

## **South Asian Capital Market Conference at Mauritius, 22-25 April 2010**



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**April 24, 2010**

### **The Role of Arbitration in Securities Market**

Good Morning

Ladies and Gentleman

I thank the organizers of the South Asian Capital Markets conference for giving me the opportunity of putting my thoughts before this distinguished audience on the subject of the Role of Arbitration in Securities Market.

Imagine a situation where thousands of vehicles are held up in a traffic jam for hours on a very busy express highway. The authorities close the road for new vehicles to enter the expressway to clear the back log of the held-up traffic. It may take up few hours to clear.

Now I would take you to a real situation from the imagination. There are some 30 millions and odd cases pending in various courts. If the government takes a decision not to admit any new litigation, it would take roughly 315 years to clear the back log the way the judgment is delivered. This is prevalent situation in India. Other countries have equally bad back-log situation. England till couple of years used to take on an average of 5 years against 12/15 years in India to pronounce judgment in litigation. England has now reduced the average period from 5 years to one year.

I would quote former Chief Justice of U.S. Supreme Court Mr. Warren G. Burger who said:

***“The notion that most people want black-robed judge, well dressed lawyers and find penalized court rooms as setting to resolve their disputes is not correct.”***

People with problems like people with pains want relief as quickly as possible.

As a true citizen of country we must always remember our primary duty that:

***WE OUGHT TO BE HEALERS OF CONFLICTS.***

We as healers of conflicts have an obligation towards society to provide mechanism that can produce acceptable result in shortest time with least possible and minimum stress on the disputed parties.

***THIS IS WHAT JUSTICE IS ALL ABOUT.***

As an alternative to litigation, Arbitration has potential to provide such relief. To avoid traffic jams we have constructed flyovers, underground railways, overhead monorail.

Arbitration has potential to provide relief like traffic jams in the back log of litigation and in fact provided relief all over the world.

We as a true citizen have to explore the full potential of Arbitration.

Arbitration should not be continuation of the courts. It should be resolving the issues at the earliest.

I cannot resist quoting one of the most distinguished and prominent lawyer of India Mr. Nani Palkhiwala who once said:

***“When International Court of Chambers – ICC – in Paris started offering the service of the court of Arbitration, businessman in different countries found it convenient to avail that facility. In course of time that convenience became preference and the preference has now ripened into a necessity.***

Mr. Palkhiwala probably out of frustration and helplessness further said that ***“If I were appointed dictator of a country in the short period of my appointment and assignation, I would definitely impose a law making arbitration compulsory in all commercial contracts.”***

In the proposed changes in the Indian Arbitration and Conciliation Act, 1996 there is recommendation of insertion of provisions for implied arbitration agreement in commercial contracts of high consideration value.

Coming to arbitration in securities market- the topic – I have been allotted, I would say that it was in the year 1872 probably New York Stock Exchange developed some sort of arbitration rules for the fair and effective administrative of securities disputes. Bombay Stock Exchange (BSE) the oldest Indian Stock Exchange of more than 125 years has something like that where respected brokers of the Exchange used to settle disputes between the brokers.

In securities industry time is the essence. Prices of shares change every second. In most of the Exchange related arbitration there is time restrictions called “Limitations”. Investors or Brokers cannot peruse a dispute through Exchange arbitration mechanism if the disputed matter is more than six months in India.

Having put a limitation on bringing dispute for arbitration Securities and Exchange Board of India (SEBI) has put a corresponding obligation on Arbitrators who are required to complete their arbitration proceedings within three months with a provision of further extension of three months with prior approval of Exchange authorities. Thus within a maximum of six months from the date of 1<sup>st</sup> hearing, the award has to be given.

In most countries customers have a resource of action to seek redress. This is through mediation, arbitration or an ombudsman.

In the securities sector, countries like USA and India Broker-Client agreement provides mandatory arbitration clause that both parties will arbitrate their disputes in a forum operated by Self Regulated Organization (SRO).

Some countries require them to belong to a dispute resolution scheme while others have set up a separate body or association to settle individual disputes. All Exchanges in India have dedicated arbitration and investors grievance cells to settle securities dispute within overall supervision of SEBI. Many countries have established such mechanism. For instance in France there has been ombudsman scheme. In Netherlands the act on Financial Supervision sets out the obligation for firms to establish adequate procedures for customers' complaints and to join alternate dispute resolution (ADR) body which is recognized by the Ministry of Finance.

In USA the Financial Industry Regulatory Authority Inc. or FINRA a Self Regulated Organization, the successor to the National Association of Securities Dealers Inc. (NASD) performs market regulation under contract.

The FINRA operates the world's largest arbitration forum for the resolution of securities related disputes. FINRA has pool of 2700 broker arbitrators called non-public arbitrator and 3500 non-broker arbitrators called public arbitrators. FINRA operates from 72 locations including some foreign locations.

In 2009 FINRA reported 7137 cases for arbitration. FINRA takes on an average 14/15 months to complete arbitration proceedings. The FINRA arbitration awards are not reasoned awards. Compared to this though India handles arbitration cases and operates from four different regional centres. The Indian Arbitration awards including securities arbitration awards are all reasoned as per India's Arbitration Act. I have given a reasoned award of complicated security arbitration consisting of 81 pages. For the benefit of audience here I would like to inform that any one can access arbitration awards of stock market on National Stock Exchange of India (NSE) and Bombay Stock Exchange (BSE) web-sites.

The legal system in most countries has healthy regard for the policy favouring arbitration and clear direction to place arbitration agreements upon the same footing as other contracts.

In the U.S. Supreme Court decision in *Shearson vs. McMahon*, Justice O'Connor noted that securities arbitrators are readily capable of handling complex claims that streamlined procedures are not inconsistent with the underlying substantive rights and the judicial scrutiny of arbitration awards – while limited – is sufficient to ensure that arbitrators meet their statutory obligations.

The court also found that any misconduct of arbitration as an efficient and fair means to resolve disputes is particularly unfounded in the contract of securities arbitration, which is, regulated by the Regulators.

Regulators like SEBI have power to ensure the adequacy of the arbitration procedures employed by the SROs. SEBI does ensure such adequacy from the inception of approving appointment of arbitrators on the panel till monitoring of awards within time limit.

SEBI engages in frequent review of SROs arbitration facilities to identify areas where procedures should be strengthened and encourage remedial steps through changes in administration or through the development of rules changes. Such pro-active efforts have ensured that the rules governing securities arbitration provide the investor a fair, efficient and impartial forum. As a true investor protection measure, SEBI has excluded claims up to Rs. 10 lacs from any arbitration cost to the investors.

There have been studies to find the adequacy of certain aspects of SRO arbitration. Such studies have led to enhancements of SRO arbitration procedures.

So far as securities industry arbitration is concerned I strongly believe and support that arbitration should be mandatory meaning that unless one exhaust the arbitration mechanism for disputes between Broker and Clients no other forums including Courts can be approached.

Investors who believe that they have been wronged by the intermediaries of the Security Industry to have their claim decided by Panel of Arbitrators that include members of the Broking firms creates at least the appearance of bias of not actual bias.

Public Investors Arbitrator Bar Association (PIABA) in USA, a bar association whose member attorneys are representing the investors in Securities Industry disputes has strongly represented to Securities Exchange Commission (SEC, USA) that no stock brokers should be permitted on FINRA's Panel of Arbitrators.

The FINRA rules provide hearing by Panel of three arbitrators whenever disputes amount is over \$ 100000 (Approx. Rs. 45 lacs). FINRA rules provide that one of the Panel Members must be from security Industry while two others are from non-security. PIABA has opposed this rule and represented that the investors be given the option of choosing the arbitrators they like.

In earlier days India used to follow the same rules as followed by FINRA. However, SEBI has amended the regulation and currently only non-brokers are permitted on Exchange Arbitration Panel.

Arbitration is poised to effect great changes to the way in which disputes resolution is conducted. It brings with the solemnity and finality of the judicial process and couples it with the procedural flexibilities of non-conventional dispute resolution methods. As the Nation moves, alternate methods of dispute resolution might just provide the key to resolving the problems of overburdened court litigation and would play a major role to build trust amongst all types of investors be it private equity and/or FII.

Under the aegis of few Exchanges in India we from Chartered Institute of Arbitrators (CIArb) have initiated arbitration awareness programmes for investors and general public to be followed by arbitration training courses all over India.

The Security Industry Arbitration in India is a "role model arbitration" regime which can be followed by others with few changes, if required, to suit their local requirements and local laws.

I extend CIArb and my personal invitation to SAFE Exchanges for any guidance and assistance concerning Arbitration in their region.

***THANK YOU!***