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Single Forum Study

SINGLE FORUM STUDY

Introduction

PROF. KATSORIS: I took the liberty of handing out a cartoon[233] during the recess because cartoons are often worth a thousand words. Many of the issues being discussed today hinge on the competency of the arbitrators selected, and in today's *National Law Journal*, which is one of the leading legal periodicals, they have a very cute cartoon dealing with arbitrator selection. I thought I would make it part of the record, if for no other reason than to show that lawyers do have a sense of humor.

Our next speaker is our wildcard speaker. He is the gentleman from Coopers & Lybrand who conducted the study on the single forum.

When arbitrations escalated from approximately eight hundred to over six thousand a year in a period of about eight years, it strained the systems of the various SROs, and much thought was given to how we could streamline or improve the system.

One of the suggestions was to look at creating a single, independent forum. SICA commissioned Coopers & Lybrand to look into that and report back to SICA, which they did. Without any further discussion I turn it over to James Steffenburg, who was the manager of that project for Coopers.

Panelist

MR. STEFFENBURG: Thank you, Gus. Thank you, Chairman Donaldson.

I'm returning here on a reprise of the last Symposium session on this topic, which appears to continue to be of interest to those in this area. Certainly some of the issues that I'll review here today, as our studies do touch on some of the issues that you have been working on and discussing here, will be of interest.

It really started back in the spring of 1990, so this is not current data. There was a request for proposal from the Securities Industry Conference on Arbitration. The proposed study was to look at the viability and preferability of a single forum. At the time, this appeared to be a very broad-based objective. In structuring our approach, we recognized that we couldn't look in depth at everything about arbitration or every issue related to a single forum.

One issue that appeared to be driving the consideration of the single forum alternative was the cost. As Gus said, there had been a large increase in case loads, particularly in the 1988 to 1990 period.

233. The cartoon is reprinted on the following page.

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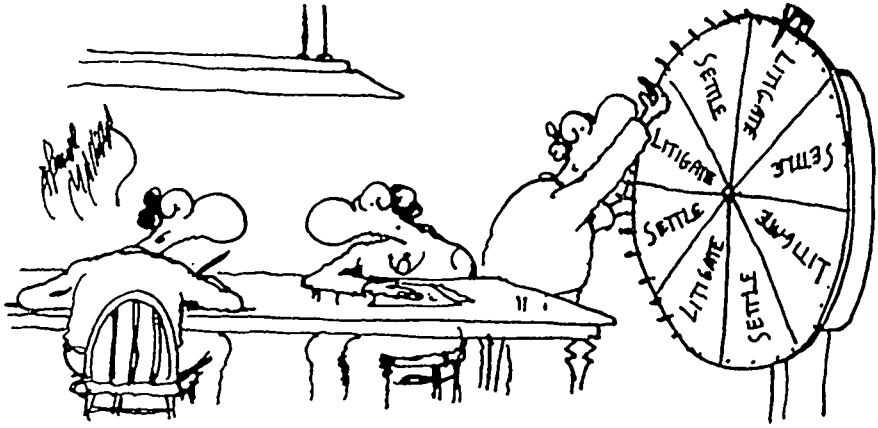

"Where did you get this arbitrator, anyway?!"

There was also an increase in the number of sessions per case, which was changing the whole way of administering the process. Arbitrator demands were growing to meet these case loads, and session-per-case increases and new record keeping requirements were being instituted with significant impact on administrative support requirements. All of these factors were raising the cost of supporting independent forums.

There were also some signs that 1990 was a good time to look at the concept of a single forum—to consolidate the activities of the SRO members of SICA. There was already significant concentration of caseload in two member forums, the NASD and the New York Stock Exchange. The Uniform Code of Arbitration, developed by SICA, was much accepted in principle by most of the SROs, creating a framework for standardization of the process.

Faced with the broad objective of assessing the viability and preferability of a single forum and recognizing the complex set of implementation issues and SRO perspectives, we tried to devise an approach that would provide an effective framework for discussion. We realized that if there was an underlying assumption that the single forum could provide more cost-effective delivery of the arbitration service, our approach must focus first on determining if an economic and/or quality benefit could result from such a consolidation. After that analysis was performed, we could look at the implementation considerations related to setting up a single forum.

Our first step was to develop an understanding of the current multiforum environment through surveys, questionnaires, and interviews with members of each of the SRO forums. Additionally, we conducted telephone interviews with some of the firm and plaintiff-side counsel.

We found four core functional responsibilities for the arbitration forums: customer inquiry services, claims processing or case management, arbitrator pool management, and case record management. At the time of our study, customer inquiry and claims processing represented the primary workload drivers for the administration of the forum process in each of the forums. In the claims-processing function, the process was generally similar, but the most significant variations that occurred in the hearing stage related to the staff attendance and the method of recording the hearings.

Arbitrator pool management varied across the forums. Recruiting efforts depended on caseload, geographic needs, availability of referral candidates, and the individual forum attitude on frequency of service for each arbitrator (which was a difficult issue then, just as Debbie Masucci has mentioned today—how often you should be using the same arbitrator). Qualifying and classifying arbitrators were generally based on profiles or questionnaires, which were similar but did vary in some of the details and the way they were administered across the forums. Training varied from the use of an arbitrator man-

ual that had been developed and distributed to the potential arbitrators, to various orientation sessions, seminars, and videos. Lastly, arbitrator evaluation varied in terms of formality and who performed the evaluation.

Once we had reviewed the process at the ten SROs, we developed a baseline single forum model to test the hypothesis that economic and/or quality benefits could result from a single forum alternative. The cost and benefits of this baseline model were then compared to the estimated total cost and benefits of the ten SRO forums.

I should point out that the determination of current cost was not always easy due to the wide variation of cost structures, accounting methods, and cost allocations. The cost assumptions were reviewed several times with the working committee of the SROs, and we reached an agreement on the numbers to be used in the study. This was key to making sure we were all working from a common baseline.

Direct costs, which included personnel costs and the direct hearing costs such as arbitrator honorarium, rental of hearing rooms, court reporters, and staff travel to hearings, were the most easily validated across all of the forums and they represented over seventy percent of the total cost at that time. This gave us a good handle on the bulk of the cost.

I guess the simplest answer to the economic benefit question was that the baseline model did suggest the potential for ten to fifteen percent direct cost reduction. However, most of these savings, if not all, could be attributed to three major areas that did not depend on the issue of consolidation into a single forum.

First, the productivity assumptions used in the model are for the number of cases handled per staff. The model used a number halfway between the average and the highest productivity ratio of the ten forums. This was an attempt to establish a benchmark for productivity in the single forum.

Second, the baseline model did not assume the presence of court reporters at the hearings, which some of the forums did utilize at that time. The reliance on tape recording was seen as a lower-cost alternative to the baseline model.

Third, full or part-time attendance of forum staff at the hearings was not included in the model. Again, this varied across the forums as to how much forum staff time was required at the hearings. As you can see, the baseline model represented a lowest-cost delivery approach to test the underlying hypothesis of economic benefits from a single forum alternative. As soon as either the court reporters or the forum staff at the hearings was added back, the direct cost savings basically disappeared.

The overall economic conclusion of the study was that the savings apparent in the baseline model were not the result of going to a single forum. Major savings were variously available to individual forums if

they chose to use a similar delivery approach. Because delivery approach directly impacts the perceived service level, a service level standard would have to be established across all ten SROs in order to determine the relative economic benefits.

While the model did not provide assurance of economic benefits, there were two areas where the single forum alternative appeared to offer some advantages. One area was arbitrator pool management. A single pool across the country could increase availability and improve scheduling. In addition, a single pool would facilitate standardized recruiting, qualifying, training, and evaluating of arbitrators. This might improve the overall quality of the arbitrators, and it might certainly improve the public's perception of that quality.

The other area was case-record management. The increased volume and complexity of cases and additional disclosure and access requirements that were coming to the fore at that time suggested that increased efficiency and effectiveness could be achieved through consolidated case management under the single forum alternative.

After review of the economic and delivery-quality issues, we looked at the implementation considerations should SICA and its members pursue the issue of a single forum. Two of those issues were the legal structure and the funding of a single forum. On the legal structure issue several alternatives were presented. The administration of the single forum could be subcontracted to a vendor or to one of the current forums. This could leave overall legal responsibility with each SRO while consolidating merely the administration of the process into a single activity and management function.

Other alternatives included a jointly-owned SRO subsidiary, an entirely new SRO entity with public and industry board membership or a fully independent entity with broader public participation. These alternatives created increasing degrees of legal and regulatory impact and certainly would require coordination with the SEC, which has oversight responsibility for the current forum structure.

Regardless of the single forum alternative or the legal structure, the funding of the arbitration process was a key issue. At the time of our study, fees and other charges only covered forty percent of the direct costs. This resulted in a significant subsidy of the process by the industry (an issue of public perception as to fairness and to SROs as to cost). As long as the industry values the SRO forum and the SEC and the public desire an affordable process for dispute resolution, this subsidy is likely to continue. During the study, we found that there was little interest in increasing participant fees that went against the idea of an economic alternative.

In our study, we discussed some options for changing the fee structure and distribution of funding. Some of the options included access fees, independent of the case load experience of an individual firm (basically assessing everyone a nominal fee for access to the forum),

and use fees, which are designed to assess costs in relation to the member firm's use of the forum services.

In summary, our study suggested that a single arbitration forum could provide some economic and service quality improvements, but these improvements could also be achieved, at least partially, by individual forums through changes in their delivery approach. The key phrase here is a delivery approach since this defines both the perceived quality of the service to the public and the cost to the industry. If the single arbitration forum alternative is revisited, it is critical that a service level standard be established to form the basis of cost and quality comparisons.

I'd be happy to answer any questions about the details of this study, at least those that I can remember from almost four years ago. I hope this gives you a flavor of the study, the single forum issues and the conclusions at that time. Thank you.

Discussion[234]

PROF. KATSORIS: Jim, before I open it up for comments or questions, I want to address something. While your report may not have answered all of SICA's questions, you certainly raised a lot of good issues, like Securities and Exchange Commission oversight, which we thought should remain, even if there were an independent forum. For a variety of reasons, however, we decided to table the single forum concept at SICA for the time being; but, it was an excellent report and we thank you for it.

One thing you mentioned is the issue of the recording of the arbitration proceedings, regardless of how one keeps it. I would like to point out that during the course of our discussion today, we're going to compare ourselves sometimes to what the American Arbitration Association does. I merely do that as a matter of comparison. It doesn't necessarily mean that I'm agreeing or disagreeing with what the AAA does. For example, I mentioned earlier that they don't have a six-year eligibility rule. Nor does the AAA require that a record be kept.[235]

On this issue of the record, however, I think the SROs have a much better rule, and that is, that the record must be kept of an arbitration.[236] Indeed, I felt so strongly about it, I wrote an article a few years ago for the *Securities Arbitration Commentator* entitled, *I Won't*

234. The following comments were made following Mr. Steffenburg's presentation on Nov. 21, 1994.

235. *See* Constantine N. Katsoris, *Should* McMahon *Be Revisited?* 59 Brook. L. Rev. 1113, 1125 (1993).

236. NYSE Rules, *supra* note 14, Rule 623, ¶ 2623; Uniform Code, *supra* note 14, § 24, at 19.

Sit Without a Record.[237] You have to have a record preserved. Indeed, it's absolutely imperative to have a record if you're going to have punitive damages in arbitration. So, I think the SROs have the better rule by requiring the record.

MR. BECKLEY: I would like to suggest four criteria in analyzing arbitration or maybe even any decision-making adjudication forum.

A decision-making forum ought to be efficient, economical, fair, and, most importantly, I think it should give the appearance of fairness. I think a single forum that is somewhat distanced from the Exchanges at this point might forward the appearance of fairness.

It might also reduce or even eliminate one of the more bizarre things we're seeing these days: overt forum shopping, where a claimant will pick a forum and a respondent will seek to enjoin that choice and get a court to order going forward in a different forum.

Or a situation I was involved in recently where a claimant hired a big, fancy New York law firm and agreed to the New York Stock Exchange arbitration, then hired somebody who knew something about arbitration and filed with the Chicago Board Options Exchange. We were in court arguing over which of those choices should be effectuated.

A single forum would eliminate much of this pre-arbitration posturing and make the process more economical and more inherently fair.

MS. McGUIRE: The SEC considered the fact that there are many forums in 1989 when it approved the SRO rules and, in its release, suggested a bias in favor of robust choices. The thought was that people, particularly claimants, should have a choice at least among SRO forums. The claimants have that choice under SRO arbitration rules, which cannot be constrained by the arbitration agreements. Claimants should have a right to go where they think they would get the best administration of their case.

Some people say that they are concerned about backlogs. So, those lawyers who were concerned about backlogs would take those cases to the forums that don't have big backlogs. Other people are concerned about arbitrators that are used more often. Some forums use arbitrators more frequently than other forums. Some lawyers don't like that and would go elsewhere.

So, the thought was that it would be better for the marketplace of forums to be available rather than for the Commission through its oversight of the rules and inspections to try to commit that one forum was absolutely right on target. We would rather in some ways do that with a variety of forums so there is an element of choice for investors. That was the thinking in 1989.

237. Constantine N. Katsoris, *I Won't Sit Without A Record*, Sec. Arb. Commentator, Sept. 1990, at 1-2.

MS. MASUCCI: The NASD has always been very supportive of the single arbitration forum concept and is regularly reviewing its feasibility. The fact remains that although there are ten self-regulatory organizations that offer arbitration, the majority of the cases fall on the shoulders of the NASD and the New York Stock Exchange. So, the issue of choice is one that is more form over substance. The reality is that most people choose one of these two organizations, and the other ones are chosen to a much lesser degree.[238]

I think what Mr. Beckley said is very accurate. We really do have to look at the process and how it can work in the most efficient, fair, and economic way, always looking at the perception of fairness. I believe that the perception of fairness has probably been the issue given the highest priority, at least for the last seven years. This is an issue that we should continue to study.[239]

MR. CELLA: The study did not take into consideration qualitative benefits such as an interactive single staff and the ability to produce a better product, but rather it tended to focus on the economics. Am I correct in my judgment on that?

MR. STEFFENBURG: Yes. Our model first tried to establish whether there was economic benefit of any significance, because it appeared as though if there weren't at that time, a lot of the interest in the single forum might not have continued at a high level. We did, however, talk about some improvements in quality. The issue of consolidating the arbitrator pool certainly could facilitate the process of recruiting, qualifying, certifying, training, and evaluating arbitrators, which, as we've heard in some of the other discussion topics here today, is part of the quality delivery function.

Whether that was dependent on a single forum or just an improvement in the way in which the process was coordinated by the individual forums was not determinable at the time. Clearly there are indications that single arbitrator pool management could provide some quality benefits. Also, the study looked at things like customer service in the area of customer inquiries. A centralized inquiry function for potential claimants might have economic and quality benefits. We did not directly measure the quality of the actual arbitration process or its decisions.

PROF. KATSORIS: Any other questions of Mr. Steffenburg? Let's move on to our next discussion.

238. *See* Eighth Report, *supra* note 6, at 25-29 (outlining the number of arbitration cases handled by different self-regulatory organizations).

239. The following comments were made following Mr. Steffenburg's remarks given on Dec. 5, 1995.