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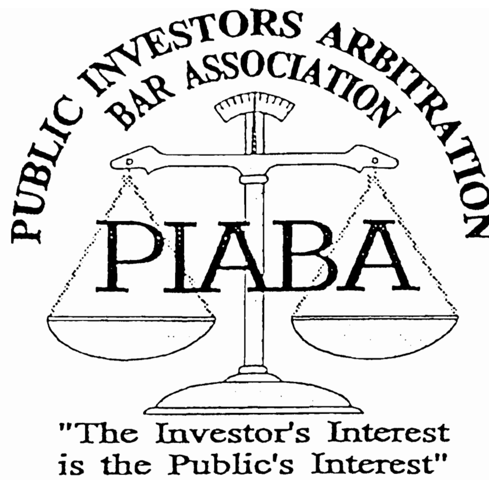

"The Investor's Interest is the Public's Interest"

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COMMENTS OF THE
PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION
TO THE PROPOSAL OF THE NASD
TO INCREASE THE FEES IT CHARGES
TO PUBLIC INVESTORS FILING FOR ARBITRATION

EXECUTIVE SUMMARY

This comment is submitted on behalf of the Public Investor's Arbitration Bar Association ("PIABA"). The Comment is directed at the NASD's proposal to raise the fees it charges public investors for the filing and hearing of arbitration claims.

PIABA believes that the proposed increase in fees is unfair to investors, and that it should be rejected by the Commission. An increase in arbitration fees, which are already significantly higher than the cost of filing a case in the courts, will deter investors from seeking access to justice. Such deterrence is especially unwise in light of recent experiences, including but not limited (a) to cut-backs in enforcement budgets at the SEC and state regulatory agencies; (b) the revelations by the Rudman Commission that the NASD does a weak job of enforcement and policing of the securities industry; and (c) the NASD's recent policy shift requiring parties to arbitration to pay anticipated hearing session and arbitrator fees in advance of the hearing.

PIABA believes that if the securities industry, acting through self-regulatory organizations such as the NASD, wishes to maintain its monopoly over the adjudication of customer disputes, it must be prepared to fund the system adequately, i.e. in a way that makes arbitration an "adequate substitute" for courthouse litigation.[1]

The fee structure proposed by the NASD will make arbitration so costly that investors will be deterred from bringing small and modest-sized cases. The SEC should therefore decline to approve the NASD's proposal to increase its arbitration fees.

INTEREST OF PIABA

PIABA was formed in 1990 as a professional association of attorneys who represent public investors in arbitration against securities firms. PIABA has 251 members from 40 states plus the District of Columbia and Puerto Rico. It conducts educational seminars for its members; advocates protection lobbies for investor rights; writes briefs as amicus curiae in significant cases on behalf of investors; and generally provides a vehicle for attorneys to share knowledge and information to enhance the representation of aggrieved investors. PIABA is recognized by the NASD, the Securities Industry Association, the North American Securities Administration Association, Inc., as well as the Commission, as an advocate for investor rights, and it is frequently consulted on significant issues affecting the adjudication of investor disputes. Its avowed purpose, since its formation is to create a "level playing field" for investors involved in securities arbitration.

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[1] PIABA wishes to draw the Commission's attention to the fact that the principal basis for the Supreme Court's decision in Shearson v. McMahon was that arbitration provided investors with an "adequate substitute" for resolving disputes in court. Indeed, the Commission's amicus curiae brief was, similarly, based on that premise. PIABA believes that arbitration fees rise, the premise on which McMahon was based may no longer apply.

COMMENT

PIABA opposes any increase in arbitration fees charged to public investors. PIABA's opposition is based upon a belief that arbitration is already too costly for investors, and that any increase in those fees would be grossly unfair to investors.

A. THE CURRENT FEE STRUCTURE - TOO MUCH ALREADY

When a case is commenced at the NASD, the investor must pay a filing fee. The size of the fee depends upon the amount being sought as damages. The fee has two components: a "filing fee" and a "hearing session deposit". For all but the smallest of cases, this initial fee is higher than the cost of filing a case in court; for a case between $50,000 and $100,000, it is several times the cost of filing a case in federal court. Of course, most investors cannot go to court because members of the securities industry almost universally require that all their public customers agree to SRO arbitration as a condition of conducting business at the firm.

Until last month, except in the most unusual of cases, this initial filing fee was all the investor was required to pay prior to the hearing on the matter. The NASD would keep track of the number of hearing sessions held, and, at the conclusion of the case, the arbitrators' award would include an assessment of these fees. Additionally, until recently, arbitrators usually assessed all the fees against the industry participant. This was almost universally true in cases where the investor prevailed. But even in cases where the investor had not been successful, the arbitrators often assessed the balance of the fees against the industry member. It was a rare event, indeed, when additional fees were assessed against the public investor.

B. RECENT CHANGES IN ARBITRAL PRACTICE - NASD POLICY CHANGES EFFECTED WITHOUT SEC APPROVAL

Even though the NASD made no formal announcement of changes, PIABA members have noticed major shifts in the above-described NASD policies and practices. The first shift was in the way arbitrators assess arbitral fees at the close of a case. Over the last two years, it has become common that the arbitrators split

arbitral fees between the investor and the firm, even in cases where the investor received a substantial recovery. Members have also noticed a tendency of arbitrators to assess against the investor of all of the arbitration fees in cases where the investor lost or received only a nominal recovery.[2]

PIABA believes that this change in fee assessment practices was precipitated by the NASD as part of their arbitrator training program. PIABA believes that the practice will deter investors from bringing modest-sized claims, much in the same way that the English policy known as "taxation of costs" deters consumers in Great Britain from taking legal action for injuries suffered by them. PIABA believes that such deterrence is "un-American", and that the NASD should not be permitted to increase that level of deterrence by increasing its arbitration fees.

PIABA is even more disturbed about the NASD's recent implementation of a policy requiring investors to pay, in advance, half the anticipated costs of an arbitration. As has been noted recently in the news media, this advance payment can amount to thousands of dollars even in cases of a modest size.

Notably, the NASD has even stated that it will not refund these monies if the case settles on the eve of the hearing, i.e. less than eight (8) business days before the first scheduled date. Needless to say, such action is unfair, not only because it provides a windfall to the NASD (which will keep the money even

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[2] This change in fee assessment can have the effect of acting as a sanction for bringing losing cases. In most courts, a party can be assessed a sanction for bringing a "frivolous" case, but not all losing cases are "frivolous". Yet the new NASD practice has just such a "sanctioning" effect.

This effect can be particularly pernicious in an adjudication system with limited discovery. There are no depositions in arbitrations. As a result,unlike a similar case in court, it is difficult for an investor in arbitration to assess the totality of his/her proof prior to a hearing. The fact that the investor did not prevail does not mean that a "sanction" is appropriate. Yet the assessment of arbitrator fees, which can amount to thousands of dollars even in small cases, can have just that effect.

though it will not have to pay the arbitrators for the hearing), but also because it will coerce settlement, especially in cases where the investor has lost a significant percentage of his/her life savings.[3]

The NASD defends its change of policy as necessary to help it close a budget gap in its arbitration department. PIABA acknowledges the existence of the budget gap, but finds it unfair for the NASD to balance its budgets by charging (if not penalizing) investors for seeking access to justice. Simply put, if the NASD, whose members <u>insist</u> on arbitration and <u>consist</u> of some of the wealthiest firms in the world, wish to continue their monopoly of the adjudication of customer disputes (because it clearly serves <u>their</u> interests), they are the ones who should pay the costs.

PIABA is especially concerned that the NASD has effected these subtle yet significant changes in the assessment of arbitral fees without public notice and comment. The NASD seeks to defend its practices by (a) denying that its training materials encourage arbitrators to act as described above, even though the NASD's own training manual specifically suggests that fees be requested in advanced and shared equally by the parties.[4] PIABA believes that

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[3] The NASD prefers to characterize this effect as "encouraging settlement", but the characterization is inappropriate. Settlement is "coerced", not "encouraged", when the NASD places an economic gun to the head of an aggrieved investor who is told he must pay (or, at best, post the equivalent of a bond) in order to gain access to a neutral decision-maker. Under such circumstances, it cannot be said that arbitration is an "adequate substitute" for litigation, or that the NASD is justly "encouraging settlement".

Indeed, under this system, a securities firm can coerce settlement by requesting numerous hearing dates, thus raising to intolerable levels the "ante" for the investor. Simply put, because the securities firm is in a better position to advance (and ultimately pay) arbitration fees, the effect of the NASD's approach to fee assessment is that it disadvantages investors.

[4] The November 1996 NASD Arbitrator Training Course Participation Guide, pp. 189-90 states:

the NASD changes of policy were sufficiently important that they should have been subjected to public notice and comment. PIABA urges the Commission to reject the current fee increases at least until the NASD restores its prior fee assessment policies.

"The total fees you'll assess the parties are based upon the number of daily sessions needed to complete the hearing. A hearing session includes any meeting with an arbitrator that lasts four hours or less.

For Example, a hearing that runs two days - eight hours each day - is subject to four hearing session fees.

If a hearing is scheduled for four or more days, or if you determine that a hearing will require more days than are presently scheduled, you might consider requesting deposits of additional hearing session fees by the parties in equal amounts...(emphasis is NASD's).

"Now that you know how to determine the amount of hearing fees, let's review how you'll assess them among the parties.

In many cases, you'll divide forum fees equally. If each of the parties had legitimate arguments at the hearing, an equal distribution of fees is probably fair...(emphasis added).

"Some parties may be surprised when you assess them hearing fees. To better prepare them, don't assume the parties - particularly pro se parties - are familiar with the fees they may be incurring. Remind them periodically of the fees being accrued.

Requesting additional hearing session deposits is one method of alerting parties to the fees. The parties may elect to use their time more wisely after the panel requests additional deposits."

C. THE NEW FEE STRUCTURE - ADDING INSULT TO INJURY

The NASD now proposes dramatic increases in its fee schedules charged to investors. These fee changes, if put into effect, will further deter investors from filing arbitration claims. The increases will be devastating for cases under $100,000, as risk-reward ratios (comparing the need to pay arbitration costs as well as attorneys fees with the probability of recovery, including the tendency of arbitrators to make "compromise" awards), militate more and more against bringing cases.

If fees are increased, investors of modest means, especially those who have lost significant amounts of irreplaceable funds, will be even more hesitant than they are now to make the payments necessary to commence, and then prosecute, a case against a securities firm. The increased fee structure may cause investors to scale back the size of their damage claims as a way to reduce filing costs, thus creating another deterrent to seeking access to justice.[5]

In January 1996, the NASD's specially-appointed Arbitration Policy Task Force, chaired by former SEC Commissioner David Ruder, issued its recommendations on securities arbitration at the NASD ("the Ruder Commission Report"). The Commission recommended, inter alia, that arbitrator compensation be increased, that arbitrator training be improved, that mediation be encouraged, and that the number of administrative personnel be enlarged. Clearly, all of these improvements would cost money. On the issue of finance, the Ruder Commission thus recommended that the arbitration department of the NASD "receive whatever resources are necessary to manage caseload growth and to implement the recommendations in this Report." Ruder Commission Report, at p.143.

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[5] Additionally, investors will be deterred from making claims for punitive damages because of the added cost of making such a claim. While such a result would no doubt be well-received among securities firms, PIABA believes that punitive damages plays an important role in securities fraud cases, that they act as an important deterrent to securities law violations and encourage the just settlement of disputes. It is, therefore, unwise to deter investors from making such claims by charging exorbitant fees for making punitive damages claims.

The Ruder Report then went into the issue of fees. It recommended that "increased expenditures for NASD arbitration be borne primarily by the NASD and its member firms." Ruder Report, at p.144. While the Ruder Commission stopped short of recommending that all increased costs be borne by members, it did state that investors should not be required to "bear more than a relatively small amount in increased fees to cover the additional expenses." Id.

The NASD proposal defies this recommendation. It seeks to balance the NASD arbitration department budget by increasing arbitration fees dramatically, not minimally. The NASD's own numbers also show that the fee increases involve more than simply "cover[ing] additional expenses". The increases are designed to close a **budget gap that is not directly related to additional expenses stemming from implementation of the Ruder Commission recommendations.**

The NASD proposes that investor and member fees increase in approximately the same proportion that they (now) bear to each other. A proportionate increase, in this case, is simply not the "relatively small percentage" that Ruder recommended. It is a significant percentage; more importantly, it significant in terms of gross dollars. As the Ruder Commission noted, NASD member firms receive substantial benefits in time and reduced expenses as a result of arbitration, and member firms have promoted predispute arbitration agreements to the point where they are virtually universal. As a result thereof, it concluded that it is not "unreasonable to ask member firms to bear the primary cost of expanding and improving the NASD's dispute resolution program." Id. The NASD has not done so, and its proposal should be rejected for that reason.[6]

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[6] The NASD has tried to justify its fee increases by pointing, inter alia, to the costs of arbitrator training. PIABA believes that training is a prime example of the type of cost that should be born exclusively by the NASD and its members. The fixed costs of running the securities industry's adjudication system should be paid by the proponents of that system, who benefit from it with regularity.

Individual investors, by comparison, derive benefit only when they use the arbitration system, an event which is

CONCLUSION

PIABA believes that fees and fairness are related. The great hallmark of the justice system in the United States is that is open to all. Access to justice is neither denied nor discouraged. As a result, the system assures both equality and fairness. For this reason, legislation in Congress attempting to tax litigation costs against the loser has failed repeatedly. In doing so, Congress has expressed its opinion that the courts are open to all who are aggrieved, and that no deterrent should be placed before a litigant seeking justice in our courts. The same should be true of an arbitration system which the Supreme Court in McMahon described as an adequate substitute for litigation in court.

The NASD's fee proposal, especially when it is viewed through the prism of the recent NASD changes in fee assessment policy, is both unfair and unwise. It defies common sense, contravenes Ruder, and makes arbitration less than "adequate" as a substitute for litigation. PIABA respectfully urges the Commission to reject it.

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likely to occur no more than once in any investor's lifetime. It is unfair to require these investors to pay proportionally more to support the institution; by contrast, it is eminently fair to require that industry members bear that burden.