INTRODUCTION

THE BATTLE OF TRENTON

On August 20, 2004, a man by the name of Rand Groves walked into the Mercer County Courthouse in Trenton, New Jersey, on a task that just about any knowledgeable person would view as utterly futile. The legal system can produce miracles like Clarence Gideon, whose handwritten petition to the U.S. Supreme Court guaranteed the right to counsel for future generations. It can establish social policy, save lives, and send corporate executives to prison. It can restrain presidents and resolve age-old grievances. But there are certain things the legal system cannot do. Rand Groves was asking for too much.

The title of his lawsuit said it all: *Rand Groves v. Merrill Lynch Pierce Fenner & Smith Inc. and Llewellyn G. Ross and National Association of Securities Dealers Inc*. One man against the most powerful brokerage firm in the world and the primary regulatory organization for all of Wall Street. It was absurd, and not just because he didn't have a lawyer. Rand Groves was trying to get an American court in the year 2004 to reverse an unjust decision of a securities industry arbitration panel.

Such a thing could not be allowed to happen. It would be against all the principles of modern securities law.

In a 1987 United States Supreme Court ruling, *Shearson/American Express Inc. v. McMahon,* it became the law of the land that nothing that might come between a broker and his client would ever again be adjudicated by a judge and jury, as is theoretically guaranteed by the Seventh Amendment to the United States Constitution. The standard "arbitration clauses" in account documents, which most customers signed without even reading, took precedence over the Constitution. The *Shearson* ruling held that even cases of the most serious kind, alleging securities fraud, had to be batted out in closed-door arbitration proceedings.

Once that principle was established, it became a kind of holy thing to Wall Street and the two regulatory agencies that operate arbitration systems, the NASD and the New York Stock Exchange. Whenever anyone has sought to tamper with the arbitration system without the consent of Wall Street, as was recently attempted by the California state legislature, the Street has closed ranks and fought back with the unflinching support of the government agency that oversees the securities industry, the Securities and Exchange Commission.

Rand Groves was unlikely fodder for such a confrontation. He was a marketing consultant, fifty-two years old, an erect six-footer with graying sandy hair, a neat mustache, and steel-rimmed glasses. He had a wife, three children approaching college age, and a house in Princeton Junction, New Jersey. He had a night-school MBA and once worked for a major advertising agency.

Groves was the embodiment of a social phenomenon that goes by several names. The media calls it the Investor Class. George W. Bush calls the Rand Groveses of this country an Ownership Society. It is a slogan that resonates with the natural yearnings that people have nowadays for empowerment and control of their own financial destiny, their own retirement savings and healthcare costs, free of the heavy hand of government.

Groves used to feel that way. In fact, he still did as he cleared the metal detectors, checked his cell phone and took the elevator to the courtroom. It's hard to let go of fantasies.

In 1999, Groves performed marketing work for a couple of companies, both of which granted him a generous allotment of stock options. These were Internet companies, so the underlying stocks were worth a great deal of money by late 1999, $5 million or so, all on paper and carrying various kinds of restrictions and mumbo jumbo that Groves didn't entirely understand. His primary concern was that his entire financial well-being was tied up in two volatile Internet stocks. So he did what people do in such situations, which was to seek expert guidance to help him manage this theoretical onslaught of paper wealth.

Firms of standing and prestige stood ready to lend a hand, their offices friendly and welcoming. There was Goldman Sachs, the prestigious investment bank whose former CEO was now a senator from New Jersey. There was Morgan Stanley, whose name conjured up images of unimaginable, robber-baron-era wealth. In years to come its gently comical ménage à trois TV commercials would portray a firm whose brokers were so "unusually devoted to your dreams," so obsessively focused and involved "one client a time," that they became a kind of marital third wheel, cheering on the kids at football games and making vacation-home plans while gazing longingly at the receding tide.

One firm was already anchored in Groves's mind—the "King of the Brokers." Merrill Lynch's reputation was beyond reproach. Its treatment by the media was respectful, deferential. Its handling of the media was distant, correct. An invitation to its annual press dinner, at the Securities Industry Association annual meeting in Boca Raton, was highly coveted—a sign of status and acceptance by Wall Street's premier brokerage.

Merrill's public image, despite occasional but not disproportionate lumps during the analyst scandal of the new millennium, was essentially unblemished. Its advertising in the late 1990s was lofty in tone and content, establishing Merrill as a valued friend and advisor. Merrill took the position that people need to run their lives like a business, and that Merrill stood ready to provide expert assistance.

To Groves, these ads spoke directly to the heart. Every word resonated. Merrill employed "consultants," not brokers. They were there to "help," not sell. "They weren't in the brokerage business, they were in the wealth management business," Groves later recalled. One Merrill ad that sung out to him was published as an insert in the *New York Times Magazine* of April 25, 1999. "Your Life, Incorporated," it began. "Corporations like to refer to themselves as 'families.' Shouldn't it be the other way around?" The ad went on for several pages to describe its seven hundred analysts in twenty-six countries, "all linked to one account. Yours." It said that a Merrill Lynch FC, or Financial Consultant, is an "advocate in your corner, helping you create opportunities in every department of your financial life."

The last page contained a simple pledge: "We hold ourselves accountable for making suitable recommendations based upon your goals, risk preference and time horizon."

It was a long text ad, of the kind that companies reserved only for their smartest, most select, high-end customers. It was flattering, it pushed the right buttons, and it worked.

Groves was a marketing professional. He knew all about the "hidden persuaders," as the ad-biz critic and commentator Vance Packard called them when the mysterious power of advertising was being explored, like the nucleus of the atom, back in the fifties and sixties. Groves knew the hypnotic spell of advertising slogans . . . *Ban Takes the Worry out of Being Close* . . . *Silvikrin Puts the "Ooh" in Shampoo* . . . *Us Tarryton Smokers Would Rather Fight Than*

Switch . . . as they are drummed into our heads year after year. He knew Packard's writings and he was savvy to hype and image-management. Yet the Merrill ads had had their intended effect long before a handwritten note arrived in the mail from Llewellyn G. Ross, a Financial Consultant in the Private Client Group of Merrill's office in Lawrenceville, New Jersey, just outside Princeton.

Ross was dapper, gray without being grandfatherly, a Princeton man in his sixties. He was always impeccably dressed, and reminded Groves of the post–*Mission: Impossible* Peter Graves, serious and debonair. Ross was the head of a small marketing company before he joined Merrill. The two men had worked together briefly several years before. And now here he was, a financial expert, a late-career change that put him on the cutting edge. Groves was impressed. He did find it a little odd that a man with a marketing background was now an expert Financial Consultant, but he suppressed his doubts. Ross was with Merrill, and Merrill knew what it was doing. Groves opened his account in November 1999.

All of the above is pretty much agreed to by all the parties concerned (except that Merrill claims that Groves contacted Ross and not vice versa). From here on things get disputatious and sullen and prickly, which is not surprising considering that litigation ensued. What nobody denies is that Groves wound up losing his nest egg, though how that happened—whether the fault was Merrill's or Groves's or the unseen hand of the market or the malevolent karma of generations past—remains in dispute.

As Groves tells the story, Ross did not generate the expert advice that he had expected. A "financial plan," for which Groves paid $250, turned out to be boilerplate that didn't deal with his primary conundrum, which was that all his wealth was concentrated in two Internet stocks. In the first months of 2000 Internet stocks were not doing very well. The Internet bubble was ending, but that was not known at the time. There had been brief dips and corrections in the past, including a particularly ferocious one in late 1998, and in early 2000 there was no way of knowing for sure what was going on. The decline in Internet stocks seemed to many people to be a "blip," a "correction," a "buying opportunity," and not the rapids just upriver from the Horseshoe Falls.

Luckily, help was at hand. Ross, either at his own initiative or at Groves's urging—depending upon whose story you believe—consulted the best mind available on such matters. Merrill's in-house expert on all things Internet-related, the famed analyst Henry Blodget, was contacted for an opinion. What he actually said is in dispute. Blodget either indicated to Groves, through Ross, that Groves's main holding was unlikely to fall below ten dollars, or he offered no opinion, depending upon whose story you believe.

What no one disputes is that the blip turned into a belch that turned into outright, prolonged retching throughout 2000 and into the following year. By the end of 2000, Groves was transformed from a paper millionaire to a paper thousandaire with $53,000 in his account. By mid-2001 he was a hundredaire and then a nothingaire. It was all over. His paper windfall was gone, but not the tax bill it generated. Groves was broke.

In April 2002, Groves hired an attorney and filed a claim against Ross and Merrill, using the only remedy permitted by a standard clause in the account agreement that he had signed in 1999—an arbitration panel organized by NASD Dispute Resolution, Inc. His claim contended that Ross was inexperienced and not properly supervised, had failed to provide proper investment advice, and was therefore responsible for the disaster that ensued. He asked for $4.2 million in damages. Merrill and Ross, through their attorneys, denied all the allegations.

If one despises lawyers as so many people do, and is upset with the trend of what George W. Bush describes as "junk lawsuits," the Wall Street system of resolving customer complaints is a dream. There are no junk lawsuits. In fact, as a result of the *Shearson* decision and several others, there are no lawsuits. Instead there is a dispute-disposal mechanism very much unique to Wall Street. Ordinarily, arbitration involves bringing a quarrel to a neutral forum, such as the American Arbitration Association. Wall Street likes to keep things within the family. Its form of arbitration differs from ordinary arbitrations in small ways and large, none of which was apparent to Groves at the outset (not that it would have mattered if they had been apparent, as there wasn't a thing he could have done about it).

As in ordinary arbitrations, papers are exchanged, and they are much simpler and freer of the legalese and Latin expressions and attestations and other lawyer-speak nonsense that is so prevalent in courts today. Advocates of arbitration are particularly enthused about that, as well as that there are no costly pretrial depositions, in which both parties take down testimony from each other in advance of trial. This is done to assist in the calm and orderly weighing of the evidence, without surprise to either party. Groves felt that no surprises were likely in his case. It seemed pretty clear-cut to him. He liked the arbitration process—its simplicity, its no-nonsense approach to things.

Arbitration has the salutary effect of being an educational process for the laypeople who are caught up in it, and Groves was no exception. He learned some things he didn't know before.

For example, he learned that the Merrill Lynch "Private Client Group," which conjures up images of "private bankers" snifting brandy at the Club, was actually a name Merrill slapped on *all* its brokers. Wall Street firms rarely used the words *broker* and *stockbroker* anymore. They had long abandoned those terms in favor of the more soothing, more professional "financial consultant" or "financial advisor." By the late 1990s, the "B-word" (and, of course, the official term, "registered representative") was rarely to be found outside of legal papers and regulatory filings.

In replying to the allegations, Merrill Lynch tended to drift a bit from its advertising and portrayed Groves as an individual who didn't need much help at all from Merrill. As a matter of fact, anyone reading its reply might have gotten the impression that Merrill was a kind of deep-discount brokerage that just executed trades for customers who were in full command of all the finer points of investing. The firm pointed out that Groves's account was nondiscretionary, meaning that Groves called the shots, not his broker. Merrill's reply went on to say that Ross on several crucial occasions recommended that Groves sell his holdings before the roof fell in. That was quite the opposite of Groves's position, so it would be necessary for the arbitrators to listen carefully to the parties, weigh the evidence, and decide which of them—Groves or Ross—was telling the truth.

Groves read the legal paperwork with a growing anger. The denials, and the deviations from the truth as he had experienced it, annoyed him. So did the effort to skirt responsibility. As he saw it, he had relied on Ross and Merrill in very much the way a patient relies on his physician to care for his health. He would explain that to the arbitrators and they would understand, when the time came for the hearing. They would believe him.

After a leisurely procession of still more paperwork and routine delays, two years went by. A standard delay, similar to what Groves might have experienced in a New Jersey court, if not a bit longer. (The Securities Industry Association maintains that arbitration is "generally much swifter and more efficient than court proceedings," but plaintiff attorneys tend to dissent from that sentiment.) It was now early 2004, and Groves was feeling increasingly desperate. His entire financial destiny, the one he wanted to control, was tied up in all the wealth that had vanished in 2000 and 2001. The arbitration hearing was his only hope. He had every reason to expect that this was not a faint hope, if he happened to read the literature that the NASD generously provides litigants, lawyers, and pretty much anyone else even remotely interested.

According to the NASD, investors were winning "53% to 61% of their cases." This statistical encouragement evaporated when one considered that any award, even arbitrarily slashed in half or by two-thirds or nine-tenths, was considered a win for statistical purposes. Groves didn't know that. All he knew was that he was finally getting his day in "court." It wasn't a court, but that just seemed to be a minor detail.

The arbitration sessions, which took place during January and February 2004, were much more comfortable than a comparable court trial. Instead of a stuffy courthouse, they were held in the pleasant surroundings of the Crowne Plaza hotel in downtown Philadelphia. As is common in arbitrations, there was a lengthy hiatus between sessions, with three weeks separating the second and third day of hearings. Three arbitrators presided—one representing the securities industry and two members of the public. The latter's numerical domination of the panel is required by NASD procedures designed to ensure the public's confidence in the fairness of the arbitration process.

Arbitrator selection is where the Wall Street system really distinguishes—perhaps a better word might be *differentiates*—itself from both the court system and other forms of arbitration. In an ordinary court trial some pesky investor lawyer or judge would probably see to it that nobody with a Wall Street background comes within a hundred feet of the jury room. Or, more likely, the trial would be settled out of court because brokerages don't like having disputes resolved by juries of ordinary people who aren't smart enough to understand the nuances and peculiarities of the way the Street does business.

That potentially thorny problem does not exist in arbitrations run by the NASD or NYSE. Since one of the three arbitrators is always a person who knows Wall Street backward and forward, the panel is less likely to be swayed by sympathy or pro-investor prejudice, or get all weepy and idealistic and go off half-cocked like Henry Fonda in *Twelve Angry Men.*

In the case of *Groves v. Merrill,* the industry representative—the smart person who'd be sure that the rest of the panel had the right facts—was a very nice lady who was a branch manager from UBS Paine Webber. Groves remembered that UBS was deeply involved in the Wall Street research scandals—the epicenter of which was none other than Henry Blodget, the man who either advised Groves or did not (depending upon whose story you believe). Blodget had been splattered over the media for emails that differed in embarrassing ways from his public comments on Internet stocks.

Groves felt that the presence of this UBS lady constituted a conflict of interest. Tough. The UBS lady was on the panel whether he liked it or not. In a NASD arbitration, the parties pick panel members from lists compiled by the NASD. If both parties can't agree, the NASD picks the panel. The parties didn't agree, so the NASD picked the panel and the UBS lady was one of its picks, and that was that.

Think of how interesting litigation would be if all civil disputes were handled this way. Imagine taking a chiropractor to court for crushing your vertebrae into jelly, and a chiropractor *must* be on the jury. The rest of the jury consists of people selected by the American Chiropractic Association. Instead of a jury of six or twelve people, all fussing and arguing, this panel is a modern and streamlined three people, which for the sake of efficiency also doubles as the judge. To add closure to the matter (which any psychologist would tell you is desirable), its findings are as final as the Nuremberg Tribunals—except when they go against the Street, in which instances the cases are frequently dragged through the inefficient court system that securities firms abhor. To preserve the privacy of all concerned—or, if one is of a cynical bent, to make it harder for investor lawyers to build future cases—the proceedings are as firmly closed to the public as a prison tribunal at Guantánamo. Spectators, including the media, are forbidden. Except for the final decision, all the papers that go flying back and forth between the parties are kept under lock and key, and are more definitively exempt from public disclosure than personnel files of the CIA.

The chiropractor-juror in our hypothetical case may be a passionate believer in ridding the profession of people who turn vertebrae into jelly. Or maybe he's more concerned that malpractice premiums are increased by big-jury verdicts. Then, using his superior knowledge of the spine-crack and neck-twist and all the other arts of the adjustable couch, he knows just what to say to carry the day with his two other jurors in reaching their etched-in-granite decision.

The NASD and NYSE and SIA and every brokerage firm in the world would want me to underline at this point, so I will do so right now, that <u>in Wall Street arbitrations, two of the three arbitrators are always members of the public.</u> There you go—I've underlined it. Ordinary guys and gals like you and me, people off the street. Right? Well, not exactly. "Public arbitrators" are hardly rounded up at random at the Greyhound station. They're much nicer than that, much smarter. They're the kind of people you find on the boards of Gold Coast co-ops or waiting to tee off at golf clubs in Locust Valley. They tend to be older people, white-buck-shoe people, businesspeople, Caucasian people. You know, the kind of people who might remind you of the post–*Mission: Impossible* Peter Graves.

In the Groves arbitration, one of the two "public" members was just some ordinary guy you'd find walking down the street who happened to have worked for seven years as general counsel of an investment bank. That was a long time ago, back in the 1980s, so it was permitted by the rules. If this were a jury, he'd have been tossed out without so much as a second thought. As Groves was soon to discover, this was not an American courtroom, with all its untidiness, messiness—and ironclad rules of fairness.

Groves v. Merrill was a routine case. Both sides politely jousted. And then—the note.

Not long before the hearing, Groves's lawyer and Merrill provided the arbitrators with loose-leaf binders containing copies of relevant documentation. There it was. Ross had, very fortunately it seems, written a note to himself on his personal notepad stationery, dated February 17, 2000. It said as follows: "Called Rand Groves. Left message concerning NBCi, stock in a downtrend." NBCi was one of the Internet stocks that Groves owned, and which was about to go over the Horseshoe Falls.

This note substantiated Ross's position, which Groves denied, that he had warned Groves that the stock was looking mighty weak. There it was, in his legible handwriting on Merrill Lynch stationery, with an address in Princeton right on top. In a case that turned on the credibility of the parties, it was dynamite.

There was only one problem: Ross wasn't in Princeton in February 2000. He was in Lawrenceville. He moved to Princeton three months later. He couldn't have written a note on Princeton stationery in February 2000.

For the rest of his life, Groves will be able to recall with crystal clarity how his lawyer nailed Ross like E. G. Marshall in an old *Defenders* episode. It stands out in his mind how his lawyer went through his brokerage statements one after the other, had him read the address on each, and then the coup de grâce: The lawyer asked Ross if he wrote the note after he learned of the claim, and not in February 2000. The response, as recalled by Groves and his lawyer: Ross saying the magic, credibility-destroying word *yes*. The proceedings then adjourned for three weeks, and at the next session Ross denied that he had created the document after he had learned of the claim, and said he did not remember when it was written. But the damage had been done, as far as Groves and his lawyer were concerned.

The arbitration panel made its decision on March 4, 2004. On the following day, Martha Stewart was found guilty in the glitziest of the Wall Street scandal cases that Groves had been reading about. Tampering with evidence had been her downfall—changing a phone log to omit a warning about a stock declining. Obstruction of justice, they were calling it. Doing something wrong is bad enough, but lying about it always compounds the error. That's how things are in the American system of jurisprudence. It seemed to Groves that Ross had done something worse than altering a phone log. His broker had manufactured evidence as far as he was concerned, and that would destroy his credibility just as it had Martha's. If this were a court trial, fabricated evidence would be a killer. Case over.

The arbitration decision was communicated to him while the Martha news was blaring on the cable news channels. The ruling was a model of simplicity and economy of phrasing. True, it did not deal with Ross's testimony, or his alleged manufacturing of evidence, but it didn't deal with Groves's testimony either. As a matter of fact, it didn't deal with anybody's testimony. As a matter of fact, it didn't deal with anything. The unanimous decision of the arbitration panel in Case No. 02-02253 was not so much a decision as it was the kind of "drop dead" response you get when you dispute your cell-phone bill. This was the panel's ruling:

"Claimant's claims are denied in their entirety."

That was that.

No, actually that wasn't that. The NASD also sent Groves a bill for an Initial Filing Fee ($600), an Adjournment Fee ($1,200), and Forum Fees ($6,000), a total of $7,800. He had already paid $1,800, so he owed $6,000. In all, he would have to fork over about $7,500 more than he would have had to pay in court fees if this had been an ordinary lawsuit. (Oh, I almost forgot to mention, arbitration is "economical for investors," according to the Securities Industry Association.)

Groves was stunned, and when the disbelief wore off, he had questions to which no answers were readily available. Why didn't the arbitrators say anything about the manufactured evidence? Why didn't that destroy Ross's case? Why didn't Groves win? Or, more to the point, why didn't Ross lose?

There was no decision, so there was no answer to these questions—not then, not ever.

Groves immediately talked with his lawyer about an appeal. His lawyer was adamant on the subject, and so were the twenty or so securities lawyers he found through the Internet and the phone book. All said pretty much the same thing: "One said to me, 'Is it raining outside? You have a better chance of being struck by lightning than winning this case.' Another said I had a better chance of winning the lottery."

Groves learned that arbitration decisions are infuriatingly uninformative because they are supposed to be infuriatingly uninformative. The aim is to provide no basis for a court to pick apart a decision. He learned that arbitration decisions cannot be overturned just because the verdict is against the "weight of the evidence," or some other standard that courts apply. He learned that arbitrations are absolutely, positively not subject to appeal under pretty much any circumstances. The legal standard is stiff. The federal Arbitration Act requires the courts to enforce arbitration agreements rigorously. The arbitrators have to be either crazy or corrupt. Or, as one federal appellate court pointed out, the proceedings must have been a "mockery or sham" or been conducted "illegally or by corrupt arbitrators." A merely stupid, unfair, or unjust decision is—well, it's just fine, when rendered by an arbitration panel. Arbitrations can also be tossed out if litigants climb a common law Mount Everest called "manifest disregard" of the facts and law—sort of a nice way of saying "a crazy decision." But attacking the judgment on that or any grounds is kind of tough (actually, pretty near impossible) when the arbitrators don't provide their reasons, as happened in Groves's case.

Groves immediately ran into a problem as he went about meeting his formidable burden of proof. A tape recorder had been whirling during the entire arbitration hearing. A total of fourteen tapes were made. He asked for the tape that contained Ross's testimony. Thirteen were fine. One was blank on both sides.

Guess which one.

Something musta happened. Maybe one of the arbitrators goofed, said the NASD. Why? Beats me. Beats the NASD. Beats Merrill Lynch. More than anything, it beats Groves. As a matter of fact, it beats him to a pulp.

The silver lining, Groves reasoned after recovering from the shock, was that the failure to record a crucial part of the proceedings might be considered a serious irregularity—serious enough to provide grounds for a court to reverse the decision. Again, the lawyers he consulted were unencouraging. Legal clinics, usually after some initial interest, reacted similarly. Groves was learning that arbitration was a specialized field of law, securities arbitration was a subspecialty of that specialty, and investor appeals of securities arbitration cases were a subspecialty of a subspecialty of a specialty, and about as rewarding to most lawyers as removing a cake pan from a hot oven with their teeth.

I met Groves as he was wrestling with this horror. I had just written a story for *Business Week* on the Wall Street arbitration system, and he was hoping for publicity that might shake loose a lawyer willing to take his case. I thought it might be a decent story, but it was a tough sell.

At *Business Week,* the relevant concept was "bore." As in size, magnitude, explosive power. This was a term I had begun hearing in 2002, but similar concepts have long been employed throughout financial journalism. Enron, which *Business Week* glorified in a 2001 cover story and thrashed later that year, was "large bore." Tyco, which *Business Week* glorified in a 2001 cover story and thrashed the following year, was "large bore." The latest news from the New York Stock Exchange, down to the last detail of its dispute with Dick Grasso and the most esoteric complexities of its internal structure and competitive challenges, was "large bore," in the sense of being weighty enough to be part of the established agenda of financial journalism—which was pretty much what the editors of *Business Week* read about every morning over breakfast, preparatory to their nine-thirty meeting, in the *Wall Street Journal* and the *New York Times.*

Anything that those two very fine publications did not regularly cover was "small bore." As a matter of fact, even such grave and recurring investor issues as fraud involving microcap stocks—which still savaged thousands of investors every year, and which had once been large bore—had shrunk down to small bore by 2004. Rand Groves could not shed light on Enron or WorldCom or Arthur Andersen or market structure or any of the other large-bore issues that preoccupied *BW* and the rest of the financial press in 2004. He was just a little guy with a big problem, so he was small bore. A story on his plight would be laughed out of any meeting of *BW* editors. My editor passed on it.

Groves was batting a thousand. Everybody was failing him.

He had only a short time to appeal, if he was going to appeal. Not that, as he saw things, he had much of a choice. He was broke and without a job, he had no savings, and all his wealth had been tied up in those two Internet stocks. He didn't even know where to file the papers. He lived in New Jersey, but the arbitration was in Pennsylvania. Groves went to libraries to find the right legal forms, read some law books, decided to go with New Jersey, specifically the Superior Court of Mercer County, Civil Division, which is located in Trenton. He filed his lawsuit with the clerk on June 4, 2004, and named both the NASD and Merrill Lynch as defendants. He asked for the arbitration decision to be overturned, and for the court to order a new hearing before a different panel. Merrill promptly moved to have the whole thing tossed out of court.

Groves had to fight the motion without a lawyer. His efforts to find one who was willing to accept the case on a contingency basis—paid only if he won—had come to naught. His parallel effort to obtain publicity had gotten some results, however. A weekly business publication called *NJBIZ* had run a lengthy piece on his plight. It was a good article, a fair article, an accurate article, and such an affront to the honor of a Wall Street firm was not to go unanswered. Merrill Lynch spokesman Mark Herr immediately wrote an outraged letter to the editor that was published two weeks later.

Merrill had no problem with anything specific in the story, but had a real problem with the story being published at all. Since the travails of customers of large brokerage firms fell into the small-bore category employed by *Business Week* and other trendsetters of financial journalism, the *NJBIZ* piece was the kind of outlier that really gets Wall Street PR people mad. It was almost as if Merrill had been a fly on the wall of my meeting with my editor, and was annoyed that such good judgment was not universal and that this pipsqueak little business publication wasn't as intelligent and discerning as larger and more sophisticated media outlets that followed the established financial news agenda. "It is astonishing that you would allow Groves the soapbox you did," the Merrill letter complained. While it asserted that Groves made "false claims," and repeated Merrill's contention that Groves was shifting blame to his "financial advisor" for his own misjudgments, that is about as far as it went in disputing anything in the piece. As far as Merrill was concerned, his claim was the height of effrontery. Indeed, Merrill seemed to feel that it was a victim of injustice by having to put up with a pest like Groves crying foul. "It is hard to imagine anyone less entitled to a do-over," said Herr.* After all, "Rand had his day in court and lost."

Well, actually that is what Groves was trying to get—a hearing in an actual U.S. courtroom—and Merrill at the moment was working hard to get it kicked out of court. Merrill's motion to dismiss the case was terse and confident, though lacking the moral outrage of the letter to *NJBIZ.* As in the letter, the brief did not have much to say about that smoking-gun note, the one showing that its broker may not have been brutally honest at all times. In a footnote, reflecting Merrill's view that the whole thing was a big yawn, the firm's lawyers said that "neither Merrill Lynch nor Mr. Ross concedes" Groves's account of what was said when the tape recorder wasn't working. The NASD's answer said that it "lacks knowledge and information sufficient to form a belief " on the subject, and "leaves plaintiff to his proofs." (The latter, incidentally, was standard legal boilerplate and not an attempt to be sarcastic.)†

A few weeks before the case was called, the NASD asked for the hearing to be postponed. Firms often ask for delays in Wall Street arbitrations, sometimes

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* Merrill's response to repeated requests for comment is described in the Epilogue. Ross said he was unable to comment because of company policy.

† Merrill later clarified its position in a legal filing, conceding that the "smoking gun" note was written after its ostensible filing date of February 17, 2000. However, Merrill maintained that, at the session that wasn't taped, Ross denied that the note had been written after he learned about the claim.

for legit reasons and sometimes to wear down the opposing party, and they are usually granted. But this wasn't a Wall Street arbitration. Judge Mitchel E. Ostrer said no, and the case went on as scheduled.

So there he was, that sweaty day in August 2004, in the Mercer County courthouse. Groves was aware of the painful irony that he was in the midst of the glories of our Revolutionary past. Across the street, at the site of what was now a Lutheran Church, George Washington met with his generals in the home of Alexander Douglass on the evening of January 2, 1777. A tarnish-green plaque attested to the fact that there, on that date, Washington decided on a perilous maneuver. One week before, Washington had crossed the Delaware to the north of the town and seized Trenton from the Hessians. The First Battle of Trenton was won. But the British had regrouped and were driving south. Right across the street, Washington had embarked on a plan of action.

Groves waited in the cold of Christmas every year to watch the reenactment of Washington crossing the Delaware and marching on Trenton—usually to be disappointed, because it was almost always called off because of bad weather or rough waters. He believed in the sappy stuff that every American schoolkid is taught—or, at least, was taught in the early 1960s, when Groves went to school—about the fundamental principles of liberty and fairness and the decency of our civil justice system. So he didn't mind being a *pro se* plaintiff, facing lawyers from the firm of Stradley Ronon Stevens & Young LLP, representing Merrill Lynch and Ross, and Drinker Biddle & Reath LLP, representing the NASD.

Had this been an arbitration hearing, a guy like Groves facing off against the two leading powers of Wall Street would have been a can of Gaines dog food, chopped up and put on a plate before a hungry Rottweiler. But this wasn't an arbitration hearing. Judge Ostrer rejected Merrill's effort to toss the case out of court.

The judge's decision—as detailed and clear as the arbitration ruling was brief and opaque—was a heartening example of the judicial system working to protect the meek against the mighty. It gave Groves every benefit of the doubt, bending over backward to help him, pointing out the inapplicability of cases cited by Merrill very much as a high-priced lawyer for Groves would have done. But it was narrowly worded. The decision made clear that to win Groves would have a heavy burden of proof. He would have to prove that the tape was intentionally erased and that, as a result, testimony wasn't considered and Groves didn't get a fair hearing.

So there he was—victorious but only for the moment, winning an interlocutory decision that was like overrunning one foxhole with the rest of Pork

Chop Hill looming above. Except that in this case even a final victory didn't mean pushing the enemy over the Yalu, because the most Groves could hope for was that his case would be sent back to arbitration for another appealable-only-if-crazy decision.

A U.S. citizen was fighting for his right to due process of law, a right he had learned back in grade school was guaranteed by the U.S. Constitution. It was crazy. What made it crazy was that in the eyes of the law, it was not even a close question. Merrill Lynch was in the right.

Groves was also right, not legally, but in the realm of the kind of gnawing feeling that settles in the gut when something really bad is happening to a person and not a goddamn thing can be done about it.

It was crazy, but it was also predestined.

Years of conditioning, media hype, advertising, image-building, and scandal-suppression by Merrill and other titans of the securities industry have produced a generation of Americans who sign papers they don't read, and buy investment products they don't understand from brokers whose backgrounds they don't bother to research. They deal with brokerage firms and mutual funds and hedge funds and investment vehicles of all kinds that are hyped by the media and treated with deference by the regulators that are supposed to be keeping watch over it all. When they get into a dispute with the Street, they are caught in a system that is Dickensian without the cute English accents.

As Rand Groves and thousands of other people have learned, investors in trouble have no friends. Not Eliot Spitzer, the media phenom who chose his targets carefully—the Wall Street arbitration system being one of many glaring omissions—as he briefly breezed through Wall Street. They didn't have a friend in Arthur J. Levitt Jr., the SEC chairman during the Clinton administration. Levitt presided over the worst abuses to descend upon Wall Street since the 1920s. He failed miserably at dealing with the problems that he did not ignore entirely, but he did a couple of things better than just about any recent SEC chairman in history—give speeches, and court the press. As early as 1997, Levitt was already being hoisted on a pedestal as "one of the most powerful and effective SEC chairmen in memory," one who had cleaned up the OTC markets and rogue brokers—when in fact thievery was running rampant, unimpeded by Artie's SEC.*

The canonization of Arthur Levitt is just one example of the blunders the press makes, again and again, whenever Wall Street or its regulators are

* See footnote, page 168.

involved. Artie swept us off our feet. We all loved him. We still do. Who wouldn't? He looked like the rich, childless uncle we all wish we could have had. But the 1990s were on Artie's watch, and he blew it, big time, in just about every way you can imagine. One lasting legacy of Artie's SEC is something one of his top aides, a guy named Barry Barbash, did in 1997. That's when Enron got the exemption from the Investment Company Act that it needed in order to structure its operations in South America and Europe in a way that would conceal them from investors and shift debt off Enron's books. (A little detail Artie left out of his book. Remember that one? He should have called it *Take On the Street—I Sure As Hell Didn't.*)

At the conclusion of his term he was proclaimed as "The Investor's Champion"—quite literally; this was the title of a profile of Levitt that made the cover of *Business Week* in late 2000. A good example of the Levitt approach can be found in his immensely hyped fight with the accounting industry. As "The Investor's Champion" piece put it, "powerful auditor-consultants are the targets of Arthur Levitt's crusade." When the smoke cleared, it was a victory—for the powerful auditor-consultants. The central tenet of his reform plan, a ban on firms offering consulting services to audit clients, went out the window, replaced by a meaningless disclosure requirement. Under Levitt, his predecessors, and successors, the SEC devoted substantial portions of its limited energy and resources to wheel spinning, media spinning, and bureaucratic trivia, while completely ignoring, or acknowledging and then ignoring, such basic investor concerns as the grotesquely unfair securities arbitration system.

Whatever you may think of the media's coverage of Iraq or the government generally—well, toss it out the window when it comes to Wall Street and its regulators. The media are on board, very much a part of the team, albeit with a proregulation, inside-Beltway tilt. You might have read about how the business community got mad at all the "SEC activism" under Levitt's successor, William H. Donaldson, so that President Bush was moved to appoint a conservative, probusiness Republican named Christopher Cox to replace Donaldson. Wasn't Cox a bad guy and Donaldson and Levitt good guys (or the reverse, depending upon your political orientation)?

The answer is "none of the above." It didn't matter whether Cox was openly pro–Wall Street, as was Levitt's successor, Harvey Pitt, or talked a good game and did nothing in the Levitt tradition, or proposed meaningless reforms that crumbled upon closer examination, as was Donaldson's practice. When it comes to protecting your interests, each of these approaches is equally ineffective. As you read this book, try to put aside your political leanings. Leave your political baggage at the door. Keep in mind that when it comes to Wall Street, Democrats and Republicans, liberals and conservatives, have joined hands. The New York Stock Exchange's biggest defenders include the liberal New York congressional delegation, and both the left and the right have their advocates and friends within the hedge fund community. Together, putting aside all differences, the left and the right have seen to it that very little of what the SEC and the other regulators do has impact on you—except, when warranted, negatively.

You're not going to read about partisan politics in this book, because it doesn't matter, and you won't read about Enron in this book either. (My little bash-Barbash anecdote is about all I have to say on the subject.) That's not because Enron is history but because it is the kind of history that is not going to repeat itself. The WorldCom scandal, the father-son pillaging of Adelphia Communications, the Arthur Andersen accounting fiasco, the lying Internet analysts—they're all yesterday's problems. Enron will never rip off another investor. You can use Tyco's financial statements to paper the walls of an operating theater—they're that clean. John and Timothy Rigas, the father-and-son team that stole and lied at Adelphia, have been punished so decisively that I'm sure they'll be model citizens until the earth is shoveled over their coffins.

Scandals like those at Adelphia and Tyco can't hurt you. They're one-shot deals—"scores," as the crooks put it. It's the long-running sagas, the scandals of yesteryear that have a way of recurring, that should trouble you. They become today's scandals, and tomorrow's.

Another thing you won't be reading about much in this book is the solution that Congress whipped up to answer the corporate crime frenzy in 2002, the law known as Sarbanes-Oxley. You won't be reading about that law because it is simply a nonstarter when it comes to tackling the problems we'll be exploring in this book. "Sox" gives corporate officers some forms to fill out, some "independent directors" to hire who won't make a difference, and a requirement to beef up their "internal controls" that won't affect corporate behavior one bit. It is a lot of bureaucratic wheel spinning that is justifiably criticized by American corporations. It's like the nice mahogany coffin you buy your Aunt Martha because you didn't treat her right when she was alive. A nice gesture, but meaningless.

Nor am I going to waste your time by talking about things that hurt the Street but don't help or hurt you one bit, such as class-action lawsuits. I'll leave it to lawyers to tackle that open sore in the legal system, which has never meant a thing to investors and merely enriches a few wealthy attorneys. As you'll be seeing toward the end of this book, one prominent class-action lawyer is actually fighting *against* investor interests, by taking up the cudgels of a campaign against a phony nonscandal called naked short-selling. One of the criticisms of Cox was that he pushed a law that made it harder for investors to pursue class-action suits. Not true. The law made it harder for *lawyers* to pursue those suits. Investors are just bystanders. You shouldn't care about class-action suits one way or the other—but neither should you waste any tears over Wall Street having to fight them.

You won't be reading much about nuisances or irrelevancies, but you will be reading a lot about regulation. This is a subject that makes a lot of people's eyes glaze over, and that is why it needs attention. It is much too important to ignore.

The system of Wall Street self-policing known as "self-regulation" doesn't protect the public from Wall Street. It protects Wall Street from you. That is its job. You might even say that serving the Street is the self-regulatory system's role in the economic paradigm, if you adhere to what is known in the academic world as Capture Theory. That is a kind of unified field theory of how the government interacts with business, and it is widely (though not universally) embraced by economists and academicians. It holds that securities regulation, and other forms of governmental intervention in business, has been co-opted, or "captured," by the very people and institutions it is designed to regulate.

You don't have to believe in Capture Theory if you want to understand Wall Street, but it helps.

The self-regulatory system's shortcomings will be one of the recurrent motifs of this book, not because the SEC, the NASD, the stock markets, and their employees are in any way bad or corrupt or malevolent, but because preserving the status quo is their institutional role in the paradigm—a role regulators execute under Republican and Democratic administrations alike. Thus you'll find that I respectfully dissent from some of my colleagues who have painted a more upbeat picture of the Street's regulators, the SEC in particular, and Wall Street in general. Media coverage is mentioned a lot in this book because the financial press is not just an observer on the Street but a player—an essential participant. Often we "participate" by not participating—ignoring issues we should be covering—or by writing stories that are just plain dumb.

Speaking of which, on some issues that I've addressed in articles and commentaries over the years, readers with particularly good memories will note that I've changed my opinion somewhat. One area in which my thinking has evolved over the years relates to the solution to what you'll be reading about in this book. It is not more government, more regulation, more bureaucrats breathing down the necks of the markets. It is not more lawsuits, except for damages you have personally suffered. Neither is it the panacea of free markets advocated by some, not if "free markets" are defined by Wall Street.

The answer to the market's woes is you.

That's not just a figure of speech. You'll see in this book that the solution is *literally* you—your investment choices, your actions, and, above all, all the things that you shouldn't do.

Don't expect the business and financial press to help you by pointing out the real issues and by holding regulators to account. (See? I'm back to the press again, and it's only been four paragraphs.) Sure, the press exposed some of the major Wall Street calamities of recent years. However, the media was a conduit for the relentless hype that made those calamities possible—and are making future calamities possible by timidity and puffery, and by failing to expose regulatory fakery. We just haven't learned our lesson. Even after the major corporate blowups of 2001 and 2002, the media's love of hype—its predilection for "puff pieces" glorifying Wall Street and Corporate America—continued unchecked. By 2003 the press was churning out puff pieces as if nothing had happened, and would blithely do so in the years ahead. "Too many crooks in business, too many failed earnings reports, and too many investigations are taking their toll," said one commentator, who went on to observe in November 2003 that "editors and writers who spent the last two years apologizing for rogue companies they earlier canonized—and for CEOs who turned their firms into personal piggy banks—are now selling the next boom."

I'm not taking this from a rant in *Mother Jones* or the *Village Voice,* by the way. What you're seeing here is the verdict of *Across the Board,* a limited-circulation journal for the corporate elite. That's right. We in the media have become so sugary that even the intended beneficiaries are getting a toothache. Referring to a spectacularly wrong-headed *Fortune* puff piece on the soon-to-be ailing Krispy Kreme, *Across the Board* noted, "Credible advertising agencies wouldn't dare serve us that much saturated goo. But who needs expensive advertising when some reporters will provide it for free?"

By 2005 it was business as usual. *New York Times* media columnist David Carr observed in May 2005, in an article exploring the woes afflicting business publications, that "skeptical readers now reserve special distrust for the business press, which blew air into faux companies and created princes out of people who turned out to be frogs, and felonious ones at that." Carr was talking about the three major business magazines, but he could also have been talking about all of the major conduits for financial news, including the cable news channels, newspapers and wire services, financial columnists, and the obsequious Wall Street trade press.

It's not getting better. Bottom-line pressures make financial journalism even less willing, and able, to devote the resources needed to root out Wall Street's ills. Fear of libel suits continues to discourage hard-hitting reporting. So does the proregulation mentality that afflicts many journalists otherwise skeptical about government. What a lot of us ignore is that in many instances regulation just isn't the solution. All too often we find ourselves advancing the position that as long as regulations are passed, and they look nice, all will be well. That's the only possible explanation I can come up with for the really miserable coverage of Wall Street regulators.

When he was SEC chairman, Bill Donaldson—a "Rockefeller Republican," as the press admiringly called him when he quit in June 2005—milked the media's love affair with regulation almost as effectively as did the Democrat Levitt. When Donaldson irritated business lobbyists and sided with Democratic SEC commissioners who favored some of Donaldson's regulatory initiatives—well, that was that for the media. A hot-and-heavy romance ensued. Soon stories emerged that Donaldson was "warring with business interests" and "Republican commissioners"—the same kind of hagiography that infected the media during the Levitt era. The fact that some of the regulations Donaldson's SEC churned out ranged from weak to counterproductive—the hedge fund and mutual fund governance rules are examples of the latter—didn't matter because the media didn't notice. By the time he left his job, Donaldson was being rhapsodized almost as much as the ineffectual Levitt had been five years earlier.

Part of the problem is an unquestioning proregulation mindset that—to cite one obvious example—ignores whether it really matters if mutual fund board members are "independent" or not. What you're also seeing is a reflexive worship of money and power. This mindset became endemic in the 1990s, when the first hedge fund "Superinvestors" came on the scene, and many of us in the media wrote stories during that era that unduly glamorized some of the biggest players.

The media's love affair with power and money is scrupulously apolitical. The financial media are equal opportunity deifiers, putting the left-leaning mogul George Soros on a pedestal, downplaying his missteps, with just as much devotion as they do to his far more numerous conservative brethren. The common denominator is not ideology but color—Intaglio Green, the color of the cloth-pulp concoction that is Wall Street's only moral compass, only purpose and allegiance. Intaglio Green knows no ideology, no political party, no religion or race.

Wall Street's yen for your wallet afflicts with equal rapacity Republican and Democrat, liberal and conservative, Arab and Jew, anti- and proabortion, rich and middle class, and even a lot of people who think they're too poor to care. It doesn't matter if you view yourself as an investor or not. It doesn't matter whether you love or hate Wall Street or whether you own any stocks or bonds or money market funds. Chances are, Wall Street is a part of your life whether you like it or not, even if you keep your money in a passbook savings account or a tin box in the backyard.

Maybe you don't vote or pay taxes. Maybe you just don't care. If so, Wall Street loves you for that. Wall Street *doesn't want you to care.*

You can't turn back the clock to the days when only the rich were "in the market," and you wouldn't want to. In 1962, the Federal Reserve found that only about one-fifth of middle-class people, the Rand Groveses of that era (households with a net worth of $5,000 to $25,000, or about $30,000 to $150,000 today), were owners of stock. The figure for people who had a net worth of more than $100,000 (about $600,000 today) was 79 percent. Those people owned 90 percent of the shares in American companies.

According to the most recent figures, which are from 2002, the picture has changed dramatically. Counting stock held by mutual funds, about half of all households own stock. Mutual funds, pension funds, 401(k) plans, and so on, consisting mostly of your money held in trust, have long since become the biggest players on the Street.

So you own the Street and you own Corporate America, in theory. That gives you enormous power, in theory. The reason all this power is theoretical, the reason you're not exercising it, is that you don't know you have that power. You also have no choice.

You have a relationship with Wall Street whether you like it or not—and it's not working out.