

SECURITIES ARBITRATION COMMENTATOR

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2006 AWARDS SURVEY

Checking Award Results by year is a process we began with the 2005 Awards and which we now continue for this past year. For purposes of comparison and context, we examine the Award results in 2006 by comparing those results to the earlier six-year period, 2000-2005..... **1**

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For the last half of 2007, SAC is making its weekly e-mail alert service available to all SAC subscribers. We believe nearly everyone is receiving the weekly Arb Alerts, but a few remain who are not. If you are not now receiving the Arb Alert, please e-mail your address to us at msims@sacarbitration.com. This is a great freebie - don't miss it! Ends 1/1/08.

2006 Annual Award Survey

A SAC Award Survey Comparing Results in 2006 to 2000-2005

Introduction & Background

One of the advantages that inures to an arbitration forum, such as NASD (nka FINRA) Dispute Resolution, when a drop-off in new volume occurs, is the opportunity to catch up on case administration. Year after year since 2000, the number of cases filed with NASD exceeded the number of cases NASD was able to process and conclude. This meant a growing and increasingly cumbersome docket. In 2004, though, the tide began to turn and close-out figures began to surpass new filings – outflow for the first time in many years exceeded inflow.

For the past few years, NASD has been able to reduce its docket during a breather in case filings that turned long-term and, ultimately, the arbitration forum has returned to a less burdened state. In a period of three years between 2004-2006, NASD was able to reduce its open docket by about 6,600 cases. A higher settlement rate than was historically the case made this surge in close-outs possible, but more cases have been decided by arbitrators, too. We noted this fact in SAC's Annual Survey of the 2005 Awards (2006 SAC 07 & 08), where we reported that customer-initiated Awards, for instance, had climbed from 1,288 Awards issued in calendar year 2000 to 2,222 Awards issued in 2004.

2004 was the high point, however. As the securities arbitration forums' dockets began to return to more manageable levels, fewer cases could be easily readied for hearing and far more of the cases on the docket were relatively new cases – i.e., not ready for hearing. Thus, we noted in the 2005

Annual Survey, the number of customer-initiated Awards dropped to 1,828 from 2,222 in 2004. As the decline in new case volume moves into its fourth year and new filings drop to a level not seen since the 1980s, efficiency morphs into overcapacity and, despite ample resources, the drop-off in new filings now precipitates a slowdown in the close-out pipeline.

Methodology & Caveats

We generally exclude Stipulated Awards from our Survey numbers. We followed this protocol when we analyzed the figures for SAC's 2005 Annual Survey, so we continued the practice for reasons of consistency and accuracy. Stipulated Awards are not the product of arbitral decision, but of negotiations between the parties that are memorialized in an Award in order to secure one or another aspect of the settlement agreement. In the 1990's, Stipulated Awards were not a large segment of the Award population and, as a consequence, we did not exclude them in performing our Surveys.

In the periods we are now surveying, Stipulated Awards have assumed a much larger presence among the total Award population, primarily due to the expungement relief phenomenon. In 2005, which is probably the peak year for expungement orders, Stipulated Awards accounted for almost 40% of all Customer-Member Awards. We had to exclude Stipulated Awards, because including them would skew results dramatically when calculating "win" rates and "recovery" rates for investors.

cont'd on page 2

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Some thoughts on settlements generally – NASD and the other SRO arbitration forums do not make public specific information about settlements between parties, so we cannot report any statistics regarding the results in those disputes or the size of the recoveries. We can report that in recent years settlements have assumed a much larger presence among closed cases. In the mid-90s, settlements constituted fewer than 50% of the cases closed, while they comprise about 70% of closed cases currently.

We need to express two caveats about settlements. As the great majority of settlements involve investor-Claimants receiving some monetary incentive to resolve their claims, it must be acknowledged that winning a favorable decision from the arbitrators – a matter we can survey – is not the only way in which an investor-Claimant can obtain satisfaction. In fact, in most cases, she does so through settlement. Secondly, the lack of adequate data about settlements means that we cannot represent that the trends and results disclosed in this Survey extend to case dispositions as a whole.

CHART 1 – TOTALS, TYPES & TALLIES

Customer-Initiated Awards

In this 2006 Award Survey, the number of customer-initiated Awards that issued during the year dropped back in a single year to pre-2000 levels. As Chart I, “Award Volume, Distribution & Win Rates” reflects, only 1,122 customer-initiated Awards issued during 2006. The number of Small Claims Awards declined more rapidly than the number of larger cases

(Customer-Member, over \$25K) decided by arbitrators. 622 Small Claims Awards issued in 2004, or 29% of all customer-initiated Awards, whereas in 2006, only 180 Awards, or 16% of the whole, dealt with Small Claims investors.

Chart 1 also discloses “win” rates for customers, the number of Awards in which a customer was granted some monetary damages compared to the total number of customer-initiated Awards. That “win” rate appears in the middle column of Chart 1; in 2006, we calculated a 40% “win” rate for customers pursuing recoveries. That “win” rate is the lowest among all of the years shown and it compares with a high-water-mark “win” rate of 53% in 2001. There is an 8-point difference between the Customer-Member “win” rate for 2006 (42%) versus the “win rate” for “All Years Combined” (50%, 2000-2006) and a seven-point difference between the Small Claims “win” rate in 2006 (32%) and the corresponding “win” rate for “All Years Combined” (39%).

The disparity in “win” rates between customers pursuing larger-dollar claims and those utilizing the streamlined Small Claims procedures is pretty glaring (C/M: 42% vs. S/C: 32% in 2006). We had no immediate explanation for that striking disparity, so we delved further by developing a separate statistical chart devoted specifically to Small Claims Awards (Chart 2); review of that analysis appears below. For now, we simply note that the 32% “win” rate in 2006 is the lowest we have tabulated for the

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Chart 1 Award Volume, Distribution & Win Rates By Type of Dispute & Year (2000-2006)					
Year	CustomerMember <u>Wins/All (#)</u> Win Rate (%)	SmallClaims <u>Wins/All (#)</u> Win Rate (%)	All Cust. Wins	MemberEmployee <u>Wins/All (#)</u> Win Rate (%)	EmployeeMember <u>Wins/All (#)</u> Win Rate (%)
2000	527/956 (55%)	148/332 (46%)	52%	103/117 (88%)	81/151 (54%)
2001	561/1026 (55%)	126/274 (46%)	53%	105/128 (82%)	96/147 (65%)
2002	690/1304 (53%)	108/283 (38%)	50%	192/220 (87%)	99/172 (58%)
2003	704/1422 (50%)	148/319 (46%)	49%	186/220 (85%)	106/188 (56%)
2004	793/1600 (50%)	213/622 (34%)	45%	209/238 (89%)	107/206 (52%)
2005	616/1356 (45%)	169/472 (36%)	43%	242/273 (89%)	101/193 (52%)
2006	395/942 (42%)	57/180 (32%)	40%	189/229 (83%)	103/178 (58%)
All Years Combined	4286/8606 (50%)	969/2482 (39%)		1226/1425 (86%)	693/1235 (56%)

Notes to Chart:

1. Stipulated Awards are excluded from the numbers.
2. "CustomerMember" Awards describe disputes by complaining customers that involve \$25,001 or more, while "SmallClaims" Awards identify disputes by complaining customers that involve \$25,000 or less.
2. The term "Wins" signifies a "win" for the Claimant. Any monetary award in favor of the Claimant is counted as a "win."
3. The "win rate" is determined by dividing the number of Awards that are "wins" into the total number of Awards that issued in that category of dispute and year.
4. The four types of dispute reflected in this Chart represent the great majority, but not all, of the Awards that issued during each of the given years. Other dispute categories include CustomerEmployee, MemberMember and NonMember Member.
5. The "All Cust. Wins" column combines the results in the "CustomerMember" and "Small Claims" columns to arrive at a "win rate" for all customer Claimants. The "win rates" for all years, 2000-2006, combined are calculated by adding together all of "wins" and dividing the sum into the sum of all Awards in that category.

small investor since SAC began compiling Award statistics in 1988.

Industry-Initiated Awards

With respect to intra-industry disputes, the output of SRO Awards

has remained relatively stable during the past five years. The number of Awards involving brokerage houses suing brokers fluctuated within a range of 220-273 Member-Employee Awards during the Survey years, with

229 such Awards issuing in 2006. Similarly, the number of employee-initiated cases decided in the past five years fluctuated within a fairly narrow range of 172-206 Employee-Member
cont'd on page 4

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Awards, with 178 such Awards issuing in 2006. As a result of their relatively stable inflow, industry-initiated Awards have become a larger percentage of all decided cases in recent years.

In 2004, the percentage of industry-initiated Awards among all decided cases was 17% (444/2666), whereas in 2006, the percentage of industry-initiated Awards rose to 27% of the whole (407/1529). Thus, industry-related matters have become a larger part of the NASD docket, but the reason relates to stable filing numbers, not real growth in the category. Looking at the Industry side of Chart 1 also supports the conclusion that “win” rates have not changed very much over the years. The range of victories for suing broker-dealers in Member-Employee cases meanders between 82-89% over the Survey years and reveals no particular trendline. For 2006, the “win” rate is 83%.

Member-Employee Awards enjoy a “win” rate that customer-claimants would relish, but the high rate of victories (and recoveries) is no doubt due to the contractual nature of the disputes. These are generally bad-debt collection cases, where the broker leaves the firm owing money on an advance compensation agreement or other promissory note. Employee-Member cases, on the other hand, are more of a mix of compensation contract cases and tort claims for wrongful termination, discrimination, defamation or other inequitable treatment in the relationship between employer and employee.

Employee-Member Awards often involve highly-charged and acrimonious disputes. Claims frequently run into the millions, recoveries are (as a consequence of often exaggerated claims) relatively low, but “win” rates generally favor the broker. The incidence of victories for the employee-claimant remained quite stable throughout the Survey years, between 52%-65%, with a 56% average for the full period and a 58% “win” rate in 2006.

**CHART 2 – SMALL CLAIMS:
PAPERS OR PRO SES**

Background

The disputes that comprise the content of Small Claims cases are often different in respects from the larger-dollar customer claims. In particular, Small Claims are more commonly single-issue claims relating to one stock loss or a point-in-time incident with the broker. Claim amounts are restricted by the upper ceiling for Small Claims eligibility of \$25,000 and client sophistication and high net worth are less frequently an element of the defense.

In the past, we have found, in very general terms, that Small Claims investors prevail less frequently than those pressing larger claims, but are likely to recover a greater percentage of their claims (*see, e.g.*, 8 SAC 2, “Public Customer Award Survey”) – i.e., a lower “win” rate, but higher “recovery” rate. While the reasons are open to speculation, our own conjecture has generally been that these statistical outcomes relate to the fact that Customer-Member Awards tend to involve a number of grievances and an aggregation of losses. Accordingly, the investor-Claimant in those cases will more likely hit one home run, but, contrariwise, collect only some of his/her losses.

While “win” rates for Small Claims Awards may have been lower historically, the gap in “win” rates in comparison with the larger-dollar claims was not nearly as great as it has been in recent years. A “win” rate of 32% does not encourage Small Claims investors to take the time and effort to file claims. Indeed, statistics released by SICA indicate that, as a percentage of the whole, Small Claims investors are a dwindling lot. Despite the expansion of the Small Claims program from a top claim of \$10,000 to \$25,000 in the late 1990’s, fewer than 10% of the claims filed with NASD have been Small Claims in the new Millennium, versus the 1990s, when the norm was closer to 15-20% of the whole.

It also seems as though Small Claims disputes settle less easily. Two hypotheses that could explain why the Small Claims procedures perform so poorly for small investors postulate: (1) that Small Claims Claimants are less likely to be represented by counsel; or (2) that, by choosing not to invoke their right to a merits hearing, Small Claims Claimants relinquish a tactical advantage to their brokerage firm opponents. In the first instance, the underlying assumption holds that parties do better when represented and, in the second instance, the underlying assumption holds that appearance at a merits hearing brings into play several factors (hometown effect; personal dynamics; arbitrator assists, etc.) that favor the Small Claims Claimant. Chart 2 tests these two hypotheses and, for the most part, deflates them as contributing factors in the “win” rate decline.

Small Claims Claimants demanding a merits hearing before the Arbitrators won monetary relief in only 26% of the submitted cases in 2006, while those who accepted the default method and submitted their case to the sole Arbitrator on the basis of documentary evidence and without a face-to-face hearing scored a 34% “win” rate! Doing worse by going to hearing instead of proceeding “on the papers” is not the norm for the small investor-Claimant. In only one previous year (2002) in the Survey period did the merits hearing group win a lower percentage of the Awards than did the “on the papers” group – and, in that year, the differential was only 1%, not 8%.

Customer-investors using the Small Claims procedures seem to opt for hearing avoidance and select the “on the papers” choice. That phenomenon has been true over time, as the middle column in Chart 2 validates. In 2000, the hearing option was selected only 13% of the time and in 2006, the same percentage holds. This may be credited to the fact that the

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Chart 2 Small Claims Awards (SCA) “Win” Rates By Presentation & Representation (2000-2005)						
Year	Merits Hearing Wins/All (#) Win Rate (%)	On the Papers Wins/All (#) Win Rate (%)	MH v. All SCA⁴	Cs Pro Se Wins/All (#) Win Rate (%)	Cs w/ Counsel Wins/All (#) Win Rate (%)	Pro Se v. All SCA⁵
2000	20/43 (47%)	128/289 (44%)	13%	122/277 (44%)	26/55 (47%)	83%
2001	22/47 (47%)	104/227 (46%)	17%	79/188 (42%)	47/86 (55%)	68%
2002	11/30 (37%)	97/253 (38%)	11%	64/162 (40%)	44/121 (36%)	57%
2003	38/63 (60%)	110/256 (43%)	20%	88/193 (46%)	60/126 (48%)	61%
2004	30/62 (48%)	183/560 (33%)	10%	67/182 (37%)	146/440 (33%)	29%
2005	17/44 (39%)	152/428 (36%)	9%	47/134 (35%)	122/338 (36%)	28%
2006	13/50 (26%)	44/130 (34%)	13%	28/101 (28%)	29/79 (37%)	49%
All Years Combined	127/289 (44%)	774/2013 (38%)	13%	467/1136 (41%)	445/1166 (38%)	49%

Notes to Chart:

1. Stipulated Awards are excluded from the numbers.
2. The term “Wins” signifies a “win” for the Claimant. Any monetary award in favor of the Claimant is counted as a “win.”
3. The “win rate” is determined by dividing the number of Awards that are “wins” into the total number of Awards that issued in that category of dispute and year.
4. The “MH v. All SCA” column presents percentages for each year that represent the ratio between those Small Claims Awards (SCA) in which an oral hearing was conducted and the total number of SCAs.
5. The “Pro Se v. All SCA” column presents percentages for each year that represent the ratio between those Small Claims Awards (SCA) that are handled by customers without counsel (pro se) and the total number of SCAs.
6. Of the 13 Claimants who opted for a merits hearing and won, seven of them represented themselves and six were represented by counsel.

procedures make “on the papers” the default option. It could also be that brokerage houses settle far more frequently when the Claimant opts for a hearing and a fight to Award than when the claim moves forward “on the papers.” Of course, settled cases are not reported, so we cannot test that thought; if true, though, it might explain

the surprisingly poor performance among the merits hearing Awards.

We can relate that, when Claimant’s counsel were involved, which was about half the time in 2006, the choice to forego a merits hearing was far more likely. Counsel

representing the customer-Claimant were present in fewer than a third of the merits hearing cases. Did that explain the lower “win” rate in merits hearings? Perhaps, Small Claims Claimants did do worse on their own in 2006, as the right side of Chart 2

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indicates (28% “win” rate” versus 37% with counsel), but it does not explain why customers are doing so badly overall in the Small Claims category. In fact, as Chart 2 also shows, the trend towards representation has increased since 2000, when 83% of the Small Claims Awards were prosecuted by pro se Claimants.

Can we blame the “research analyst” cases, which, as a genre of

claims, produced a relatively dismal “win” rate? These “analyst” cases dominated the Small Claims picture last year, when we performed our 2005 Award Survey, but there were fewer than a dozen this year among the 180 Small Claims Awards. We thought perhaps there were clues among the single Arbitrators, but we found that they were generally experienced (there were a couple for whom this was a training ground) and, among all the arbitrators assigned to decided Small

Claims cases, not one was a repeat. In other words, we found no arbitrators who decided a Small Claims Arbitration more than once in 2006!

CHART 3 – RATING RECOVERY RATES

Low on hypotheses for explaining the anomaly of ultra-low “win” rates for Small Claims customers, we moved on to the larger-dollar claims – the Customer-Member Awards – and examined recovery rates in Chart 3.

Chart 3 Recovery Rates: CustomerMember Awards 2000-2006					
Range of Compensatory Claims: \$25,001 to \$1 million					
Year	Avg Recovery (%)	Median Recovery (%)			
	Avg Award/ Avg Clmd Comp (\$)	Median Award/Median Comp Clmd (\$)			
		All C/M Awards	Florida	New York	California
2000	\$155.8/\$211.3 74%	\$56.0/\$120.0 47%	\$73.5/\$142.0 52%	\$39.2/\$80.0 49%	\$58.0/\$129.7 45%
2001	\$133.1/\$228.0 58%	\$55.9/\$125.0 45%	\$50.0/\$126.4 40%	\$50.0/\$135.9 37%	\$77.0/\$144.7 53%
2002	\$120.7/\$244.4 49%	\$54.2/\$154.0 35%	\$68.4/\$180.0 38%	\$47.2/\$150.0 31%	\$55.4/\$117.5 47%
2003	\$135.5/\$290.7 47%	\$69.8/\$204.4 34%	\$85.0/\$200.0 43%	\$56.5/\$220.0 26%	\$110.4/\$216.0 51%
2004	\$129.0/\$307.4 42%	\$71.3/\$224.0 32%	\$54.6/\$220.0 25%	\$58.9/\$256.3 23%	\$99.3/\$288.0 34%
2005	\$129.9/\$299.6 43%	\$72.0/\$208.9 34%	\$81.9/\$191.0 43%	\$70.0/\$245.4 29%	\$55.0/\$200.0 28%
2006	\$153.1/279.0 54%	\$67.1/\$197.1 34%	\$50.0/\$152.1 33%	\$67.1/\$147.0 46%	\$58.6/\$124.0 47%

Notes to Chart:

1. Stipulated Awards are excluded from the numbers. Counterclaim awards are not considered in this Chart.
2. \$000s are omitted in expressing all dollar figures.
3. Average recoveries are determined by aggregating the amounts awarded in each case and the compensatory claims in each case and determining the average of each by dividing by the number of Awards.
4. Median recoveries are determined by listing all Awards in dollar order, first, by total amount awarded and finding the middle value, and, second, by compensatory claim and finding the middle value. Those aggregate results are then divided by the number of Awards.
5. Awards reflecting more than \$1 million in compensatory claims were deliberately omitted from this Survey, to minimize the skewing effect of potentially grossly inflated claim amounts and to develop suitable recovery rates for year-to-year comparisons.

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Award recovery rates have become a controversial statistic. Claimants' team, lawyer Daniel Solin and expert Edward O'Neill, published a study this year that questioned the usefulness of the traditional recovery rate calculation – amounts awarded over compensatory amounts claimed in winning cases – and adopted a new calculation, expected recovery rate, that also factors in the customer's chances of winning. NASD complained that the Solin-O'Neill Survey did not consider the presumably satisfactory outcomes for those 70% who settled. NASD also described the highly unreliable nature of the claim amounts it publishes in its Awards and implied that determining recovery rates was a problematic, if not useless, pursuit.

The problem is, people want quantifiable data on the chances not only that the Claimant will prevail, but, if she prevails, what she will recover of that which she lost. Mediations and direct negotiations are heavily influenced by counsels' predictions about their chances of success. Experienced counsel may be informed by their own personal observations, but statistical information about recoveries helps validate that empirical evidence and provides a base point for dialogue. Inexperienced counsel – most usually the Claimant's lawyer – would be particularly disadvantaged by the absence of such data. The act of making claim amount information more reliable only requires the will of the forum to assist its parties.

In a bow to the controversy, we arranged Chart 3 to express recovery rates in two forms: as an average, which considers the aggregate dollars awarded and claimed, and as a median, which sorts the sample by awarded amount and chooses the figure in the middle and then re-sorts by claim amount and chooses the figure in the middle. Average recovery rates are most reliable when the sample is quite large, since outsized awards or exaggerated claims have a skewing

effect. To dampen the effect of exaggerated claims, we included in our survey sample only those Awards with a compensatory claim amount of \$1 million or less. We only calculated a median recovery rate for the three situs states in our Survey – in view of the smaller samples – and we limited the Survey states to the three states with the most Awards.

Average recoveries in Customer-Member Awards involving claims between \$25,001 and \$1 million returned to higher levels in 2006. The average recovery rate of 54% achieved in 2006 reflected a rebound from the historically low levels of 2004 and 2005. It was still lower than the surprisingly high 74% recovery rate for Customer-Member Awards that was recorded in 2000, but, overall, well above the norm for the remaining Survey years. The median recovery rate of 34% for 2006 matches the rates of the past four years, when recovery percentages first began to decline. Note that the median amounts awarded have not come down – quite the opposite – but the median amounts claimed have grown by 50% and more.

We were particularly interested in the results for the three States with the most Customer-Member Awards. New York State Awards have regularly posted a low recovery rate relative to the other popular hearing situs. One can see that result in the tallies for 2001-2005 and, especially, for 2003. New York recovery rates have been so low, relative to other states, that at least one Claimant's attorney has used our statistics in court to argue against having to arbitrate in the State. Long Island's daily, *Newsday*, has published articles decrying the low New York rate and the Attorney General's office even opened an inquiry a few years ago.

In 2006, New York's median recovery rate of 46% rose 17 percentage points over the results in 2005 and stood well above the median recovery rate of 34% for all states. California beat New York and it, too,

recovered from a low reading in 2005, but, with that exception, California has consistently approximated or beat the median recovery rate reading for all states. Florida has generally displayed relatively high median recovery rates, too, but in more erratic fashion. Still, 2006 is the only year among the Survey years when Florida's showing is lower than New York's. Unlike the national recovery score, Florida's decline in 2006 seems attributable more to a lower median award amount than to an inflated median claim amount.

CHART 4 – EMPLOYEE WINS & RECOVERIES

Employee-Member Awards have maintained a steady path during the seven-year Survey period, relative to the statistical fluctuations of the customer-initiated Awards. Chart 4 is a simple Chart. Columns 2 and 4 repeat information taken from the final column of Chart 1 for convenience and comparison with the new data in columns 3 and 5 on median recovery rates. We already discussed the “win” rates for Employee-Member Awards above; Chart 4 provides a look at recovery rates.

We chose a median recovery rate approach, because it dampens the skewing effect of exaggerated claim amounts and, particularly in this type of dispute, inflated claims are common to certain types of injuries and circumstances. Infliction of emotional distress, damage to reputation, and other intangible claims are more difficult to measure in dollar terms than the monetary losses in a customer's account. That the claims may truly be inflated is not a conclusion we can definitively reach, just because recovery rates are declining, but we cite it as a factor that may affect predictability.

Clearly, over the Survey period, the year-to-year median recovery rate has experienced a dramatic decline, moving from 53% in 2000 to 19% in 2006. The median compensatory claim amount for 2006 (\$300k) has

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doubled over the Survey years from what it was in 2000 (\$167k). Note the very high median claims for 2004 and 2005. Even though award amounts were higher in those years (there were also more cases tried than in other years), median recovery rates were pushed downward by stratospheric monetary claims.

Such lofty sums have a greater probability of being inflated, we would project, and certainly that dynamic would impose a lowering effect on recovery ratios, but we must also observe that the median amount awarded of \$56.7k was relatively anemic for 2006. The median award for 2000 was about 40% more (\$88.1k)

and in 2005 – the year of the lowest median recovery rate – the median award amount was \$118.8k, more than twice the 2006 award amount and the highest award amount of any Survey year. Yet, the award amounts do not nearly keep pace with the escalating claim amounts and recovery rates in these recent years are consequently depressed.

We do not have a ready guess that explains what factors caused the doubling and tripling of claim amounts beginning in 2004. We can only observe that the “win” rates in this arena might evoke the envy of counsel handling customer-related disputes, but the recovery rates, if applied to the

customer side, would certainly evoke despair.

CHART 5 – SHOW THE MONEY

Employee-Member Awards may have been subject to an ultra-low recovery rate, but, as a group, these cases garnered more dollars for the winning Claimants than the brokerage houses won in 2006. Employee-Claimants are not especially likely to win generous punitive damages awards, according to Chart 5 (2003 was an exception, when the *Sawtelle* Award imposed a \$25 million sanction on Waddell & Reed), but attorney fee awards are not uncommon. In 2006, employees won more in attorney fee *cont'd on page 9*

Chart 4 Employee Member Awards: 2000-2005 Win & Recovery Rates				
Year	E/M “Win” Ratios Wins/All (# of Awards)	Median Recovery Ratios Median Award/Median Comp Clmd (\$)	Win Rate (%) (from Col. 1)	Median Recovery Rate (%) (from Col. 2)
2000	81/151	\$88.1/\$166.5	54%	53%
2001	96/147	\$46.2/\$228.1	65%	20%
2002	99/172	\$43.5/\$100.0	58%	44%
2003	106/188	\$48.2/\$184.2	56%	26%
2004	107/206	\$87.5/\$500.0	52%	18%
2005	101/193	\$118.8/\$725.0	52%	16%
2006	103/178	\$56.7/\$300.0	58%	19%
All Years Combined	693/1235	\$60.1/\$290.0	56%	21%

Notes to Chart:

1. Stipulated Awards are excluded from the numbers.
2. \$000s are omitted in expressing all dollar figures.
3. The term “Wins” signifies a “win” for the Claimant. Any monetary award in favor of the Claimant is counted as a “win.”
4. The “win rate” is determined by dividing the number of Awards that are “wins” into the total number of Awards that issued in that category of dispute and year.
5. Median recoveries are determined by listing all Awards in dollar order, first, by total amount awarded and finding the middle value, and, second, by compensatory claim and finding the middle value. Those aggregate results are then divided by the number of Awards.

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Chart 5 Total Amounts Awarded (\$) By Type of Dispute & Year (2000-2006)				
Year	CustomerMember <u>Total \$ Awarded (bold)</u> Punis (\$)/Atty Fees (\$)	Small Claims <u>Total \$ Awarded (bold)</u> Punis (\$)/Atty Fees (\$)	MemberEmployee <u>Total \$ Awarded (bold)</u> Punis (\$)/Atty Fees (\$)	EmployeeMember <u>Total \$ Awarded (bold)</u> Punis (\$)/Atty Fees (\$)
2000	\$94.4M \$24.4M/\$2.9M	\$822K \$24K/\$80K	\$8.3M \$46K/\$441K	\$3.0M \$1.2M/\$1.8M
2001	\$529.2M¹ \$223M/\$14.8M	\$632K \$25K/\$18K	\$10.2M \$0/\$528K	17.7M \$500K/\$625K
2002	\$153.0M \$24.4M/\$4.6M	\$532K \$5K/\$15K	\$19.9M \$0/\$899K	\$25.4M \$1.6M/\$1.5M
2003	\$190.8M \$28.6M/\$10.1M	\$1.7M \$14K/\$71K	\$27.2M \$350K/\$748K	\$47.0M \$25.2M/\$2.2M
2004	\$169.8M \$20.4M/\$9.8M	\$2.7M \$40K/\$166K	\$28.2M \$25K/\$1.1M	\$39.4M \$661K/\$1.8M
2005	\$162.0M \$9.6M/\$6.4M	\$1.9M \$115K/\$127K	\$52.2M \$135K/\$5.3M	\$46.0M \$350K/\$2.3M
2006	\$149.7M \$15.7M/\$12.7M	\$515K \$11.8K/\$17.6K	\$25.3M \$0/\$1.4M	\$31.4M \$62.8K/\$621.9K

Notes to Chart:

- 2001 Results for CustomerMember Awards are skewed by a huge award in *Sanchez v. Perusquia*, NYSE ID #2000-008556 (Houston, 11/15/01). A group of Claimants was awarded \$429.5M against a jailed broker. The awarded amounts included \$208.7M in punitive damages and \$11M in attorney fees. Without the *Sanchez* Award, the results for 2001 would have been quite the same as for 2000.
- M=Millions and K=Thousands when expressing all dollar figures.
- By referring to the number of "Win" Awards reflected in each dispute category of Chart 1 and dividing that number into the aggregate award amounts reflected above, one can determine the average amount awarded to a winning Claimant. For instance, dividing 527 CustomerMember "wins" in 2000, as noted on Chart 1, into the \$94.4M in aggregate amounts awarded, per Chart 5, yields an average award amount of \$179K for CustomerMember Awards issued in 2000. Similarly, there were 616 CustomerMember Awards issued in 2005, which, when divided into the \$162.0M awarded in that category in 2005, yields an average award amount of \$263K.

awards alone than Small Claims customers won in total damages (\$621.9k vs. \$515k).

Of course, punitive damages are most generously awarded in the larger customer cases. In 2006, punitive sanctions comprised more than 10% of the total amount awarded in Customer-Member Awards of \$149.7 million. In total dollar terms, 2006 was the second lowest year for Customer-Member

Awards among our Survey years, but it was also the most outstanding year (excepting 2001 and the skewing effect of the *Sanchez* Award) for winning Claimants, in terms of the size of the average award. The average amount awarded in 2006 in this category was \$379,000, followed by \$271,000 in 2003 and \$263,000 in 2005. While "win" and general recovery rates have experienced a decline over the Survey years, the

average winning Claimant is taking home a bigger award.

The biggest Customer-Member Award in 2006, *Adams v. McFadden*, NASD ID #03-05687, came out of Louisiana and assessed a total of \$20.2 million against broker-dealer Securities America, Inc. and Respondent McFadden. The top three Awards in dollar terms resulted from

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customer-initiated claims and Securities America paid in the third largest as well (*Cain v. Securities America*, NASD ID #04-08770: \$9.3 million). *Sahni v. Prudential Securities*, NYSE ID #2002-010156, was the last of the trio and concluded with a \$11.8 million award. (*ed: We covered the Sahni Award in our Securities Award Monthly publication (2006 SAM 8), because it was an Explained Award, and summarized the Award confirmation decision in our Securities Litigation Alert publication, SLA 2006-48).*

There were 31 SRO Awards that assessed amounts in excess of \$1 million during 2006. Most of them were Customer-Member Awards, but four were Employee-Member Awards. The largest in this group, titled *Grodner v. First New York*, NASD ID #05-05431, alleged breach of contract claims and cost First New York \$8.4 million. Two of the \$1 million-plus awards were assessed against customers of broker-dealers for account deficits. In the larger of the two Member-Customer Awards, *Deutsche Bank v. Bantleman*, NASD ID #03-00375, a client who borrowed against restricted securities was ordered to pay \$1.2 million to Deutsche Bank Securities. Finally, in the sole Member-Employee Award, *Wachovia Securities won \$1.1 million in a loan default case against a former employee (Wachovia Secs. v. Gallagher, NASD ID #05-05125).*

Conclusion

This Survey of 2006 Awards marks the second time we have performed an annual Award Survey. In earlier Award Surveys, we have generally canvassed a span of years for two main reasons: first, the universe of Awards in a group of years is sufficiently large to minimize the skewing effect of outlying Awards; and, secondly, the larger sample permits statistical break-outs that are impractical with a single year's Awards. Our sense, though, was that we were missing something by

grouping a decade or half-decade's worth of Awards into a single sample.

A sense of the present is one of the benefits of focusing specifically on the prior year's Awards. Each year has its own dynamics, whether because of macro-developments in the securities markets, legislative and regulatory changes, variations in arbitration practice and even reforms in case administration, and these changes may be seen to have their impact on arbitration results and party behavior. By plotting the Award results year-by-year, we see the changes on an annual basis. In summary, here are some of the statistical findings of this year's Survey:

In 2006, Small Claims Awards displayed the most profound and troubling changes, among the various types of Awards. We found in this Survey that :

- The number of Small Claims Awards declined more rapidly than the number of larger cases decided by arbitrators. 622 Small Claims Awards issued in 2004, or 29% of all customer-initiated Awards, whereas in 2006, only 180 Awards, or 16% of the whole, dealt with Small Claims investors.
- The 32% "win" rate we tabulated for the Small Claims investor is the lowest we have seen since SAC began compiling Award statistics in 1988.
- Small Claims matters tend to settle less easily. Our extrapolations predict that settlements are in the 50% range, whereas 70% is the overall settlement rate today.
- In 2006, only 13% of Small Claims Awards were decided after a merits hearing, but those demanding a merits hearing – most of whom were pro ses – fared worse than Claimantst who followed the "on the papers" default route – 26% vs. 34%.
- It's not the Arbitrators! No arbitrators who decided Small Claims arbitrations served more than once in that capacity during 2006. In general, the selected Arbitrators were experienced neutrals – only a couple of first-timers.

- In 2006, employees won more in attorney fee awards alone than Small Claims customers won in total damages.

Customer-initiated Awards in general reflected mixed results:

- A 40% "win" rate for customers was the lowest among all of the Survey years and contrasts with a high-water-mark "win" rate of 53% in 2001.
- Average recoveries in Customer-Member Awards involving claims of \$1 million or less rose to 54% of the winning Claimants' losses, reversing a four-year downward trend to lower recovery rates.
- New York State Awards, which have regularly posted a low recovery rate, relative to all other states, changed course in 2006 and attained a 46% median recovery rate, as compared to a 34% median recovery rate for all states.
- Average amounts awarded in 2006 Customer-Member Awards were at the highest level of any Survey year (after adjusting for the *Sanchez* case). The average amount awarded in this category during 2006 was \$379,000, followed by \$271,000 in 2003 and \$263,000 in 2005.
- In 2006, punitive sanctions comprised more than 10% of the total amount of \$150 million awarded to Claimants in Customer-Member Awards. Attorney fee awards constituted another 8.5%.

Industry-initiated Awards issued by the forums have remained relatively stable in number during the Survey years:

- The dwindling inflow of customer-related cases has made Industry cases a larger part of the FINRA docket. In 2004, the percentage of Industry Awards among all decided cases was 17%, whereas in 2006, the percentage rose to 27% of the whole.
- By the same token, the incidence of victories for the employee-claimant has remained quite stable throughout the Survey years,

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between 52-65%, with a 56% average for the full period and a 58% "win" rate in 2006.

- Over the Survey period, the year-to-year median recovery rate has experienced a dramatic decline, moving from 53% in 2000 to 19% in 2006.

- Despite an ultra-low recovery rate, employees in arbitration won more as Claimants than did the brokerage firms in Member-Employee Awards — \$31 million vs. \$25 million.

- Neither winning Members nor winning Employees benefited materially from punitive damages awards.

Many of the findings in this Survey are consistent with expectations and historical norms. Others are revealing in so far as they debunk some of the negative myths about arbitration and demonstrate that

arbitrators are utilizing the weapons and remedies available in their arsenal to achieve justice.

The Small Claims results suggest something more disturbing, though, as these results differ so much from the outcomes of the past and appear to be following a trendline that is not improving. There was a time when little disparity existed between Small Claims outcomes and those of the larger-dollar Customer-Member Award disputes, when Small Claims Claimants chose the hearing alternative 30% or 40% of the time, instead of 13% of the time, and when opting to pursue one's day in court did not represent, at least statistically, an imprudent decision.

The first mission of the Securities Industry Conference on Arbitration, when it began in 1977, was to develop

uniform and fair procedures for the adjudication of small claims disputes between customers and their broker-dealers. These customers are the "heart" of the market and its connection with a vital flow of capital to business.

Are these small investors leaving the markets? Is that the reason for the decline in Small Claims volume? Are they rejecting the Small Claims process? Are they growing more reluctant to enter the process without representation finding representation more difficult to obtain? We do not pretend to find solid answers in the gross statistics. They are valuable, though, for making observations as to the possible and for spotting possible trends and stimulating inquiry into solutions. Perhaps, it is time for SICA to return to its core project and re-examine the Small Claims procedure it developed 30 years ago.

IN BRIEF

(Covering SAAs 2007-21 through 2007-27)

NASD-NYSE MERGER COMPLETED: *Rule changes to accommodate the merger of these two self-regulatory organizations were approved by the SEC in late July (SR-NASD-2007-023) and a three-year transition period commenced with the closing of the transaction.* Approval of By-Law amendments that will enable the regulatory merger of NASD and NYSE into a new regulatory agency named FINRA (Financial Industry Regulatory Authority) was granted by the SEC (SEC Rel. 34-56145, clearing the way for the closing. The July 26 Approval Release runs 84 pages and treats arbitration in three places: On pages 36-38, the Release discusses and summarizes the many comments from the public. On pages 49-51, the Commission summarizes the NASD responses to the accusations and concerns expressed by some commenters about NASD arbitration. On pages 77-79, the SEC repeats the NASD assurances and concludes, "...the Commission cannot find as a matter of law that consolidation of the NASD and NYSE arbitration forums must be conditioned on providing customers with a choice of another dispute resolution forum." (*ed: *This last quoted statement should be useful before courts considering unconscionability challenges based upon a one-choice system. The statement may be construed as a Commission finding that the "law" does not view a single SRO forum as a Hobson's Choice for investors. **Approximately 80 comment letters were received by the SEC, but only a handful discussed arbitration in particular (see item below).*) (SAC Ref. No. 2007-14-01 & 2007-31-01)

COMMENTS ON NASD-NYSE CONSOLIDATION: *Most of the comment letters submitted in response to NASD's rule filing on consolidation (SR-NASD-2007-023) have discussed the impact on the regulatory side of the combination; a small number has expressed comment on the merger of the NASD-NYSE dispute resolution forums.* In the last edition of SAC (2007 SAC 01) we reported on the tense dialogue between SICA's Public Members and NASD-DR's Linda D. Fienberg on the fairness of SRO arbitration and the perception problems with a single-choice SRO forum. We returned to the SEC WebSite, after the close of the comment period (April 16, 2007) on the By-Law amendments, to check for further comment letters about the merger's likely impact. There we found another comment letter from Ms. Fienberg, dated May 29, 2007, and arbitration-related comment letters from Les Greenberg, Kathryn L. Lundgren, Steven B. Caruso (on behalf of PIABA), and William T. Galvin, Secretary of the Commonwealth, Massachusetts Securities Division.

Ms. Lundgren's letter took a quick shot at arbitration, complaining simply that the number of available forums would be cut in half by the merger. **Mr. Greenberg** relates his impressive background as former in-house counsel, who has, since 1973, represented both investors and broker-dealers. He became an arbitrator in 1976 and has served with a number of forums,

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