffs lawyers have Wall Street's mandatory arbitration system in a bind. Here's how they did it.

BY EMILY BARKER

LAST SUMMER 15 WOMEN, ALL CURRENT or former employees of Smith Barney Inc., sat around a conference table in Chicago to talk about why they thought the giant brokerage was such an awful place for women to work. There was no shortage of ideas: Everyone had something they wanted to change. One woman complained of gender bias in a test that the company gave to broker trainees to measure their aggressiveness. Questions like "Would you rather play football or take a walk in the park?" seemed obviously aimed at men.

Change the test, someone suggested. Write some questions to test female aggressiveness. "Would you rather have an epidural, or go through natural childbirth?" "Would you rather start a diet while PMS-ing, or wait a week?"

Everyone laughed. "Let's just get rid of the test," someone else said.

And they did. Sitting with the 15 Smith Barney women, their attorneys, Mary Stowell and Linda Friedman of Chicago's Leng Stowell Friedman & Vernon, took careful note of the suggestions. Periodically Stowell and Friedman would walk downstairs with those ideas to another conference room, where Smith Barney's lawyers and some of the company's top executives were waiting to hear them. Just over a year earlier, Stowell and Friedman had made headlines by suing Smith Barney for sex discrimination on behalf of a class of women employees. Now the plaintiffs and the company were in the middle of settlement mediations. They weren't talking dollars, though. Stowell, Friedman, and their clients were trying to remake what they felt was a fundamentally unfair system.

The settlement that they finally reached—announced in November 1997, and at press time awaiting court approval—is a first on Wall Street: It offers a new forum, custom-designed for discrimination allegations. No longer will such claims be restricted to the securities industry's arbitration venues, which are run by the National Association of Securities Dealers, Inc. (NASD) and the New York Stock Exchange (NYSE). Under Securities and Exchange Commission rules, all employees registered to sell securities with the NASD or the NYSE must sign what are known as U-4 forms, which, among other things, bind them to arbitration in all disputes with their employers, including claims under Title VII of the Civil Rights Act of 1964. Stowell and Friedman's suit took aim at those contracts. "Mandatory arbitration of employment claims in the securities industry serves no public function and provides no public benefit," they charged in their complaint, which asked the court to declare the practice unconstitutional. "Rather, [it] is intended primarily to limit the liability of secu-

The class action brought against Wall Street titan Smith Barney by Mary Stowell (left) and Linda Friedman resulted in a historic settlement that offers employees a specially-designed forum to handle discrimination claims.

ANDY GOODWIN (STOWELL AND FRIEDMAN); RAFAEL FUCHS (BULL)

rities industry employers by allowing them to choose an employer-friendly forum where they are more likely to succeed and where awards tend to be smaller than in civil courts."

With attacks like these, securities industry arbitration is on the run. Stowell says she "picked up the baton from some other lawyers who started the fight"—namely, San Francisco's Cliff Palefsky and Michael Rubin. Both lawyers are currently embroiled in a major test case of securities industry arbitration in the U.S. Court of Appeals for the Ninth Circuit. And other attorneys have taken the cue. In Boston last January, for example, a federal judge ruled in *Rosenberg* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, that a former financial analyst, Susan Rosenberg, could bring her sex discrimination claim to court instead of NYSE arbitration.

The Wall Street establishment, it turns out, is also starting to come around. Last summer the Equal Employment Opportunity Commission declared that requiring employees to sign arbitration agreements contradicts the aims of civil rights legislation. Soon afterward, the NASD itself backed away from mandatory arbitration, announcing a proposed rule change that would no longer require brokers to arbitrate their discrimination claims with employers. Individual brokerage houses, of course, can still insist on arbitration. But the current system is clearly in retreat. A close look at the two biggest skirmishes reveals the battle lines. Will the Rosenberg decision eliminate mandatory arbitration for civil rights claims entirely? Or will the model in the Smith Barney settlement—where plaintiffs take their claims to a revised arbitration forum tailored for discrimination claims—win out?

EARLY IN THE SMITH BARNEY CASE, AFTER A hearing in New York, Stowell and Friedman recall that a lawyer representing the NYSE handed them a fat binder. Inside, Stowell found page after page of decisions upholding mandatory arbitration. "Do you know there's not a single case that supports your position in the Second Circuit?" Stowell recalls the other attorney asking. The binder itself was so heavy, Stowell says, that she considered asking her opponent to mail it to Chicago.

There are good reasons why there's no shortage of case law. Since 1987 arbitration has been mandatory for all securities industry customer-broker disputes. And since 1991, when the Supreme Court ruled in *Gilmer* v. *Interstate/Johnson Lane Corp.* that age discrimination claims can be subject to mandatory arbitration, it's been used to enforce civil rights claims as well. Though arbitration is generally faster—and therefore cheaper—than litigation, plaintiffs usually must pay forum fees that average around $3,000. Typically, securities industry arbitrations take place before a panel of three arbitrators with experience in the securities industry who are appointed by the NYSE or NASD. Under the Federal Arbitration Act, NYSE and NASD arbitrations cannot disregard the law. But they are not strictly bound to follow it either. Moreover, their rulings are generally limited to a few lines, and they are not required to provide any explanation of their awards. Opponents of mandatory arbitration argue that the NYSE and NASD discourage long decisions to reduce the risk of a successful appeal.

Does arbitration, in fact, favor the employer? In 1996 San Francisco's Orrick, Herrington & Sutcliffe surveyed 275 NASD and NYSE arbitrations conducted since 1989 and concluded that it was a favorable forum for employers, who won on discrimination claims in 78 percent of NASD arbitrations and in 66 percent of NYSE arbitrations. According to data cited by Merrill Lynch in the Rosenberg suit, however, a plaintiff's chances of prevailing in federal court are even more dismal, around 12 percent.

As plaintiffs attorneys specializing in employment law, Stowell and Friedman say that they were never enamored of the securities industry's system, especially for discrimination claims. For one thing, it's tough to get paid. "Even civil rights lawyers have to pay rent," says Stowell. "And you could not get fees awarded, even if you won." Without any obligation to follow statutory law, securities industry arbitrators were not bound by the fee-shifting provisions of the Civil Rights Act of 1964, which allowed a successful plaintiff in a civil rights case to collect attorneys' fees from the other side. "One of the things that we resolved early on was that we would not go through the NASD or the NYSE process with a client of ours," Friedman says. Yet for years they itched to take on what they saw as rampant sexual discrimination in the securities industry.

STOWELL AND FRIEDMAN FIRST worked together in 1987. Two years later they formed their own firm, specializing in age, race, and sex discrimination claims. After almost ten years, they have refined their double act. Stowell, 52, is brisk, talkative, and self-possessed, while Friedman, 38, is soft-spoken and intense. "Clients will often say, when they're furious, they'll call me, because I'll share the rage," Friedman says. "If they want a good listener who will take the other side and play devil's advocate, they'll call Mary."

In the early 1990s Stowell and Friedman began handling claims in the securities industry, including a highly publicized sex discrimination case against Chicago-based brokerage Rodman & Renshaw Inc. They had found a back door into court. "We scoured the [NASD and NYSE] rules and found the provision that class claims were ineligible [for arbitration]," Friedman says. "So we filed what we think was the first class claim under the 1991 Civil Rights Act against a securities firm"—Detroit's Olde Discount Corp. They also took advantage of the court of public opinion. In what would become a pattern for Stowell and Friedman's suits against the securities industry, the complaint featured lurid stories of blatant discrimination and harassment that the media soon seized upon.

In 1995 Stowell and Friedman got a call from Roberta Thomann, a former Smith Barney sales assistant who had been demoted after a pregnancy leave. They agreed to represent Thomann and two of her female colleagues from Smith Barney's Garden City, New York, branch office. But to bring a class action, they needed to show that discrimination against women was companywide. From Smith Barney's internal phone books, they assembled a database of company employees, guessing at gender from first names. From this rough count, they came to some striking conclusions. Of 460 Smith Barney branch managers, for instance, it appeared that only eight were female.

Those statistics went into the complaint that they filed in federal court in Manhattan on May 20, 1996, along with some shocking allegations about rampant sexual harassment in Smith Barney's Garden City office. Most memorable was the so-called "Boom-Boom Room," a basement hideaway adorned with a toilet bowl hanging from the ceiling, where male brokers allegedly gathered to drink Bloody Marys served from a garbage can and to make jokes about their female colleagues. The complaint also attacked the system of mandatory arbitration in place at Smith Barney, naming NASD and NYSE as co-defendants. Controlled by the securities industry, Stowell and Friedman argued, mandatory arbitration fosters discrimination instead of remedying it.

The suit was catnip to the New York press and a public relations disaster for Smith Barney. The National Organization of Women labeled the company a "Merchant of Shame." In court, the company argued that the suit was not a legitimate class action since the alleged discrimination had occurred only in the Garden City office of a vast, decentralized company. But more women came forward, Stowell says. The second amended complaint listed 23 named plaintiffs in 14 different offices across the country. Filed in October 1996, it prompted a fresh round of bad publicity for Smith Barney.

Smith Barney's counsel, Mark Belnick of New York's Paul, Weiss, Rifkind, Wharton & Garrison, thought that there might be some middle ground between the two sides—especially when it came to arbitration. "Smith Barney does not believe to this day that mandatory arbitration is unfair," Belnick says, but adds that as a practical matter, it had problems. "As long as there is a perception among a substantial portion of [Smith Barney's] employees that civil rights claims can't be fairly decided in this system," Belnick says, "then the system isn't working."

BILL O'CONNELL

The Rosenberg decision, litigated on the plaintiffs side by Richard Goodkin (left), Marc Redlich, and Merle Ruth Hass, is the most striking opinion against mandatory arbitration yet.

THE PLAINTIFFS TEAM HAD ASsumed that the the suit would not settle quickly. But that assumption changed within the first day of negotiations in July 1997. From the beginning, Smith Barney wanted to keep the focus of the talks on mandatory arbitration rather than a fund of money, Belnick says. Smith Barney was willing to drop the NASD–NYSE arbitration system and design a new one from scratch.

Stowell and Friedman embraced the idea. There were 23,000 potential class members, Friedman points out, and there was no way of calculating how many would actually have discrimination claims. "Mary and I shared with the women how that works," says Friedman. "If you put together a fund with a limited amount of money without knowing how many people are going to come forward, it's like having a dinner party with one pie but inviting forty."

Designing a new arbitration system became the focus of the mediation. In their conference room, the plaintiffs brainstormed, with guidance from Stowell and Friedman. Two women described the lengthy, humiliating psychiatric interviews that Smith Barney had required when they took sexual harassment and emotional distress claims into NASD arbitration. One of these women, Eileen Valentino, recalls being quizzed about her gynecological and marital counseling records, with no assurance that the information would remain confidential. "I said, no woman should have to go through this," she says. No medical or psychiatric exams would be allowed in the new system, the plaintiffs decided.

Other demands followed as the mediation stretched over two weekends. As Stowell, Friedman, and two plaintiffs describe it, the negotiations were

Smith Barney Cuts A Deal

If approved, the settlement that Mary Stowell and Linda Friedman have reached with Smith Barney will affect a class of 22,000 women who were employed by Smith Barney in its capital markets, investment banking, or retail sales divisions between May 20, 1993, and November 21, 1997. These women will be able to take discrimination claims against Smith Barney—lumped together with any other employment-related claims—through a three-stage dispute resolution process: a claims forum, mediation, and an arbitration hearing. Plaintiffs will have two years from the approval of the settlement to bring claims. In the arbitration, an administrator approved by both sides—Duke University Private Adjudication Center—will choose a panel of three arbitrators. Smith Barney will pay the arbitrator's fee and at least part of the plaintiffs counsel's fee: up to $5,000 for an unsuccessful claim, and the entire fee for a successful one.

Medical or psychiatric evidence will be allowed only if the plaintiff has made a claim for physical or emotional injuries. Plaintiffs will not be required to undergo any physical or psychological examination. In addition, Smith Barney cannot bring any counterclaims against the plaintiff in the arbitration, although it may raise them in other forums. And no "after-acquired evidence" will be permitted—in other words, Smith Barney cannot argue that a plaintiff would have been fired anyway because of some wrongdoing that only came to light after she was fired.

The arbitrators' decision is final. Under the Federal Arbitration Act, it can be vacated by a state or federal court only in the event of misconduct or incompetence by the arbitration panel.

Smith Barney agrees to spend $15 million on diversity programs. The company will also increase the percentage of women in various positions, from training programs to branch managers.

—*E.B.*

a powerful, uplifting experience, the kind of participatory exchange that feminist sisterhood is supposed to be about. Not every idea that was floated made its way into the final settlement. When the names of individual managers came up, sometimes the women let their rage boil over. They compiled a "hit list" of Smith Barney managers that they accused of discrimination, and fantasized about how to punish them. "Bodily dismemberment came up once," recalls Stowell. Mostly, though, the plaintiffs just wanted the men to be fired. "We finally resolved it that they would be able to bring all these issues up at their personal mediations," says Stowell, who claims that later she "lost the list."

What finally resulted provides some unprecedented guarantees for the class of Smith Barney's female employees [see "Smith Barney Cuts a Deal," above]. But Stowell and Friedman acknowledge that it puts them in an odd position. The settlement simply substitutes another form of mandatory arbitration—albeit a kindler, gentler one. "Our real dislike of mandatory arbitration is not that it's arbitration," insists Friedman, "but that it's mandatory and it's predispute and it's run by the securities industry." Stowell cites the diversity program that Smith Barney has agreed to implement as one of the settlement's strongest advantages. "We could never have accomplished any of these things through court," she insists. "A court could not require a company to spend $15 million recruiting, training, promoting, mentoring, and counseling women and minorities."

Not everyone agrees that the new arbitration system will be better than court. Named plaintiff Pamela Martens, joined by two other dissident plaintiffs, has emerged as the settlement's biggest critic. Heading into mediation last summer, Martens had wanted to seek a $200 million settlement from Smith Barney. She did not attend the mediation in person, she says, and was stunned at the result—not only because of the lack of compensatory damages, but also because Stowell and Friedman had not pressed for the firing of Smith Barney employees accused of discrimination and harassment. Stowell and Friedman withdrew as her counsel last September after she threatened to file a malpractice complaint against them. Martens, who says she still has a copy of the "hit list," ultimately opted out of the settlement; meanwhile, another named plaintiff, Edna Broyles, has filed an objection. At press time Judge Constance Baker Motley had not yet approved the settlement or addressed Broyles's concerns.

Broyles has objected to the fee structure that handsomely rewards Stowell and Friedman. Indeed, with the court's approval, up to $12 million will go to the plaintiffs lawyers, while 23 named plaintiffs will share $1.9 million for their efforts in the litigation. None of the plaintiffs will receive compensation for discrimination claims unless they prevail at arbitration. Martens is also deeply suspicious of the new arbitration system. Under the settlement, Martens argues, Smith Barney will be paying the fees for virtually all professionals involved: arbitrators and plaintiffs counsel as well as its own defense attorneys. "A private justice system run by the wrongdoer," she calls the revised system in a court filing.

What's encouraging to Martens and her allies is a recent federal court decision in Boston. Last January U.S. district court judge Nancy Gertner took a look at mandatory arbitration of discrimination claims in the securities industry. She didn't like what she saw.

THE BOSTON CASE BEGAN BACK IN March 1994. When 47-year-old Susan Rosenberg walked into her boss's office that month to ask for a file, she says he handed her a vibrator instead. Her boss, John Wyllys, later claimed that it was simply a novelty toy, a battery-operated "stress buster" device. In any event, several weeks later Rosenberg was fired from her job in a Merrill Lynch office in Boston. The dispute became the basis for the first successful legal challenge to mandatory arbitration in the securities industry since the Gilmer case in 1991.

Rosenberg's attorneys are not long-standing opponents of mandatory arbitration. They're not even plaintiffs lawyers. For her complaint against Merrill Lynch, Rosenberg turned to a family friend, solo practitioner Richard Goodkin, who in turn recruited Boston defense litigator Marc Redlich, a former Harvard Law School classmate. Both say that Rosenberg's case was compelling not only because of her allegations of sex discrimination and harassment, but also because NASD would require her to air them in mandatory arbitration instead of in court. "There was something particularly egregious about the securities industry arbitration," says Redlich.

Rosenberg's claim was first dismissed for lack of probable cause by the Massachusetts Commission Against Discrimination, the state civil rights enforcement agency that investigates complaints. Determined to avoid NASD arbitration, Redlich and Goodkin sued Merrill Lynch in Massachusetts state court in 1996 for sex and age discrimination. Removing the case to federal court, Merrill Lynch moved to compel arbitration in November 1996. In response, Redlich argued that securities industry arbitration was manifestly unfair. At an April 1997 hearing Judge Gertner asked the two sides to explore the issue further and then reconvene.

By the next hearing, in October 1997, Redlich was armed with evidence about the workings of NYSE arbitration, some of it supplied by California plaintiffs lawyer Cliff Palefsky. Redlich emphasized what he called the institutional bias of the system: NYSE, whose members would presumably be the defendants in discrimination suits, picked, trained, and supervised arbitrators. "The Big Board acting as Big Brother," was how Redlich described the system to Judge Gertner. Merrill Lynch's counsel, Barry Weiner of Boston's Shapiro, Israel & Weiner, made *Gilmer* the cornerstone of his argument, arguing that Redlich was making the same "generalized attacks" that the Supreme Court had rejected six years earlier.

In her January 1998 memorandum and order, Gertner disagreed. Finding Rosenberg's critique of mandatory arbitration more detailed and convincing than Gilmer's, she ruled that Rosenberg's claim could proceed in court. NYSE's domination of the arbitration system was "deeply troubling," the judge found. "Its structural imbalance makes it an inadequate forum for vindicating civil rights." Merrill Lynch promptly appealed Gertner's decision, citing Gilmer, among other cases. "She concluded that the structure of the New York Stock Exchange made its arbitration panels incapable of being fair," says Merrill Lynch assistant general counsel Terry Kassel. "The Supreme Court has several times rejected that argument." At press time, the company's appeal was pending.

In the meantime, Merrill Lynch has been considering changes in its arbitration system. What is prompting the move, says Kassel, is the "sea change" going on in the securities industry over mandatory arbitration. Plus, Merrill Lynch has faced the prospect of its own mammoth, high-profile case—a suit filed by Stowell and Friedman around the same time that they sued Smith Barney. The nearly complete settlement bears a strong family resemblance to the Smith Barney suit. According to Stowell, plaintiffs will be able to take their complaints to a new arbitration system. Though talks have been deadlocked since January on the issue of attorneys' fees, that settlement, if approved, would affect an estimated class of 2,500 female sales representatives. But meanwhile, Merrill Lynch may opt to give all employees a choice: a new arbitration system, NASD/NYSE arbitration—or court. "What we're looking at is a departure from industry practices," says Kassel. "We think it is an attractive and unprecedented step [that will differentiate us from] our competitors."

Kassel's point is an important one. What may doom mandatory arbitration for discrimination claims is not litigation but market pressure. In turn, that might make for an unusual, but significant, advantage for some companies. Wall Street's old guard may soon be telling its wronged employees: Stay, and we can handle your discrimination claim however you want. ■