

Allocating Fees: Who Pays?

SAC Surveys Fee Allocation Decisions at AAA, NASD, and NYSE

In August 1995, SAC conducted a survey of Awards issued during 1994, in order to determine how arbitrators were allocating forum fees at the end of the cases. We looked only at customer-related Awards: Member-Customer collection cases in 7 SAC 4&5; and, in 7 SAC 6, Awards in which customers initiated the process. In the latter category — customer-initiated claims — we included Small Claims, where a single arbitrator determines fee allocation, as well as the larger claims, generally handled by a three-person Panel. For more detail about the way we approached our 1994 analysis, please refer to the explanations at 7 SAC 6(5).

In this current SAC Award Database Survey, we update our review of the manner in which arbitrators are allocating fees and break out our findings by year, 1995-1997 (the figures for 1997 only cover the period from January-August 1997). We thought this to be a timely exercise for three reasons:

(1) fees, broken down into filing fees, hearing session deposits, increased member surcharges, and the new pre-hearing and hearing process fees have made the fee component in NASD Arbitration a more weighty consideration for brokerage firms; (2) the NASD fee hike proposals pending before the Securities and Exchange Commission will mean forum fee increases of about 50% for all participants; and (3) a growing public perception, recently voiced in a PIABA comment letter to the Commission (9 SAC 6(12)), that “[o]ver the last two years, it has become common that the arbitrators split arbitral fees between the investor and the firm....”

Our general findings from SAC’s earlier survey of 1994 Awards were as follows:

When the customer wins: (1) rarely does the winning customer pay the bulk of the fees assessed at any of the top three arbitration forums: AAA, NASD and NYSE; (2) fee-splitting oc-

curs in the majority of the cases at the AAA and the NASD, but, at NYSE, the broker-dealer respondent is assessed the bulk of the fees the majority of the time.

When the customer loses: (1) at AAA, the customer was assessed the bulk of the fees in 0 cases, while at NASD the major burden fell on the customer twice as often as it did the broker-dealer and at NYSE, the major burden fell equally as many times on the customer as it did the broker-dealer; and (2) fee-splitting was the predominant choice at AAA, the majority choice at NASD, and a minority choice at NYSE.

The Chart below provides the figures for fee allocations in 1994 arbitration Awards, broken out by forum and by winning vs. losing cases. The “Notes” section of the Chart explains our methodology. Percentage results for 1994 are provided in the final Summary Chart for 1994-1997 at the end of this article.

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Fee Allocations -- 1994 Customer-Initiated Cases											
Forum	All Awards			Sec. A: Customer Wins				Sec. B: Customer Losses			
	Total Awards	Cust. Wins (sec. A)	Cust. Loss (sec. B)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/ N/K (0)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/ N/K (0)
AAA	34	25	9	11	0	14	0	1	0	8	0
NASD	819	425	394	184	20	219	2	43	99	250	2
NYSE	164	75	89	43	6	22	4	29	30	30	0

Notes: Each forum's Awards for the year are broken down in the "All Awards" section into "Cust. Wins," (customer wins some monetary award on claims) and "Cust. Loss," (customer denied any monetary award). In "Sec. A: Customer Wins," we break down those Awards classified as "Cust. Wins" into four fee allocation categories. In "Sec. B: Customer Losses," we do the same for those Awards classified as "Cust. Loss."

The four categories of fee allocations are: (1) Award allocates the bulk of the forum fees against the respondents, i.e., the broker-dealer parties; (2) Award allocates the bulk of the forum fees against the claimants, i.e., the customer(s); (3) Award allocates the forum fees relatively equally; and (0) Award either does not disclose how forum fees were allocated or it ordered a refund of the fees already assessed.

FEE ALLOCATIONS *cont'd from page 10*

Reviewing the 1995 customer-initiated Awards, we found the following: **when the customer wins:** (1) the customer pays the major burden of the fee assessment somewhat more frequently at the AAA and the NASD, but still rarely; and (2) fee-splitting, which was the majority choice at AAA and NASD for 1994, gives way to a tendency to assess the major fee burden on the bro-

ker-dealer respondent in the majority of the cases. At NYSE, this was the approach in 1994 and remains about the same in 1995. **when the customer loses:** (1) AAA Arbitrators do not assess the major burden on the customer in any cases, while at NASD the burden falls on the customer in many more cases than in 1994; and (2) fee-splitting remains the predominant choice at AAA,

considerably less so at the NASD, and, at NYSE, Arbitrators tend to fee-split as often as they assess the major fee burden against one or another party class.

The 1995 Chart below sets forth the figures in similar fashion as the preceding 1994 Chart.

Fee Allocations -- 1995 Customer-Initiated Cases											
Forum	All Awards			Sec. A: Customer Wins				Sec. B: Customer Losses			
	Total Awards	Cust. Wins (sec. A)	Cust. Loss (sec. B)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/N/K (0)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/N/K (0)
AAA	47	30	17	18	2	10	0	2	0	15	0
NASD	1197	594	603	347	57	184	6	92	276	231	4
NYSE	174	74	100	53	2	19	0	34	31	35	0

Notes: Each forum's Awards for the year are broken down in the "All Awards" section into "Cust. Wins," (customer wins some monetary award on claims) and "Cust. Loss," (customer denied any monetary award). In "Sec. A: Customer Wins," we break down those Awards classified as "Cust. Wins" into four fee allocation categories. In "Sec. B: Customer Losses," we do the same for those Awards classified as "Cust. Loss."

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The Awards for 1996 reinforce the apparent trends noted in 1995: (1) **when the customer wins**, the broker-dealer respondent assumes the major fee burden the majority of the time and the customer is rarely so charged; and, (2) **when the customer loses**, fee-splitting

is the predominant choice at AAA, while the customer is assessed the major fee burden at NASD in almost half of the cases. There is a perceptible shift at NYSE towards placing the major fee burden on the customer, but less so than at NASD.

The 1996 Chart on the following page sets forth the figures in similar fashion as the preceding Charts.

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FEE ALLOCATIONS *cont'd from page 11*

Fee Allocations -- 1996 Customer-Initiated Cases											
	All Awards			Sec. A: Customer Wins				Sec. B: Customer Losses			
Forum	Total Awards	Cust. Wins (sec. A)	Cust. Loss (sec. B)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/ N/K (0)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/ N/K (0)
AAA	49	27	22	17	0	9	1	2	0	20	0
NASD	1650	886	764	532	55	290	9	101	343	317	3
NYSE	130	46	84	32	5	8	1	22	31	30	1

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The four categories of fee allocations are: (1) Award allocates the bulk of the forum fees against the respondents, i.e., the broker-dealer parties; (2) Award allocates the bulk of the forum fees against the claimants, i.e., the customer(s); (3) Award allocates the forum fees relatively equally; and (0) Award either does not disclose how forum fees were allocated or it ordered a refund of the fees already assessed.

Finally, for 1997, we surveyed only the Awards issued through August of last year. The results are as follows: (1) **when the customer wins**, the arbitrators at all forums tend rarely to assess the major fee burden against the customer (no more than 5% at any forum)

and most commonly choose to place the major fee burden on the broker-dealer respondent; and, (2) **when the customer loses**, the broker-dealer rarely pays the major fee burden at the SRO forums, while fee-splitting or charging the customer have become relatively

equal options (at AAA, fee-splitting remains the predominant option).

The 1997 Chart below sets forth the figures in similar fashion as the preceding Charts.

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Fee Allocations -- 1997 Customer-Initiated Cases (thru 8/97)											
	All Awards			Sec. A: Customer Wins				Sec. B: Customer Losses			
Forum	Total Awards	Cust. Wins (sec. A)	Cust. Loss (sec. B)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/ N/K (0)	B/D Pays (1)	Cust. Pays (2)	Split Fees (3)	Refund/ N/K (0)
AAA	19	10	9	5	0	4	1	0	1	8	0
NASD	941	533	408	338	27	159	9	50	176	180	2
NYSE	69	33	36	19	1	13	0	7	14	15	0

Notes: Each forum's Awards for the year are broken down in the "All Awards" section into "Cust. Wins," (customer wins some monetary award on claims) and "Cust. Loss," (customer denied any monetary award). In "Sec. A: Customer Wins," we break down those Awards classified as "Cust. Wins" into four fee allocation categories. In "Sec. B: Customer Losses," we do the same for those Awards classified as "Cust. Loss."

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FEE ALLOCATIONS *cont'd from page 12*

The 1994-1997 Summary Chart, which appears below, presents the statistical results in percentage form for each of the four years surveyed, by forum and by Award outcome for the customer. Under the "Customer Wins" column, percentages are supplied for how often the customer was assessed the major fee burden and for how often the fees were basically split. Not shown are the remaining times when the broker-dealer received the major fee assessment (excluding those few times when the fees were refunded or the assessment was not provided in the Award). The "Customer Loses" column presents a similar breakdown.

When the customer wins, (1) the Summary Chart reflects a continuous tendency among Arbitrators at all forums to excuse the customer from the major fee burden. At AAA and NASD, one can see a shift from splitting the fees between the two sides in the majority of cases to assessing the major fee

burden against the broker-dealer respondent. This trend is most pronounced at the NASD, which moves from a 52% fee-splitting incidence in 1994 to 30% in 1997.

When the customer loses, the tendency to split fees, which was the approach in 64% of the NASD Awards in 1994, mitigates substantially over the past three years to 44% in 1997. Since NASD is the predominant forum and its fee-splitting cases trend downward for both customer wins and losses, the generalization that arbitrators are more commonly splitting fees does not appear supported by our survey results.

Let us quickly cite two caveats to this finding. First, there does appear to be a somewhat greater incidence of fee-splitting at NYSE, certainly in the losing case category and AAA reflects a consistent pattern of fee-splitting in the losing cases. Secondly, in the "Customer Loses" Award category, the re-

duction in fee-splitting at NASD is counter-balanced by an apparent increase in the frequency with which losing customers are charged the major fee burden.

In that respect, those who perceive that customers are paying a greater proportion of the fees in recent years appear to be in error. When they win, customers are, in general, paying a smaller proportion of the fee assessments in recent times. At NASD, winning claimants paid half or more of the fees 57% of the time in 1994, but only 35% of the time in 1997 (AAA: 56% and 40%, respectively; NYSE: 37% and 42%, respectively). At NASD, losing claimants paid half or more of the fees 90% of the time in 1994, while in 1997 that figure dropped a bit to 87%.

Perhaps, a more accurate appraisal is that arbitrators are weighing the outcome more heavily than in the past in *cont'd on page 14*

Fee Allocations -- % Customer Pays (1994-1997)						
	Award Outcomes		Customer Wins		Customer Losses	
Forum	Year	Cust. "Win" (%)	Cust. Pays (%)	Split Fees (%)	Cust. Pays (%)	Split Fees (%)
A	1994*	74	0	56	0	89
	1995	64	7	33	0	88
	1996	55	0	33	0	91
	1997**	53	0	40	11	89
N A S D	1994*	52	5	52	25	64
	1995	50	10	31	46	38
	1996	54	6	33	45	42
	1997**	57	5	30	43	44
N Y S E	1994*	46	8	29	34	34
	1995	43	3	26	31	35
	1996	35	11	17	37	36
	1997**	48	3	39	39	42

* 1994 figures are drawn from SAC Fee Allocation Survey, 7 SAC 6(5)
 ** 1997 figures are for the first eight months, though August 1997.

FEE ALLOCATIONS *cont'd from page 13*

making allocation decisions. Again, at NASD, that tendency would favor customers, as the overall “win” rate before NASD Arbitrators rose somewhat from 1994 to 1997 (52% to 57%). At AAA, the “win” rate declined markedly from 74% in 1994 to 53% in 1997. NYSE’s customer “win” rate moved from 46% to 48%.

We do not mean to intimate a view as to what is “fair” or “right,” in presenting these findings. Arbitrators are free to apply equitable standards in making the allocation decision, ranging from loser pays to basing the allocation upon conduct at hearing or some other legitimate standard. The Arbitrator’s Manual, developed by the Securities Industry Conference on Arbitration, advises: “[i]t is within the panel’s discretion to decide which party, if any, shall pay these fees and expenses. The panel may use the same basis as it did in determining compensatory damages.”

The NASD’s “Arbitrator Training” Guide (Version 1.1, 11/96) provides more extensive guidance: “[i]n 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. However, if it appears that one party is specifically to blame for the length of a proceeding, the panel might opt to deviate from the 50/50 split. For example, you might assess the entire fee against a party that has taken frivolous positions in a case.... Liability is not the only factor to consider when you assess forum fees.... [Example omitted. Qs:] Would you take Mr. Miller’s behavior into account when awarding costs? Why or why not? [Ans.] *Yes, even if the claimant prevails, you would nevertheless consider the actions that prolonged the hearing.*”

Our purpose in this Survey has been to provide parties with information for use as one factor in selecting a forum, in negotiating settlements, and in advising clients of historical probabilities. With that said, we have a few closing observations to offer:

(1) One factor we were unable to account for in developing the statistics used in this Survey is the amounts on deposit from different parties before the hearing’s conclusion, when the allocation of fees was decided. Many times, diligent parties pay their fees, while those not interested in the proceeding or seeing it go forward often do not make required deposits. With the emphasis on collecting fees beforehand, we worry that “a bird in hand” approach may guide some Arbitrators. Considering fees on deposit in a bid to “keep” that which has been paid on account is not encouraged by any guidance we have read. Arbitrators may be helpful in assuring that parties have made required deposits pre-hearing, but the judgment as to who should pay is better reached independently from practical concerns about collection.

(2) Fee assessments at NASD are becoming a complicated affair. There are non-refundable filing fees, which are allocable; broker-dealers pay a member surcharge, which is not allocable, a pre-hearing process fee and a hearing process fee, which are not allocable; then there are the hearing session fees deposited by both parties, which are allocable. First, this complicated structure suggests that arbitrators could use more education on this subject when the NASD revises its Training Guide, and more information post-hearing, e.g., a separate forum fee allocation form. Secondly, given the sizeable nature of the non-allocable fees, broker-dealers will likely pay a larger share of the overall fees, even when the arbitrators assess the bulk of the allocable fees against the customer-claimant.

(3) There is an anomaly in the NASD fee assessment structure which should be addressed. The “Initial Pre-Hearing Conference Procedure” script used by NASD Arbitrators advises the Panel to “[d]iscuss whether to assess additional hearing session deposits pursuant to NASD Regulation Code of Arbitration Procedure 10205(a) or 10332(a).” NASD’s “Arbitrator Training” Guide asks Arbitrators to “...con-

sider requesting deposits of additional hearing session fees by the parties in equal amounts,” for example, when four or more days of hearings are planned. The Guide then states that, “[i]f a case settles or is withdrawn within eight business days of a scheduled hearing date, NASD Regulation will retain all hearing session deposits. If a case settles or is withdrawn after the hearings have started, assess fees for the sessions conducted” (underscoring added).

At least two subscribers have recently told us that they have lost multiple hearing session deposits by settling before the first hearing. This seems unfair, as well as anomalous; the primary use of hearing fees is to pay the arbitrators, a cost not incurred when the case settles. Moreover, the practice will simply encourage parties who have agreed to settle, but who have placed multiple hearing session deposits in NASDR’s hands, to attend the first day of hearings and then settle. That would be a nuisance for everybody. (*ed: We did not confirm our reading of the guidance or the anecdotal observations with NASD, but we will happily print any comment NASDR might submit.*)