information, fraudulent omission of material fact will occur. The comments opposing the proposal generally maintained that the current rules are sufficient and the proposed rules are extremely burdensome. In particular, the opponents state that the record-keeping and compliance burden is particularly chilling to these stocks and the time it takes to locate and review financial statements on a company will limit a firm's choice of stocks to recommend.

The Association is not proposing to adopt Rule 2360 at this time. Therefore, this proposed rule change does not discuss the comments on that proposed rule.

After the public comment process, the staff recommended and the NASD and NASD Regulation Boards approved the following modifications to the proposed rule at their meetings in May 1998. Proposed Rule 2315 was amended to add exemptions for securities of certain financially sizable issuers, securities of banks and insurance companies, and transactions with institutional investors. In addition, the Rule was amended to require a member to review certain current financial information and other business information about the issuer, in addition to the requirements set out in the original rule proposal, before making a recommendation to a customer, and to require members to designate a qualified registered individual to review the information required by the rule.

After NASD Board approval of the modifications to the proposed rules in May, the staff received an additional comment that requested the staff to consider an additional exemption from the scope of proposed Rule 2315. The commenter suggested that recommended sales transactions in OTC equity securities with customers should be exempt from proposed Rule 2315. The premise for the exemption is based on the need to expedite liquidation of customer positions in OTC equity securities without the need for a member to review specified information regarding the issuer as required by the proposed rule. The commenter suggested that a delay in processing the sale may preclude a customer from capturing a particular market opportunity which may result in the customer reducing his return or increasing his loss in a particular investment. The suggested exemption would not apply to short sales by investors in these securities. Due to the nature and the timing of the comment, NASD staff requested that the Commission specifically seek comment in its notice to the public on the potential need for such an exemption from proposed Rule 2315.

At a subsequent Board meeting in December 1998, the staff recommended and the Board approved further modifications to Rule 2315. In particular, the Board approved an expansion of the definition of ''current financial statements'' in NTM 98–15 to include financial information contained in the registration statements of Securities Act registered securities and all financial information provided in connection with securities offered in connection with exemptions from registration provided by Regulation A,[15] Rule 505,[16] or Rule 506.[17] The Board also approved a revision to the exclusions from the Rule for initial public offerings and offerings conducted in compliance with Regulation A and Rules 504–506 under the Securities Act. That exemption is now limited to transactions that meet the requirements of Rule 504 and Section 4(2) transactions.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Specifically, the Commission seeks comment on the potential need for an exemption from proposed NASD Rule 2315 for recommended sales transactions in OTC equity securities. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD.

All submissions should refer to File No. SR–NASD–99–4 and should be submitted by March 22, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[18]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–4954 Filed 2–26–99; 8:45 am]

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[15] 17 CFR 230.251.

[16] 17 CFR 230.505.

[17] 17 CFR 230.506.

[18] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41056; File No. SR–NASD–97–79]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change Relating to Fees and Hearing Session Deposits for the Arbitration of Claims by Public Investors, Members and Associated Persons

February 16, 1999.

I. Introduction

On October 29, 1997, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), through its wholly-owned subsidiary NASD Regulation, Inc. (''NASD Regulation'') filed with the Securities and Exchange Commission (''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend Rules IM–10104, 10205 and 10332 of the NASD's Code of Arbitration Procedure (''Code'') to increase the arbitration filing fees, hearing session deposits, and arbitrator honoraria for intra-industry and public investor arbitrations administered by NASD Regulation.[3]

Notice of the proposed rule change, together with the substance of the proposal, was published for comment in Securities Exchange Act Release No.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] This rule filing replaced SR–NASD–97–39, in which NASD Regulation originally proposed amendments to the filing fees and hearing session deposits.

39346 (November 21, 1997), 62 FR 63580 (December 1, 1997). Forty-three comment letters were received on the proposal.[4] The NASD responded to comments on February 12, 1998, February 24, 1998 and March 31, 1998.[5]

II. Description

Background and Introduction

NASD Regulation is proposing to amend the Code to increase the filing fees and hearing session fees charged to public investors, member firms and associated persons for arbitrating disputes under the Code. In addition, NASD Regulation is proposing to increase the honoraria paid to arbitrators. The fees and deposits for arbitration proceedings fall generally into three categories: (1) Filing fees; (2) hearing session fees; and (3) member surcharges. This filing does not concern member surcharges.

Filing fees are submitted by the party filing a claim and are required for all claims, including cross-claims, counterclaims and third party claims. These fees pay some NASD Regulation's average direct costs of administering the early stages of an arbitration case.[6]

Hearing session fees may be assessed by the arbitrators for each hearing session held in a case.[7] Arbitrators decide who will pay these fees in their award at the end of the case. Claimants have to deposit with NASD Regulation the hearing session fee for the first hearing when they file their claim,[8] and arbitrators may request that either party submit additional deposits of hearing session fees as the case progresses. A hearing session deposit is intended as an advance payment for the first, or a subsequent, hearing session. If pays some of NASD Regulation's average direct cost of conducting a hearing session.

Under the existing fee structure and these proposed fees, NASD Regulation is subsidizing through fees on members only and through general revenues the cost of administering arbitration cases for investors with small and moderate claims.

Proposed Rule Change

NASD Regulation is proposing to amend the schedules of fees for both intra-industry and public investor disputes. The filing fees and hearing session deposit changes proposed are discussed in four separate categories: (1) Filing fees for claims by public investors against members (''Public Investor-Member Disputes''); (2) filing fees for claims by members against public customers (''Member-Public Investor Disputes'') or other members or associated persons (''Intra-industry Disputes'');[9] hearing session fees and deposits in all cases between public investors and members, and in intra-industry cases; and (4) miscellaneous changes. NASD Regulation also proposes changes to the arbitrator honorarium schedule.

Filing Fees: Public Investor-Member Disputes. NASD Regulation is proposing to amend Rule 10332 to increase the filing fee for disputes between a public investor claimant and a member respondent by an average of 50 percent in most brackets[10] and add three new brackets to graduate further the fee schedule.[11] The proposed filing fees

[4] *See* letters from Daniel A. Ball, Lewis, Goldberg & Ball, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 3, 1997 (''Letter 1''); Erwin Cohn, Cohn & Cohn, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 3, 1997 (''Letter 2''); J. Boyd Page, Page & Bacek, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 11, 1997 (''Letter 3''); Diane A. Nygaard, The Nygaard Law Firm, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 10, 1997 (''Letter 4''); Gary M. Berne, Stoll, Stoll, Berne, Lokting & Schlachter, P.C. to Margaret H. McFarland, Deputy Secretary, Commission, dated December 4, 1997 (''Letter 5''); Martin R. Galbut, Galbut & Conant, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 4, 1997 (''Letter 6''); Robert Dyer, Allen, Dyer, Doppelt, Milbrath & Gilchrist, P.A., to Margaret H. McFarland, Deputy Secretary, Commission, dated December 4, 1997 (''Letter 7''); Neal J. Blaher, Law Office of Neal J. Blaher, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 3, 1997 (''Letter 8''); (there is no Letter 9); Patricia A. Shub, Patricia A. Shub, P.A., to Margaret H. McFarland, Deputy Secretary, Commission, dated December 10, 1997 (''Letter 10''); Michael R. Casey, Casey and Molchan, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 10, 1997 (''Letter 11''); Mark A. Tepper, Mark A. Tepper, P.A., to Margaret H. McFarland, Deputy Secretary, Commission, dated December 11, 1997 (''Letter 12''); J. Pat Sadler, Sadler & Associates, P.C., to Margaret H. McFarland, Deputy Secretary, Commission, dated December 8, 1997 (''Letter 13''); Philip M. Aidikoff and Robert A. Uhl, Aidikoff & Uhl, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 12, 1997 (''Letter 14''); Martin L. Feinberg, to Jonathan G. Katz, Secretary, Commission, dated December 10, 1997 (''Letter 15''); James E. Beckley, James E. Beckley and Associates to Jonathan G. Katz, Secretary, Commission, dated December 19, 1997 (''Letter 16''); Public Investors Arbitration Bar Association (''PIABA''), dated December 11, 1997 (''Letter 17''); Barry D. Estell, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 4, 1997 (''Letter 18''); James E. Beckley, Securities Industry Conference on Arbitration (''SICA''), to Jonathan G. Katz, Secretary, Commission, dated December 10, 1997 (''Letter 19''); Andrew O. Whiteman, Hartzell & Whiteman, LLP, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 11, 1997 (''Letter 20''); Seth E. Lipner, Deutsch & Lipner, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 11, 1997 (''Letter 21''); Harold J. Bender, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 9, 1997 (''Letter 22''); Emily Feldman, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 10, 1997 (''Letter 23''); Lawrence Sullivan, to Margaret McFarland, Deputy Secretary, Commission, dated December 10, 1997 (''Letter 24''); Joseph C. Long, Professor of Law, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 11, 1997 (''Letter 25''); Joseph D. Sheppard III, Carnahan, Evans, Cantwell & Brown, P.C., to Margaret H. McFarland, Deputy Secretary, Commission, dated December 19, 1997 (''Letter 26''); Robert D. Mitchell, Mitchell Law Offices, to Margaret H. McFarland, Deputy Secretary, Commission, dated December 12, 1997 (''Letter 27''); Peter R. Cella, Duignan & Cella, to Jonathan G. Katz, Secretary, Commission, dated December 15, 1997 (''Letter 28''); Diane Nygaard, The Nygaard Law Firm, to Jonathan G. Katz, Secretary, Commission, dated December 30, 1997 (''Letter 29''); Don K. Leufven, Alonso & Cersonsky, P.C., to Margaret H. McFarland, Deputy Secretary, Commission, dated December 12, 1997 (''Letter 30''); James E. Beckley, James E. Beckley and Associates, to Jonathan G. Katz, Secretary, Commission, dated December 30, 1997 (''Letter 31''); Jonathan H. Colman, to Jonathan G. Katz, Secretary, Commission, dated December 22, 1997 (''Letter 32''); Joel E. Davidson, Senior Vice President and Deputy General Counsel, PaineWebber, Inc., to Margaret H. McFarland, Deputy Secretary, Commission, dated January 9, 1998 (''Letter 33''); Scot D. Bernstein, Law Offices of Scot D. Bernstein, to Jonathan G. Katz, Secretary, Commission, dated January 22, 1998 (''Letter 34''); Tracy Pride Stoneman, Susemihl & McDermott, P.C., to Margaret H. McFarland, Deputy Secretary, Commission, dated December 17, 1997 (''Letter 35''); Richard P. Ryder, Securities Arbitration Commentator, to Jonathan G. Katz, Secretary, Commission, dated January 16, 1997[sic] (''Letter 36''); Paul J. Dubow, Senior Vice President and Senior Deputy General Counsel, Dean Witter, Discover & Co., to Jonathan G. Katz, Secretary, Commission, dated January 28, 1998 (''Letter 37''); James E. Beckley, James E. Beckley and Associates, to Jonathan G. Katz, Secretary, Commission, dated January 21, 1998 (''Letter 38''); Morton Levy, to Jonathan G. Katz, Secretary, Commission, dated January 27, 1998 (''Letter 39''); Neal J. Blaher, to Guy P. Fronstin, Staff Attorney, NASD Regulation, dated December February 6, 1998 (''Letter 40''); Neal J. Blaher to Guy P. Fronstin, Staff Attorney, NASD Regulation, dated February 6, 1998 (''Letter 41''); Robert Dyer, Allen, Dyer, Doppelt, Milbrath & Gilchrist, to Linda Fienberg, Executive Vice President of Dispute Resolution, NASD Regulation, dated March 2, 1998 (with attached letter from Neal J. Blaher to Guy P. Fronstin, Staff Attorney, NASD Regulation, dated February 25, 1998) (''Letter 42''); (there is no Letter 43); Richard P. Ryder, Securities Arbitration Commentator, to Jonathan G. Katz, Secretary, Commission, dated September 17, 1998 (''Letter 44''); and Seth E. Lipner, Secretary, PIABA, to Arthur Levitt, Chairman, Commission, dated October 14, 1998 (''Letter 45'').

[5] *See* letters from John M. Ramsey, Vice President and Deputy General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated February 12, 1998 (''Response One''), February 24, 1998 (''Response Two''), and March 31, 1998 (''Response Three'').

[6] Average direct costs are discussed further *infra*.

[7] A hearing session is any meeting between the parties and the arbitrator(s) that lasts four hours or less, including a pre-hearing conference with an arbitrator.

[8] NASD Regulation staff can waive the initial filing fee and hearing session deposit if the claimant demonstrates financial hardship.

[9] The proposed rule change treats associated persons of members like public customers for purposes of fees.

[10] Fees are based on the amount in dispute, and ''bracket'' refers to a range of amounts in dispute (*e.g.*, $50,000.01 to $100,00) to which a particular fee applies.

[11] For example, the old bracket of fees for claims of $10,000.01 to $30,000 has been divided into two

range from $25 to $600, while the current filing fees range from $15 to $300.

Filing Fees: Member-Public Investor Disputes and Intra-Industry Disputes. NASD Regulation is proposing to amend Rule 10332 to change to the filing fees when a member files a claim against a public investor. The current filing fee is $500 for all brackets. NASD Regulation is proposing to substitute a graduated filing fee beginning at $200 (for claims of $1,000 or less) and ending at $5,000 (for claims over $10,000,000).

NASD Regulation is also proposing to amend Rule 10205 to increase and graduate the filing fees for intra-industry disputes. Currently, the filing fees are $500 regardless of the amount in dispute. NASD Regulation is proposing to graduate the filing fee from $200 (for claims of $1,000 or less) to $5,000 (for claims over $10,000,000).

Fees for Hearing Sessions. NASD Regulation is proposing to amend Rules 10205 and 10332 to increase the hearing session fees that can be assessed for each hearing session held in a case. The proposal increases the initial deposits required for all cases, and adds three new brackets to graduate further the hearing session deposit schedule.[12] In addition to the initial hearing session deposit required when a case is filed, the hearing session deposit schedule is used by the arbitrators to assess fees for each of the hearing sessions held in case, which together with other miscellaneous costs are referred to as forum fees. The hearing session deposits range from $25 to $1,200. Hearing session fees are the same within brackets for public investor-member, member-public investor, and intra-industry cases.

Miscellaneous Changes. NASD Regulation is proposing to amend Rule 10205(a) to provide that if the claimant is an associated person, he or she will pay the filing fee and hearing session deposit specified for public customers. However, if the associated person is a joint claimant with a member, the member will pay the filing fee and hearing session deposit specified for industry claimants. In order to encourage parties to identify, when possible, the dollar amounts involved in a case, NASD Regulation is also proposing to amend Rules 10205(e) and 10332(e) to increase the hearing session deposit for claims where the amount in dispute is not disclosed by the claimant in the Statement of Claim. The fee will be increased from $600 to either $1,000 or an amount specified by the Director of Dispute Resolution or the arbitrators, not to exceed the maximum hearing session deposit specified in the rules.[13]

Finally, NASD Regulation is proposing to amend Rules 10205(i) and 10332(h) to provide that the filing fees and hearing session fees for large and complex cases brought under Rule 10334[14] will be those specified for cases exceeding $10,000,000. In support of the fees for cases administered under the large and complex case rules, the NASD has stated that there are significant and distinct costs associated with such cases, including an administrative conference, multiple hearing sessions, pre-hearing issues to be resolved and customized arbitration procedures that may be requested by the parties.

Arbitrator Honoraria. NASD Regulation is proposing to amend IM–10104 to increase the honoraria paid to arbitrators. The honorarium will be increased from $150 to $200 per arbitrator for each hearing session, with an additional $75 per day for the chairperson of the panel. The Office of Dispute Resolution's honorarium cost for a panel of three arbitrators for one hearing session under the proposed schedule is $675. The honorarium for a pre-hearing conference will be $200. The honorarium for a case not requiring an oral hearing will be increased from $75 to $125.

Direct Costs of Administering Arbitration Cases

NASD Regulation states that the fees proposed in this rule filing were developed to recover much of its average direct costs for administering arbitration cases. In developing the proposed fee increases, NASD Regulation reports that it identified the average costs attributable to such activities as receiving, processing, analyzing, and serving claims, selecting arbitrators, and scheduling and conducting hearings.[15] The proposed filing and hearing session fees do not pay for NASD Regulation's general costs for administering the arbitration department, including costs for arbitrator recruitment and training, computer systems, office space, senior management and legal services. Instead, these fees are designed to cover the actual costs incurred by NASD Regulation in administering particular cases. NASD Regulation estimates that the revenue from the proposed filing and hearing session fees will total about 68% of its average direct costs for administering cases.[16]

In particular, NASD Regulation states that the filing fees were designed to cover much of the actual costs of the arbitration process from filing up to the pre-hearing conference. These costs include the processing, analyzing and serving of claims, and selecting arbitrators. In lower bracket cases, NASD Regulation states that the filing fees are lower than its cost of providing the service, and in larger bracket cases, the filing fees approach but do not exceed its average cost of providing the service. The costs generally increase as the amount in controversy increases.

Similarly, NASD Regulation states that the hearing session fees are designed to cover some of the actual costs of administering a hearing. The cost of conducting a hearing session includes arbitrator compensation and travel expenses, hearing conference rooms, and the cost and expenses of NASD Regulation staff directly involved

brackets: one from $10,000.01 to $25,000 with a new filing fee of $125 (compared to $100 for the old bracket), and another from $25,000.01 to $30,000 with a new filing fee of $150. The old bracket was divided to take into account the new ceiling for simplified arbitration cases, which was raised from $10,000 to $25,000. *See* Securities Exchange Act Release No. 38635 (May 15, 1997), 62 FR 27819 (May 21, 1997) (SR–NASD–97–22). The largest filing fee increases are for the largest cases; for example, the filing fee for claims of more than $10,000,000 is being raised 100 percent from $300 to $600.

[12] For example, the old bracket for claims of $10,000.01 to $30,000 has been divided into two bracket, one from $10,000.01 to $25,000 with a new hearing session deposit of $450 (compared to $300 for the old bracket) for single arbitrator, and another from $25,000.01 to $30,000 with a new hearing session deposit of $450. In the $25,000.01 to $30,000 bracket the hearing session deposit for three arbitrators will be $600 (compared to $300 for the old bracket). The hearing session deposit for claims of $5,000.000.01 or more is being reduced to $1,200 from $1,500.

[13] In cases where the claimant is seeking a remedy other than damages (recision, for example) and does not specify damages, NASD Regulation has stated that its staff will attempt to establish the market value of the securities that are the subject matter of the claim before resorting to the higher maximum default fee specified in paragraph (e) of the two rules.

[14] Rule 10334 (the rule for large and complex cases) was extended for five years and the use of the procedures is now entirely voluntary. *See* Securities Exchange Act Release No. 39024 (September 5, 1997), 62 FR 47856 (September 11, 1997).

[15] NASD Regulation described its cost analysis, noting in part that the cost of these functions was identified by totaling the staff hours and other expenses devoted to the function. Also, the number of occurrences of the function was counted. The total cost was divided by the number of occurrences to derive the average cost.

[16] While its latest budget figures suggest that the filing and hearing session fees may pay for approximately 68% of its direct costs of arbitrating disputes, NASD Regulation's actual experience with revenue received as of June 4, 1998 suggests that the fees may pay approximately 50% of the direct costs. *See* letter from Elliott Curzon, Assistant General Counsel, NASD Regulation, to Robert A. Love, Special Counsel, Division of Market Regulation, Commission, dated June 4, 1998.

in the case. NASD Regulation states that its analysis indicates the projected average cost to provide a single hearing session is $1,200. The hearing session fees proposed in this filing for three person panels are graduated, from $600 (for cases involving $25,000.01 to $30,000) to $1,200 (for cases above $500,000).[17]

III. Summary of Comments

The Commission received 43 comment letters on the proposed rule change, of which 40 opposed the proposed rule change and three favored it.[18] The NASD responded to comment letters.[19]

Increasing Fees Will Deter Investors

Many of the commenters argue that the arbitration fees are already too high,[20] and that the proposed increase in fees will deter investors from filing claims and impair investors' ability to obtain compensation.[21] One commenter suggests that the proposed fee increases could cause claimants to underestimate or not include damages in their claims in an effort to avoid paying the higher filing fees.[22] Two of the commenters, investors with claims in arbitration, state that it was a burden for them to file a claim under the current fee structure.[23] One of them also states that she could have gone to court at a lower cost but was prevented from doing so because of her arbitration contract.[24] One commenter argues that the fee increase would destroy confidence in the system.[25] In addition, commenters state that arbitration proceedings are already more expensive than filing an equivalent claim in court.[26] One commenter states that because NASD Regulation will be charging hearing session fees for the pre-hearing conferences, firms could delay proceedings by engaging in elaborate motion practice and requesting pre-hearing conferences on a variety of motions, which could impose an additional financial burden on public customers.[27]

In support of the proposed rule filing, one commenter argues that the cost of arbitration is still less than cost of litigation because a plaintiff incurs filing fees in court and is subject to significant out-of-pocket expenses for deposition transcripts, court reporters and transcripts, and travel associated with depositions.[28] That commenter also argues that requiring a claimant to incur some meaningful expense would weed out frivolous claims but not discourage valid claims. Finally, the commenter argues that others' claims of undue burden are overstated because he has never encountered a claimant who stated the current fee was not affordable or who asked the commenter's firm to pay the filing fee.

In its response to the comment letters, NASD Regulation states that it does not believe that the increased filing fees will constitute a deterrent to arbitration because they remain a small portion of the amounts alleged as damages (below one percent) and because the Director of Dispute Resolution can waive the fees upon a demonstration of financial hardship.[29]

NASD Regulation responds to the concern about the expense of pre-hearing conferences by stating that these conferences may save parties money because they may avoid or reduce time-wasting disputes over discovery, evidence, presentations and similar matters. NASD Regulation, which bases its views on feedback from parties and observations by staff, also states it will continue to monitor the pre-hearing conference process to evaluate its effectiveness.

Securities Industry Should Pay for Fee Increases

Many securities firms ensure that any future disputes they may have with customers will be handled in arbitration through the use of predispute arbitration clauses in their customer agreements. Numerous commenters argue that the securities industry should pay most, if not all, of the proposed fee increase[30] because it costs the industry less money to handle its cases in arbitration,[31] rather than in court.[32] For example, one commenter argues that the securities industry should bear any fee increases to cover NASD Regulation budget deficits because of the cost savings it receives by avoiding both jury trials and the higher fees charged by the American Arbitration Association (''AAA'').[33] Two commenters argue that, because customers are compelled to use NASD arbitration by their brokerage firms, it is unfair to require them to deposit as much as half of the projected cost of arbitration (which they state is possible under the proposed fee increase) in order to pursue their claims.[34] Another commenter argues that the NASD's high expenses are a consequence of the industry's successful efforts to compel arbitration at the NASD or other self-regulatory organizations (''SROs''). The commenter maintains that it is inappropriate to combine the industry's ability to choose arbitration over litigation in the courts with an NASD requirement that customers who use the forum must contribute to maintaining it.[35] Two commenters assert that NASD Regulation did not follow the recommendation in *Securities Arbitration Reform*, Report of the Arbitration Policy Task Force to the Board of Governors, National Association of Securities Dealers, Inc. (January 1996) (''Task Force Report''), which stated that members should pay most of the costs of arbitration, while investors should only pay a small share of an increase in fees.[36]

In support of the proposed rule change, two commenters argue that members already bear most arbitration costs, and that the current ratio of member and customer fees is maintained in the proposed fee increases.[37] In addition, one commenter argues that the industry should not pay 100% of the fee increase because

[17] Hearing session fees for smaller cases, with a single arbitrator, are between $25 and $450.

[18] *See supra* note 4.

[19] *See supra* note 5.

[20] *See* Comment Letter Nos. 7 (''The NASD fees are already too high, considering the lack of fairness in the procedures''); 17; and 26.

[21] *See* Comment Letter Nos. 1 (''Raising the cost of arbitration increases the financial risks that investors must bear. Investors will be deterred further from filing claims.''); 3 (''We are extremely concerned that proposed fee increases will hurt investors' ability to obtain recovery for legitimate damages * * *.''); 4; 11; 17; 18; 20; 21; 22; 32; 34 (''Fear of filing fees should not deprive public customers of access to justice, yet that is exactly what will be brought about by the NASD's proposal.''); 35; and 39.

[22] *See* Comment Letter No. 32.

[23] *See* Comment Letter Nos. 23 and 24.

[24] *See* Comment Letter No. 23.

[25] *See* Comment Letter No. 16.

[26] *See* Comment Letter Nos. 2; 11; 15; 16; 18; and 34.

[27] *See* Comment Letter No. 10.

[28] *See* Comment Letter No. 33. In contrast, one commenter opposes the proposed rule stating that the argument that litigation is more expensive is weakened by innovations in court procedures such as limits on the length of depositions and sanctions for delays. *See* Comment Letter No. 16.

[29] *See* NASD Response One. NASD Regulation also adds that if the arbitrators assess forum fees against a party that its staff knows is laboring under a financial hardship, that information will be considered in connection with its decision whether to initiate collection efforts.

[30] *See* Comment Letter Nos. 3; 6; 7; 11; 15; 20; 21; 25; 26; 28; 30; 32; 34.

[31] *See* Comment Letter Nos. 7; 26; and 34 (''The securities industry gets the benefits of forced arbitration of disputes. There is nothing wrong with the securities industries paying for that benefit through its trade organization.'').

[32] *See* Comment Letter Nos. 6; 11; 15; 17; 20; 25 (''if the brokerage industry wants * * * to mandate a specific private system, the industry should be willing and required to bear virtually the entire expense of that system''); 28; and 32.

[33] *See* Comment Letter No. 30.

[34] *See* Comment Letter Nos. 10 and 11.

[35] *See* Comment Letter No. 8.

[36] *See* Comment Letter Nos. 3 (''the expense of this increase should be borne by the securities industry as recommended by the NASD's Arbitration Policy Task Force''); 16; and 17.

[37] *See* Comment Letter Nos. 33 and 37.

claimants, as well as the industry, benefit from arbitration. The commenter noted in particular that claims in arbitration are resolved more quickly than claims in litigation.[38]

NASD Regulation responds that the proposed rule change, in combination with previous rule changes increasing member surcharges and adding a process fee for members only,[39] ensures that the securities industry will continue to pay most of the costs of arbitration.[40] NASD Regulation states that the notice of the proposed rule change [41] demonstrates that the industry will bear the majority of the costs of operating the arbitration program and that the customer's portion of the costs will continue to be relatively modest. Moreover, NASD Regulation responds that the assertion that some members may enjoy indirect savings from arbitration as a result of lower litigation costs, settlements, or judgments does not provide a basis under the Act for disapproving the proposed rule change. NASD Regulation asserts that the appropriate basis for Commission approval of the proposed rule change is whether the proposed fees provide for the equitable allocation among the users of the arbitration program of reasonable fees.

NASD Regulation argues that claimants also enjoy substantial savings in arbitration because, for example, arbitration takes less time than litigation.[42] It also points out that appeals of decisions are rare, involve narrower grounds and are less likely to succeed, and that claimants avoid the expense of depositions and similar costs associated with discovery in litigation. Finally, NASD Regulation states that arguments concerning whether mandatory arbitration is appropriate should not be addressed by the Commission in this rule filing, and that the Supreme Court has expressly upheld the enforceability of predispute contracts to arbitrate disputes between investors and broker-dealers.[43]

Commenters also argue that the increase in the allocation of fees is significant in percentage terms, and in the dollar amount an investor will have to pay in filing and forum fees.[44] Another commenter states that the NASD should consider the historical allocation of expenses, not the historical revenue split, between member users and investors/individual employee users.[45] The NASD responds that its filing demonstrates that the proposed fees are reasonable because the filing and hearing session fees pay only for a portion of the average direct costs of providing arbitration services to the parties.[46]

Arbitration Contracts

Several of the commenters suggest that the fee increases in the proposed rule change would undermine the rationale underlying the Supreme Court's decision in *McMahon,* which holds that predispute agreements to arbitrate claims between customers and broker dealers under the Act are enforceable.[47] Commenters also argue that arbitration is supposed to be an inexpensive and speedy alternative to litigation, and question how that could continue to be true after the proposed fee increases.[48] NASD Regulation responds that arbitration will continue to be more economical than litigation in light of the complexity of court litigation, especially discovery costs.[49]

Administration of the Arbitration Process

Several commenters assert that the proposed rule change does not address problems with the administration of the arbitration process, and that the Commission should not approve the proposed rule change until NASD Regulation has addressed these problems.[50] Specifically, commenters cite concerns about submitting materials to arbitrators,[51] scheduling,[52] the arbitrator selection process,[53] the discovery process,[54] and the telephone system.[55]

In response, NASD Regulation states that the commenters who argue that the forum is less efficient than courts by comparing arbitration fees to court fees and expenses fail to make a proper comparison. NASD Regulation points to the significant tax subsidy that supports public courts, the large administrative overhead of the court system, and the cost to parties added by the complexity of court litigation. NASD Regulation also states that arbitration is a private forum whose costs must be paid for either by its sponsor or users. It states that it is more equitable to fund arbitration with revenue from member firm users rather than from general assessments against all members. NASD Regulation also states that the overwhelming majority of the costs of the forum will be paid by member users of the forum and not by investors.

In support of the proposed rule change, one commenter states that a fee increase is necessary for NASD Regulation to perform adequately its administrative function because it will help maintain the efficiency of the arbitration process and upgrade arbitrator training.[56]

Fees May Make Arbitration Unaffordable for Some People

Commenters also argue that the proposed fee increases, if implemented, could deny investors equal protection under the law or due process because arbitration would be mandatory, but too expensive for investors.[57] Two

[38] *See* Comment Letter No. 37.

[39] *See* Securities Exchange Act Release No. 38807 (July 1, 1997), 62 FR 36858 (July 9, 1997) (increasing a member surcharge each time a member firm or associated person becomes a party to an arbitration case) and Securities Exchange Act Release No. 39504 (December 31, 1997), 63 FR 1134 (January 8, 1998) (SR–NASD–97–96) (imposing a process fee on members who are parties in arbitration proceedings).

[40] *See* NASD Responses One and Three.

[41] *See* Securities Exchange Act Release 39346 (November 21, 1997), 62 FR 63580 (December 1, 1997).

[42] *See* NASD Responses One and Two.

[43] *See* NASD Response One, *citing Shearson/American Express, Inc.* v. *McMahon,* 482 U.S. 220 (1987) (''*McMahon*'').

[44] *See* Comment Letter Nos. 17 (''the increase is significant in percentage terms and dollar terms'') and 28.

[45] Comment Letter No. 36.

[46] *See* NASD Response One. In addition, NASD Regulation discussed the general costs and revenues of its program in response to this comment.

[47] *See* Comment Letter Nos. 4; 17; and 48.

[48] *See* Comment Letter Nos. 8 (''[A]rbitration was—and is—intended as a speedy *and inexpensive* alternative to litigation.'') and 34 (''[T]he arbitration concept was originally sold as an inexpensive alternative to traditional litigation. The proposed filing fee increases may not appear large to the professionals who will review them; but they are huge to elderly public customers who are living on fixed incomes and have lost the bulk of their life savings.'') (emphasis in original).

[49] *See* NASD Response One.

[50] *See* Comment Letter Nos. 5; 20; and 21.

[51] *See* Comment Letter No. 5.

[52] *See* Comment Letter Nos. 5; 20; and 21.

[53] *See* Comment Letter Nos. 5; 21; and 35. The Commission notes that it has recently approved a proposed rule change filed by the NASD relating to the selection of arbitrators under a new list selection process. *See* Securities Exchange Act Release No. 40555 (October 14, 1998), 63 FR 56670 (October 22, 1998).

[54] *See* Comment Letter Nos. 20; 21 (''Problems with the discovery process and the abuse thereof * * * have gone unaddressed in these amendments.''); and 26.

[55] *See* Comment Letter Nos. 20 and 21.

[56] *See* Comment Letter No. 37.

[57] *See, e.g.,* Comment Letter Nos. 1 (''[M]any of our clients are denied equal protection under the law because they do not have the financial means to pay for NASD arbitration.''); 12 (''[A]dding additional costs to the Claimant * * * will result in more Claimants being denied fair and reasonable access to the arbitration process * * *. This appears to raise very serious equal protection arguments.''); 13 (''As long as brokerage firms are allowed to force public customers into SRO sponsored arbitration any increase in fees raises equal protection and antitrust issues.''); 16; 18; and 25 (''[T]he customer is required to surrender his right to litigate * * * in court * * * in favor of a private system which he does not want and which, if the fee increases are granted, he will be required to bear a substantial financial burden to support

Continued

commenters argue that to increase the fee to investors would create a system of justice available only to the rich.[58]

NASD Regulation responds that the fees remain a low percentage of the damages claimed, and that NASD Regulation may waive fees and deposits if a customer demonstrates financial hardship.[59] NASD Regulation also responds that mandatory arbitration, which the Supreme Court has upheld, is not at issue in this proposed rule change.

Non-SRO Alternative

Several commenters suggest that NASD Regulation adopt a rule that would allow investors the choice of resolving their disputes at a non-SRO forum, and point that PIABA has submitted a petition to the Commission on this point. They argue that such a rule would eliminate the need for an increased budget or fees for two reasons: first, because many claimants would choose the AAA,[60] which they argue is a better forum than NASD Regulation; [61] and second, because the appropriate fees for NASD Regulation's arbitration services can only be determined when its arbitration forum is required to compete with other arbitration forums.[62] In addition, one commenter suggests that the NASD's arbitration expense projections are high compared with the AAA expenses.[63] In support of the proposed rule change, one commenter argues that the AAA fees are substantially higher than the proposed fees, and that ''claimants' bar is willing to pay higher fees if it deems it to be in its best interest.'' [64]

In response, NASD Regulation states that enabling investors to take their claims to AAA would not address commenters' concerns about the cost of arbitration because AAA is no less expensive and is not subsidized by member firms.[65] It also states its understanding that AAA does not waive its fees in cases of financial hardship. NASD Regulation also submitted a comparison of NASD Regulation and AAA fees and charges for customer arbitrations, stating that ''NASD arbitration charges under the proposed new fee schedule will generally be substantially less than the AAA's charges for comparable cases.'' [66] In addition, NASD Regulation states that the issue of the widespread use of arbitration contracts raised by the commenters is not before the Commission in connection with this rule filing.

Arbitrator Honoraria

One commenter argues that the arbitrator honoraria should not be increased.[67] The commenter argues that SRO arbitrators are volunteers rendering a public service, not professional arbitrators, and that because the proposed increase would not actually compensate arbitrators for the amount of time they typically devote to cases, the increase would not attract more qualified arbitrators. He also stated that if this honorarium increase did attract arbitrators, it would raise a concern that those arbitrators might not award appropriate damages against respondent firms for fear of being struck from future panels. Another commenter argues that an increase in arbitrator honoraria is reasonable but that it should not apply to pre-hearing conferences.[68] One commenter states that the expense of the arbitrator honoraria increase should be paid by the industry, and characterizes the Task Force Report as supporting this argument.[69]

Miscellaneous

One commenter argues that the proposed fee increase would reduce the uniformity of the arbitration rules used by the SROs and lead to forum shopping, as was typical before SICA was established to create a uniform code.[70] One commenter who supports the proposed rule change states that it takes no position on the issue of uniformity but noted that other SROs are smaller and may have lower expenses, and accordingly no need to increase fees.[71] One commenter argues that the fee increase will cause investors to use other SRO arbitration forums not prepared to handle the increase in case load.[72] Another commenter suggests that NASD Regulation increase the amount it contributes to funding the arbitration budget rather than trying to make arbitration self-sustaining.[73]

One commenter states that public customers' interests are not represented in the administration of the NASD's Arbitration Department.[74] NASD Regulation responds that the public is represented in the administration of the arbitration program because NASD Regulation's National Arbitration and Mediation Committee (''NAMC'') includes several public members.[75] NASD Regulation also responds that three of the six members of its Subcommittee on Arbitration Fees, which was formed by the NASD Regulation Board of Directors to develop the proposed fee increases, are representatives of the public.[76]

Finally, several commenters argue that there have been changes in the NASD's fee administration that have not been noticed for comment, or approved by the Commission, that result in arbitrators increasingly assessing fees against customer claimants, even when these claimants recover an award.[77] One commenter, an individual investor who recently completed an arbitration at the NASD, states that even though he prevailed in arbitration, the arbitrators assessed half the arbitration fees against him.[78] He also states that if he had been allowed to file his claim in court, the fees would automatically have been assessed against the loser. One commenter states that a practice of assessing fees against investors can have the effect of a sanction for bringing losing cases. That commenter argues that the fact that an investor does not prevail does not mean that a ''sanction'' is appropriate.[79] Another commenter notes that there is a developing trend

* * *. Such a condition * * * presents a situation where the customer is actually being denied equal protection of the law.'').

[58] *See* Comment Letter Nos. 3 and 4.

[59] *See* NASD Responses One and Three.

[60] *See* Comment Letter Nos. 7; 26; 27; and 30 (''The American Arbitration Association alternative would be a means of reducing the caseload and the budget deficit of the NASD.'').

[61] *See* Comment Letter Nos. 14; 20 (''AAA's case administration is much, much better * * *. The letter notes also that ''the cost of the AAA is much higher * * *''); 27; and 35.

[62] *See* Comment Letter No. 13.

[63] *See* Comment Letter No. 36.

[64] *See* Comment Letter No. 37.

[65] *See* NASD Response One.

[66] *See* letter from John M. Ramsey, Vice President and Deputy General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated August 18, 1998.

[67] *See* Comment Letter No. 28.

[68] *See* Comment Letter No. 36. The commenter does not believe that pre-hearing conferences warrant the same fee for arbitrators as a hearing session because they are often conducted over the telephone and are of short duration.

[69] *See* Comment Letter No. 3.

[70] *See* Comment Letter No. 28.

[71] *See* Comment Letter No. 37.

[72] *See* Comment Letter No. 16.

[73] *See* Comment Letter No. 4.

[74] *See* Comment Letter No. 11.

[75] *See* NASD Response One.

[76] NASD Regulation identified James E. Burton, CalPERS, Bonnie Guitton Hill, Times-Mirror Corp., and William S. Lapp, Laurie, Libra, Abramson & Thomson and PIABA board member, as representative of the public.

[77] *See* Comment Letter Nos. 1 (''We are experiencing more and more cases where customers are directed by the arbitrators to pay all or 50% of the hearing session fees even when the member firms are found liable.''); 17 (''Over the last two years, it has become common that the arbitrator split arbitral fees between the investor and the firm, even in cases where the investor received a substantial recovery. * * * 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.''); and 39.

[78] *See* Comment Letter No. 24.

[79] *See* Comment Letter No. 17.

among arbitration panels to request additional session deposits. In that commenter's view, this results from information and training materials given to the arbitrators at training sessions, or advice given by employees of NASD Regulation. The commenter views this as inappropriate because fee assessments are a matter of arbitrator discretion.[80]

NASD Regulation responds that, contrary to commenters' assertions, its figures demonstrate that members are paying approximately 80 percent of the fees assessed, and that public investors are paying 20 percent.[81] NASD Regulation stated that it is also revising its arbitrator training to clarify the issues that arbitrators should consider in assessing forum fees in order to encourage the fair allocation of forum fees for investors and industry parties. NASD Regulation states that such factors include whether a party substantially prevailed, or engaged in dilatory or unreasonable conduct. Moreover, NASD Regulation stated in conjunction with this rule proposal that it now advises arbitrators of the dollar amount of the fees that may be assessed under the fee schedules so that they more clearly understand the consequences to all parties of fee allocations based upon a percentage. Previously, some arbitrators may have ordered percentage-based allocation of fees without checking the total dollar amounts that had accumulated over multiple hearing sessions. Finally, NASD Regulation states it is no longer suggesting, in training materials or otherwise, that arbitrators assess interim hearing session deposits until after a substantial number of hearing sessions have been held.[82]

IV. Discussion

Under Section 19(b) of the Act, the Commission must approve a self-regulatory organization's proposed rule change if it finds it is consistent with the Act.[83] The key statutory provision with respect to an association's fees is section 15A(b)(5) of the Act,[84] which requires that the rules of an association provide for the ''equitable allocation of reasonable'' fees.

In support of this proposal, NASD Regulation conducted an analysis of its costs in order to determine how to allocate fees and fee increases reasonably and fairly among members and investor users of the program. In particular, NASD Regulation analyzed its operating cost figures in order to compute appropriate fee increases.[85] NASD Regulation's analysis permitted the Office of Dispute Resolution to extrapolate its likely costs for 1998 and compare them to the expected revenue under the new fee structure. NASD Regulation's analysis of its average cost of performing these activities[86] and a hypothetical cumulative cost for each case,[87] charted against the fee revenue received for each case, indicates that the revenue from filing fees has been expended before a pre-hearing conference is held. NASD Regulation's analysis also indicates that once an award is rendered following a hearing, all of the revenue from the additional forum fees (principally the fees based upon the number of hearing sessions) that could be collected in a case also has been expended.[88] In short, the filing fees and hearing session deposits, even with the increase in fees proposed in this rule filing, do not cover the cost of administering the program.[89]

Based upon the analysis of its costs of administering the arbitration program, NASD Regulation designed the proposed fee increases to attempt to cover the projected actual costs incurred by NASD Regulation in administering particular cases. In particular, NASD Regulation states that the filing fees were designed to cover much of the actual projected costs of the arbitration process from filing up to the prehearing conference. According to NASD Regulation, in the lower bracket cases the filing fees are lower than its cost of providing the service, and in larger bracket cases, the filing fees approach but do not exceed its average cost of providing the service. The hearing session deposit fee increase was also based upon the analysis of the projected average cost to provide a single hearing session.[90]

The Commission believes that the proposed fee increases for members and associated persons are reasonable under the Act because they are designed to cover the direct costs of administering the arbitration program. Moreover, the

[80] *See* Comment Letter No. 8.

[81] *See* NASD Responses One and Three. NASD Regulation states that these percentages cover the time period September 1, 1996 to August 31, 1997. This figure does not include the initial filing fee paid by claimants. When filing fees and hearing session fees are added together, and adjustments are made for deposits and refunds, the customer share of net revenue during that period was 23%. According to NASD Regulation, its data for 1995, 1996 and 1997 also show approximately the same customer to member ratio.

[82] NASD Regulation states it has experienced increasing difficulty collecting forum fees from unsuccessful claimants after an award has been made, and notes its understanding that other, non-industry forums, such as AAA, will not accept a case for disposition unless fees are paid in advance.

[83] In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[84] 15 U.S.C. 78*o*–3(b)(5).

[85] NASD Regulation looked at costs associated with such activities as: (1) Receiving and processing claims; (2) analyzing and serving claims; (3) selecting arbitrators; (4) scheduling hearings; and (5) conducting hearing sessions.

[86] NASD Regulation stated that it computed the average activity cost by taking the total cost for each activity and dividing it by the number of times each activity occurred.

[87] NASD Regulation stated that it charted the activities and their costs sequentially as they likely would occur in a case to produce a hypothetical cumulative cost at each major stage of a case.

[88] NASD Regulation stated that its analysis takes into account that some activities (processing motions, for example) will occur several times in a case. In addition, the costs of some activities (notably, holding hearings) vary greatly so that, although it is possible to establish an average cost for the activity, the cost of the activity in a particular case could be substantially higher or lower than the average. Finally, NASD regulation states that in its experience, the cost of some activities tends to vary by the amount in dispute, with larger cases tending to cost more to administer at certain stages than smaller cases. It believes that the cost variance may result from the increased contentiousness of the litigants when there are larger damages in dispute as well as from the fact that there are sometimes more parties involved in cases where large amounts are in dispute.

[89] While its budget figures project that the proposed filing and hearing session fees may pay for approximately 68% of its direct costs of administering cases, NASD Regulation's actual experience with revenue received during the year suggests that the fees may pay approximately 50% of the direct costs. The proposed filing and hearing session fees would not pay for NASD Regulation's general costs for administering the arbitration department, including costs for arbitrator recruitment and training, computer systems, office space, senior management, and legal services. *See* letter from Elliott Curzon, Assistant General Counsel, NASD Regulation, to Robert A. Love, Special Counsel, Division of Market Regulation, Commission, dated June 4, 1998.

[90] According to the NASD, in 1996 the cost of the dispute resolution program exceeded fee revenue by $11.3 million. For 1997, even with the implementation of increases in the member surcharge and an increase in revenue due to increases in the arbitration caseload, the cost exceeded revenue by $14.9 million. For 1998, the cost of the program was expected to exceed revenue by $6.1 million (this was assuming the proposed changes were approved and implemented by the beginning of the year; it also excludes, however, the member process fee, which was implemented to cover this gap). The costs associated with particular cases, however, fall along a wide spectrum depending on the nature of the case. Cases that are settled shortly after being filed usually cost little to administer. Cases that involve numerous and complex issues, numerous pre-hearing rulings and conferences with the arbitrators, lengthy hearings and, finally, an award are more costly to administer than other cases. The Office has also found that the larger the amount in dispute, the more costly the case is to administer because there are usually more parties involved (which makes communication more costly and time-consuming), there are more motions and other disputes to resolve, and pre-hearing conference and hearing logistics are more complicated. This wide spectrum of costs is the reason that the Office imposes graduated fees in two stages: filing fees and forum fees (the latter are partly prepaid through hearing session deposits).

fee increase (to cover direct costs) as applied to those claims that solely involve industry parties is consistent with the SRO rules to resolve industry disputes outside the court system, through the arbitration process.[91]

The proposed new filing fees range from $25 to $600 for public investors. The average increase is 50% in most categories. The largest filing fee increases are in cases where the claims are for $1 million or more.[92] There is no increase in the $1,000 to $10,000 categories. The Commission believes that these increases are reasonable because they are designed to require that public investors pay no more than the average direct costs incurred by NASD Regulation to provide arbitration services to the parties. Moreover, the arbitrators in their award may determine that a respondent must reimburse an investor for any filing fee it has paid.[93]

The amount of the hearing session deposit increases are also reasonable. The resulting hearing session deposits are graduated from a relatively low level for cases in lower brackets so as to not discourage public investors from seeking relief, up to the projected average cost of conducting hearings in the higher brackets.[94] Under the proposal, the hearing session deposit will be the same for claims filed by public investors and members. The hearing session deposit, and by extension the hearing session fees, are designed not to exceed the NASD Regulation's actual costs. According to the proposal, these costs are, on average, approximately the same regardless of who the parties are, even if they may vary by the amount in dispute or the number of parties involved. It is these average direct costs for providing a hearing (including arbitrator compensation and a hearing room, for example) that are paid for with these fees. In addition, the fees are not automatically imposed on either party.

The proposed rule change also provides for the equitable allocation of these filing and hearing session fees. Under NASD Rule 10332(c) governing the assessment of fees, which remains unchanged by this rule filing, ''[t]he arbitrators, in their awards, shall determine the amount chargeable to the parties as forum fees and shall determine who shall pay such forum fees.'' Under the rule, arbitrators may apportion forum fees among the parties, or may assess all of them against one party or the other. Under the rule, the arbitrators also may determine not to assess some or all of the fees, in which case NASD Regulation would have to absorb the costs of the proceeding. Under its rule structure, the only fee NASD Regulation is assured that it does not have to return to the parties is the initial filing fee.

Significantly, NASD Regulation has stated it will waive the initial filing fee and hearing session deposit at the time of filing if a party can demonstrate financial hardship.[95] It is the Commission's understanding and expectation that NASD Regulation will make known to potential claimants, especially investors, that there can be a financial hardship waiver of the filing fee and initial hearing session deposit. The Commission also understands that the procedure for filing a request for a waiver will be clear to claimants. After the initial filing fee and hearing session deposit are paid or waived, the arbitrators in a given case have the discretion to require additional hearing session fee deposits. In a case where the NASD Regulation has waived the initial filing fee due to financial hardship, it would seem improvable that an arbitrator would require the claimant to pay hearing session fee deposits. (Conversely, an arbitrator could well conclude not to require additional hearing session fee deposits on financial hardship grounds even where NASD Regulation staff had refused to waive the filing fee and initial hearing session deposit.) Because the financial hardship waiver is important to the Commission's finding that the proposed fee increases are equitable, the Commission plans to monitor closely NASD Regulation's administration of the waiver process. Further, NASD Regulation states that it takes financial hardship into account when deciding whether to pursue collection action against a party who has been ordered to pay fees, but has failed to do so.

Arbitrators are charged with making fee assessment decisions after consideration of whether a party substantially prevailed, or engaged in dilatory or unreasonable conduct. Arbitrators, who are entrusted with resolving many other difficult issues involving the parties, also are capable of resolving the equitable allocation of these increased fees.[96] NASD Regulation stated in conjunction with this proposal that it now advises arbitrators of the dollar amount of fees that may be assessed under the fee schedules against the parties so that they clearly understand the consequence to all parties of fee allocations based upon a percentage. NASD Regulation also has stated that it is revising its arbitrator training to clarify issues and factors arbitrators should consider in assessing forum fees, in order to promote fair fee assessments. Moreover, the overall fee structure continues to provide that the arbitration program is subsidized by the NASD and its members.[97]

Some commenters argue that the fee increases in the proposed rule change are inconsistent with the Act because some investors may be deterred by the fees from bringing claims to arbitration. The Commission understands that investors will weigh any increase in the fees as part of their consideration whether to file an arbitration claim. As the Commission has stated previously, arbitration fees ''should not be permitted to operate in a manner that weighs too heavily on individual parties or serves as a disincentive to pursuing the redress of investors' grievances against broker-dealers or their

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[91] *See, e.g.,* NASD Rule 10201.

[92] In the $3 million to $5 million category, the increase is 140%; in the $1 million to $3 million, $5 million to $10 million, and over $10 million categories, the increase is 100%.

[93] NASD Rule 10332(c).

[94] NASD Regulation's projected average cost to provide hearings in 1998 is approximately $1,200 per hearing session. This is based upon NASD Regulation's activity-based costing study, described more fully in the notice of the proposed rule change. *See* Securities Exchange Act Release No. 39346 (November 21, 1997), 62 FR 63580 (December 1, 1997). The activities used in computing this cost include arbitrator expenses and compensation, hearing room expenses, expenses of keeping a record, and staff work and expenses. NASD Regulation states that the Office's experience also shows that the costs of conducting hearings vary as the amount in dispute and the number of parties involved increase. In many cases, staff attorneys may need to attend some or all of the hearing sessions, staff coordination of logistics may be more difficult and complicated, and staff communication with the parties may be more involved and time-consuming.

[95] Arbitrators also may order a respondent to reimburse a claimant for the amount of the filing fee paid at the beginning of the case.

[96] NASD Regulation has stated that, historically, arbitrators have assessed approximately 77 percent of the fees against member parties to arbitrations. NASD Regulation does not expect this pattern to change, but also has undertaken to monitor fee assessments.

[97] NASD Regulation states that a small number of large firms are involved in more than 50 percent of all arbitration cases, and it determined to shift member costs to these member users. The NASD's arbitration program will continue to be subsidized by member firms, but the subsidy has largely shifted from all members to member users. This subsidy comes from two separate fees imposed only on member parties to arbitration cases. In 1994, NASD Regulation began charging members a non-refundable ''member surcharge'' fee (and increased the fee in 1997) if the member or an associated person of the member was named in an arbitration proceeding. In 1998, NASD Regulation began charging a ''member process'' fee against firms involved in an arbitration as the case progresses to different phases (accordingly, a firm that is able to settle a case before a hearing would be able to avoid some of the member process fee). The fee was intended to address a projected $6.1 million deficit that would remain even with the approval of this rule proposal. *See supra* notes 39 and 90.

associated persons.'' [98] Clear procedures for waiving initial fees in cases of financial hardship and arbitrator discretion should help prevent fees from becoming too onerous for individual investors.

Set out below are three charts that compare hearing session fees under the current and proposed new fee structures. The first chart includes sample hearing session fees for larger cases, which typically are resolved by three arbitrators. The second chart includes sample hearing session fees for smaller cases, which typically are resolved by a single arbitrator. The third chart includes sample fees for smaller cases decided on the paper record.

Chart I is based largely on the sample cases set out in Exhibit 2 to the proposed rule change. It takes into account both the amount of the hearing session fees that could be assessed and the number of hearing sessions typically conducted within the bracket.

CHART I

Case dollar amount and number of hearing sessions	Hearing session fees under current rule in 1990 dollars	Hearing session fees under current rule in 1998 dollars (adjusting current fees for inflation) [99]	Hearing session fees under new rule
$30,000.01–$50,000 (four hearing sessions)[100]	$1,600	$2,008	$2,400
$50,000.01–$100,000 (four hearing sessions)	2,400	3,012	3,000
$100,000.01–$500,000 (six hearing sessions)	4,500	5,647	6,750
$500,000.01–$1,000,000 (nine hearing sessions)	6,750	8,470	10,800
$1,000,000.01–$3,000,000 (ten hearing sessions)	10,000	12,548	12,000

Chart II is based upon the fees that can be assessed for cases up to $30,000 that are decided with an in-person hearing.

CHART II

Case dollar amount [101]	Hearing session fees with one arbitrator under current rule in 1990 dollars	Hearing session fees with one arbitrator under current rule in 1998 dollars (adjusting fees for inflation)	Hearing session fees with one arbitrator under new rule
$.01–$1,000	$30	$38	$50
$1,000–$2,500	50	62	100
$2,500.01–$5,000	200	250	250
$5,000.01–$10,000	400	502	500
$10,000.01–$25,000 [102]	600	752	900
$25,000.01–$30,000 [103]	900	1,128	1,350

Chart III is based upon sample cases decided on the paper record without an oral hearing. This option, which is available for cases up to $25,000, is the least expensive option for resolving disputes.

CHART III

Case dollar amount	Fees for cases decided on the paper record under current rule in 1990 dollars	Fees for cases decided on the paper record under current rules in 1998 dollars (adjusting fees for inflation)	Fees for cases decided on the paper record under new rules
$.01–$1,000	$15	$19	$25
$1,000.01–$2,500	25	31	50
$2,500.01–$5,000	75	94	125
$5,000.01–$10,000	75	94	250
$10,000.01–$25,000	NA	NA	300
$25,000.01–$30,000	NA	NA	NA

[98] Securities Exchange Act Release No. 26805 (May 10, 1989), 54 FR 21144 (May 16, 1989).

[99] Current fees, adjusted for inflation, are added here as a point of reference. They were not included in the NASD's proposed rule change.

[100] Under the new fee structure, parties with disputes in this bracket will be able to agree to have one arbitrator decide their case. If one arbitrator is used, the hearing session fee would be $1,800.

[101] Two hearing sessions are assumed for all cases up to $25,000, and three hearing sessions are assumed for cases between $25,000.01 and $30,000. *See* letters from John M. Ramsey, Vice President and Deputy General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated August 18, 1998 and September 10, 1998.

[102] If three arbitrators were used, the current fee for two hearing sessions would be $800, the current fee adjusted for inflation would be $1,004. Three person panels are not typically available under the new fee structure for cases below $25,000.01.

[103] If three arbitrators were used, the current fee for three hearing sessions would be $1,200, the current fee adjusted for inflation would be $1,506, and the fee under the new rule would be $1,800.

The existing fee schedule was established in 1990.[104] Inflation has risen 25% since that time.[105] Moreover, the NASD's arbitration facilities have grown in the past eight years since the fees were last revised.[106] In dollar amounts, the additional cost to investors with smaller claims as a result of the fee increased would not be substantial. For large claims, a significant amount of money already is at stake in the litigation and the amounts that the arbitrators may assess against one or both of the parties is not so large that it should affect the decision to pursue claims, especially when the arbitrators assess fees only after fully considering each party's position. Again, the NASD's financial hardship fee waiver process should help assure that investors do not forego their claims solely on account of the fee increase.

Comments challenging the efficiency and quality of arbitration administered by the NASD reinforce the importance of the work undertaken by the NASD's Arbitration Policy task Force and its NAMC, as well as the Commission's own oversight of the arbitration process.[107] These criticisms, however, do not refute NASD Regulation's demonstration that it expends significant amounts of money administering its arbitration program that have not in the past been matched by fee revenue, and that these fee increases are directed at recovering the direct costs of administering the forum. More importantly, they also are outweighed by the fact that arbitrators make fee allocations after a hearing on the record.

Some commenter's other broad attacks against the proposed fee are equally unpersuasive. As noted above, several commenters, citing *McMahon,* questioned whether the fee increases would prevent claimants from being able to vindicate their rights in arbitration. Because the fee increases will not affect the substantive rights of claimants, and because NASD Regulation has a fee waiver process for claimants who have a financial inability to pay the fees, the Commission sees no conflict with *McMahon.*[108] As to the comments regarding whether arbitrators require periodic payments of hearing session deposits and how arbitrators allocate fees in their awards, NASD Regulation states it is revising its arbitrator training to clarify the issues and factors arbitrators should consider in assessing forum fees, in order to ensure that those fees are assessed fairly.[109] It is clear that determinations about whether to request additional hearing session deposits from the parties during a case are at the sole discretion of the arbitrators.

In conclusion, the proposed fee increases are reasonable because they do not exceed the direct average cost of resolving a dispute. Moreover, the NASD's financial hardship fee waiver process should help assure that investors do not forego filing their claims solely on account of the fee increase. Finally, the proposed fee increases are equitably allocated because it is the arbitrators who decide who will pay them in any individual case.

V. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[110] that the proposed rule change (SR–NASD–97–79) is approved.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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[104] Securities Exchange Act Release No. 28086 (June 1, 1990), 55 FR 23493 (June 8, 1990).

[105] Consumer Price Index, All Urban Consumers, All Items, U.S. Department of Labor, Bureau of Labor Statistics.

[106] For example, 3,617 cases were filed in 1990, and 5,997 cases were filed in 1997. To administer these cases, NASD Regulation has developed a new computer system to process the selection of arbitrators under a list selection system for selecting arbitrators that the Commission recently approved. *See supra* note 53.

[107] The NASD has reported that it has implemented steps to improve efficiency, including the early selection of arbitrators. The increase in arbitrator honoraria proposed in this filing is part of NASD Regulation's effort to attract and retain qualified arbitrators. Moreover, the Commission has recently approved NASD Regulation's list selection method for choosing arbitrators, which may be preferred by investors. *See* Securities Exchange Act Release No. 40555 (October 14, 1998), 63 FR 56670 (October 22, 1998). NASD Regulation also has reported to the Commission initiatives to improve case processing and administration by, among other things, upgrading its computerized case tracking system and hiring additional staff.

The comments that arbitration fees are higher than court fees do not on their own indicate that the proposed fees are not reasonable. Litigation is likely to involve other significant costs associated with depositions and attorney fees that would likely be lower in an arbitration setting.

[108] We also do not agree with the commenters' statements that the fee increases would raise equal protection or due process concerns. A threshold requirement of any constitutional claim is the presence of state action. *See, e.g., Lugar* v. *Edmondson,* 457 U.S. 922, 936 (1982). A government agency's oversight or approval of a regulated entity's business and operations does not constitute state action. *See, e.g., Jackson* v. *Metropolitan Edison Co.,* 419 U.S. 345, 357 (1974). Courts that have considered the issue have concluded that the NASD's operation of an arbitration forum does not constitute state action simply because the Commission reviews and approves arbitration rules. *See, e.g., Cremin* v. *Merrill Lynch Pierce Fenner & Smith, Inc.,* 957 F. Supp. 1460, 1465–1470 (N.D. Ill. 1997).

[109] *See* NASD Response One.

[110] 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41084; File No. SR–NYSE–98–34]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the New York Stock Exchange, Inc. to Amend Rule 104.10 to Require Floor Official Approval for Destabilizing Odd-Lot Transactions

February 22, 1999.

I. Introduction

On October 16, 1998, the New York Stock Exchange, Inc. (''NYSE'') submitted to the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend Rule 104.10 by deleting the odd-lot exception. The proposed rule change was published for comment in the **Federal Register** on December 4, 1998.[3] On November 20, 1998, the NYSE submitted a letter to the Commission clarifying the treatment of odd-lot offsets, the substance of which was incorporated into the notice and this order.[4] The Commission received no comments on the proposal. This order approves the proposal.

II. Description of the Proposal

The Exchange is proposing to amend NYSE Rule 104.10(b)(i) by eliminating paragraph (C), which provides an exception to the Floor Official approval requirement for specialist purchases and sales on destabilizing ticks to offset position acquired by the specialist in executing odd-lot orders in the same day.

NYSE Rule 104 governs specialists' dealings in their specialty stocks. In particular, NYSE Rule 104.10(6) describes the manner in which a specialist may liquidate or increase his or her position in a specialty stock. In general, the rule requires such

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 40711 (November 25, 1998), 63 FR 67160.

[4] Letter from Agnes Gautier, Vice President, Market Surveillance, NYSE, to Richard Strasser, Assistant Director, Division of Market Regulation (''Division''), Commission, dated November 20, 1998 (''NYSE Letter'').