THE CASE FOR FLAT FEES IN SECURITIES ARBITRATION

Every General Counsel at every brokerage firm that has ever been named in a securites arbitration, and every individual broker in the same situation, is aware of the cost of defending a customer claim or an employment claim against the firm or broker. While securities arbitration has proven to be a cost-effective method of resolving disputes, the process is still expensive and time consuming.

One of the problematic issues in defense of securities arbitration claims is the unknown – the unknown costs of defense. The unknown factor has always been a significant factor in litigation – there are simply too many variables in litigation, and too many factors that are out of control of the client, and its attorney. The problem of course, is that the course of litigation is often dictated by the other client, the other attorney, and to a large extent, the arbitrators themselves.

That truism does not help General Counsel with his core problem – controlling litigation costs. Firms, and individual brokers, need to know what a defense case is going to cost, and the fact that there are variables that he cannot control does not change that issue. With cost cutting, litigation budgets and pressure to control litigation expense, defendants need to know what a case is going to cost, so those costs can be budgeted and planned.

While defendants and potential defendants will complain about those costs, and the variable nature of same, a key player in the quest for predictability of litigation defense costs is often overlooked – the selection of defense counsel.

Certainly GCs and individual brokers know that the choice of counsel makes a difference, but too often the choice is made solely on the basis of the lowest hourly rate. That method has been proven to be the least effective way of controlling costs. If you select counsel based on cost, you can easily end up with inexperienced counsel controlling your litigation. His inexperience will ultimately cost multiples of the savings from the lower hourly rate; and perhaps a significant award against the firm.

The way to control costs is to have outside counsel handle the defense of the securities arbitration on a flat fee. Heresy! Flat fees in litigation? Unheard of! Impossible! Suicide for the attorney!

Flat fees work for clients. They provide certainty in the budgeting process, an order to cash flow for defense costs, and a base upon which decisions can be made as to settlement.

But do flat fees work for defense counsel? They can, and do. The same certainty of cash flow benefits defense counsel. Everyone knows at the start of the case what the defense is going to cost. While factors need to be built in to address unknown contingencies, the vast majority of those cases do not involve those contingencies, and the flat fee is the fee at the end of the day.

Think about it for a moment. Certainly an out of control claimant or claimant's counsel, can run up litigation costs significantly. But in securities arbitrations, with limited discovery, and no depositions, the ability of claimant's counsel to run up costs is limited, He cannot schedule multiple depositions of every corporate officer, he cannot conduct unlimited third party discovery, and quite frankly, in the overwhelming majority of securities arbitration cases, Claimant's counsel is limited in what documents he is entitled to demand in document discovery.

Certainly there are exceptions, but the simple fact is that Claimant's counsel has no real interest in running up anyone's costs. He is typically on a contingency, and his interest is in obtaining the best result for his client at the lowest cost. He is not going to go away, and is not going to fold simply to save some time in discovery, but he also has no interest in demanding, and thus reviewing and digesting, enormous amounts of irrelevant discovery.

The reality is that experienced securities defense counsel knows what a case is going to cost to defend, within certain parameters. Certainly there are variables, but across cases, those variables even out. One case might involve the review of 1,000 emails, and take more time, but another is going to have 10 emails. Over a series of cases, across multiple clients, the cost evens out.

The simple fact is that defense counsel is the one with the experience, knowledge and background to make litigation decisions. He has handled hundreds of cases. Individual brokers have no experience in making litigation decisions, and the unknown cost of those decisions, and of the entire litigation, is a significant concern. In house counsel, with more experience with litigation costs has more knowledge, but is not involved in the day to day decision making process.

We provide services on a flat fee basis all the time, even where there are unknown costs, for exactly this reason. Take a 1017 application for example. Having handled 1017 applications for new firms, and for modifications for existing firms, our firm knows the cost of handling the application. Some are simple, some are complex. Sometimes the details of a particular application make the application more difficult. Some of the factors are out of control of the client and counsel – a FINRA examiner who is difficult or inexperienced, a member regulation staffer who is a stickler on a particular aspect of an application that most do not care about, an enforcement proceeding that is commenced in the middle of the application process, and on and on and on. But we do 1017 applications on a flat fee, with payment made in stages, and we take the risk of the unexpected, not the client.

We can do that because of our experience and the number of 1017 applications that we handle. Set a fee, the client knows what it is going to cost, and when that cost will arise and can plan for those costs. One application will have a factor that raises the cost, and thus reduces the profitability, another will go through faster than expected, and most will be done exactly as expected. With proper planning, the flat fee benefits everyone.

We handle private placements, for an issuer and for the placement agent, the same way. Our experience tells us what to expect, how much it is going to cost, and we can make a reasonably accurate projection of the legal fee for the project. There are certainly variables in

transactional work – difficult clients, difficult attorneys, unexpected documentation issues, additional agreements that need to be drawn, and more. But once again, with enough experience one can factor those variables into the fee, and many of those variables can be controlled or eliminated.

The defense of a customer claim, and even an employee claim against a firm, is similar. The key again, is experienced counsel. In my own practice, I have defended hundreds of cases, probably over 500. We know what the costs are going to be. We know how much time it will take to defend that claim, and can charge a flat fee, payable in stages at specific times in the litigation. We know the difference between the work involved in the defense of a churning case, versus a misrepresentation/fraud case, verses a market making case, and we can project those costs, and set a flat fee. And we do.

Certainly there is the occasional case where an arbitrator orders a massive document production or review, and the costs increase. But that contingency is built into the flat fee, because in the overwhelming majority of cases, that contingency never occurs. If the firm has enough experience, and enough cases, the one oddball case is not a significant issue.

The key to all of this is experienced defense counsel, who has systematized the process. Most defense counsel understand that the days of divergent costs and unlimited hourly billing are gone – if they ever existed. In order to properly represent the securities defendant, firms need to work smarter, use the computer systems that exist for the benefit of the client, and continue to systematize the process so that computer systems are used to their best advantage, and that portions of the work flow are assigned to the person with the lowest skill level required to complete that portion of the work.

At our firm, the process starts with our computer database. All information regarding a case is entered into the database. Contact information for the client, the adversary, the FINRA staff (most of whom are already in our database). Database entries are created for the type of case, the type of claims, the amount demand, and other relevant information regarding the case.

This may sound trite, but it is important, and updating the database throughout the course of the proceedings is equally important. When a document request needs to be generated, that database, along with our document template, generates the document. A legal assistant can, in a few mouse clicks, generate correspondence, a document request, or any other document, as a template for an attorney's review and modification. Discovery requests, motions to compel, pre-hearing briefs, even settlement agreements, are all connected to the database. For specific series of cases, we have a template of answer, drafted once for that series of cases, but used in multiple cases, with appropriate modifications.

This is of course, how most firms work. No client should be paying for the preparation and review of a pre-hearing churning memorandum from scratch. My firm has a brief bank that we maintain of hearing memorandums. We have collections of memos on churning, suitability, fraud, misrepresentation, fraudulent inducement, a broker's fiduciary duty (or rather lack thereof), negligence, breach of contract, and consumer protection statutes, from a variety of states. When a new memorandum is needed, we do not re-invent the wheel. One of the legal

assistants reviews the brief bank, pulls the memos and memo sections that are required for the new memo, puts a template together for one of the associates. The associate reviews the template, modifies the body to fit the case, updates the research as needed, and prepares the brief.

The same is true for other stages of the litigation. In discovery for example, our computer database has discovery requests that quite naturally include all of the items in the FINRA discovery guide. That list is updated as the discovery guide is changed, and is ready to be used in the next arbitration, without the time or expense of creating it from scratch. We also have a template for discovery requests in a churning case, in a suitability case, another for a misrepresentation case, and so on. Cases involving allegations revolving around market making have a template, as do claims for defense of broker claims. Document requests need to be tailored for each case, but they do not need to be created from scratch every time.

We have even taken the process so far as to standardize the preparation of an answer. In the instances where we have multiple defense cases for the same firm, arising from similar facts, we prepare a model answer, which includes all of the allegations and defenses that could be used in that type of case. The system is set up to ask questions, and to include certain paragraphs of responses and defenses, depending on the allegations of that particular complaint. When a new answer needs to be prepared, a legal assistant again uses that computerize form, creates a template for the answer, which is then given to the associate.

Therefore, instead of an associate starting to prepare an answer by typing on a blank piece of paper, she is starting to prepare the answer with a template in front of her, that has previously been reviewed by the partner handling that particular client's matters, and vetted by him. This simple step alone saves thousands of dollars in the pleading stage of the matter, as well as the advantage of providing consistency across cases so that a pleading in one case does not contradict the same pleading in a similar case for the same client.

This is not to suggest that litigation defense is a commodity, or computerized. It cannot be, and every case, every document, every pleading, is reviewed, modified, and approved by a partner. The reality is that segments of a litigation practice can be systemized, to the benefit of the firm and the client, and the use of computer systems, coupled with our vast experience in the defense of securities arbitrations, enables our firm to offer flat fees to our clients.

A revolution? Hardly. We think of it as an evolution of the attorney-client relationship.

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