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**PREDISPUTE ARBITRATION AGREEMENTS IN
SECURITIES DISPUTES: *RODRIGUEZ DE QUIJAS*
V. *SHEARSON/AMERICAN EXPRESS, INC.*—
SPEEDY JUSTICE OR JUST SPEED?**

I. INTRODUCTION

At the beginning of a relationship between a stockbroker¹ and a new customer, the broker typically obtains an agreement that any future disputes between the parties shall be subject to binding arbitration.² The agreement waives the customer's opportunity for court adjudication and trial by jury.³ The issue in this Note is whether such predispute arbitration agreements⁴ between stockbrokers and public customers⁵ are

1. The terms "broker" and "stockbroker" will be used as a convenient shorthand in this Note, referring to both the broker as an individual and the brokerage house employing the broker.

2. A typical agreement requires arbitration of disputes and specifies how the arbitration will be conducted (usually by specifying an organization to conduct the arbitration). *RESOLVING SECURITIES DISPUTES* 22 (Practising Law Institute, Corporate Law and Practice Course Handbook No. 535, 1986). The customer may be offered a choice of forum between organizations offering to conduct arbitrations, known as self-regulatory organizations (SROs). *Id.* at 27. SROs are most often owned or controlled by the securities industry; the busiest SROs are the New York Stock Exchange, Inc., and the National Association of Securities Dealers, Inc., which currently handle about 90% of the arbitrations nationwide. Metropolitan News-Enterprise (Los Angeles), Jan. 24, 1990, at 11, col. 1. A typical clause provides:

Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, the transactions with you for me, or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect of the National Association of Securities Dealers, Inc., and/or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc., as I may elect. If I do not make such election by registered mail addressed to you at your main office within five (5) days after demand by you that I make such election then you may make such election. Judgment upon any award ordered by the arbitrators may be entered in any court having jurisdiction thereof.

Rodriguez de Quijas v. Shearson/Lehman Bros., 845 F.2d 1296, 1297 n.2 (5th Cir. 1988), *aff'd sub nom. Rodriguez de Quijas v. Shearson/American Express*, 109 S. Ct. 1917 (1989).

3. See Katsoris, *The Securities Arbitrators' Nightmare*, 14 *FORDHAM URB. L.J.* 3, 4 (1986).

4. This Note considers only *predispute* arbitration agreements. Agreements reached in settlement of an existing dispute are uniformly upheld, but involve quite different principles and equities. *E.g.*, *Gardner v. Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970), *cert. denied*, 401 U.S. 978 (1971); *Moran v. Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968). Therefore, post-dispute arbitration agreements are beyond the scope of this Note.

5. This Note does not discuss the arbitrability of disputes between brokers, who are more likely to be in positions of relatively equal bargaining power. Such agreements are less controversial, and are routinely enforced. *E.g.*, *Axelrod & Co. v. Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971). Moreover, arbitration is required in most inter-broker disputes because of securities exchange rules affecting members of

enforceable.

The securities industry has argued from the earliest cases that arbitration is a mere choice-of-forum issue, providing swift, economical and fair resolution of broker-customer disputes.⁶ Securities customers have resisted arbitration, however, arguing a wide variety of procedural deficiencies and substantive unfairness.⁷ The wealth of litigation on the issue demonstrates that both sides of securities disputes consider enforceability an important matter.

The traditional answer to the enforceability question arose from the resolution of a perceived conflict among the Federal Arbitration Act⁸ (the FAA), the Securities Act of 1933⁹ (the Securities Act) and the Securities Exchange Act of 1934¹⁰ (the Exchange Act). The FAA generally requires enforcement of predispute arbitration agreements on motion;¹¹ the Securities Act grants the right to judicial redress and declares void agreements to waive any provision of the Securities Act.¹² The issue in this Note arises from the potential conflict between the FAA and the Securities Act in deciding the enforceability of an agreement to arbitrate securities disputes, specifically whether a predispute arbitration agreement between a securities customer and a broker is void as an agreement waiving a provision of the Securities Act, i.e., the right to judicial redress, or whether securities arbitration agreements are enforceable under the FAA.

In *Wilko v. Swan*,¹³ the United States Supreme Court concluded that predispute arbitration agreements could not be enforced as to securities disputes arising under the Securities Act.¹⁴ This "bright-line" resolution of the arbitrability question has dulled recently with the creation of numerous exceptions.¹⁵ A recent United States Supreme Court case, *Rodriguez de Quijas v. Shearson/American Express*,¹⁶ finally abandoned the *Wilko* rule and thus removed the legal barrier to enforcement of

the exchange. *E.g.*, Constitution of the New York Stock Exchange, art. IX, § 1, *reprinted in* 2 N.Y.S.E. Guide (CCH) ¶ 1501 (1986).

6. *E.g.*, *Wilko v. Swan*, 346 U.S. 427, 437-38 (1953).

7. *Id.* Customers have argued the forum is fundamentally biased in favor of the securities industry. *See infra* notes 228-61 and accompanying text.

8. 9 U.S.C. §§ 1-14 (1988).

9. 15 U.S.C. §§ 77a-77aa (1988).

10. *Id.* §§ 78a-78kk.

11. 9 U.S.C. § 2.

12. 15 U.S.C. § 77n.

13. 346 U.S. 427 (1953).

14. *Id.* at 438. For a discussion of *Wilko*, see *infra* notes 20-46 and accompanying text.

15. *See infra* notes 19-114 and accompanying text.

16. 109 S. Ct. 1917 (1989).

predispute arbitration agreements in securities disputes.¹⁷

In allowing enforcement of arbitration agreements, the Court overturned a long line of well-entrenched precedent supporting the *Wilko* rule.¹⁸ Just six years before *Rodriguez de Quijas*, the *Wilko* rule appeared so firmly established that the Securities and Exchange Commission (the SEC) announced to brokers that simply requesting such agreements from customers would be deemed a deceptive practice which could subject brokers to legal sanction.¹⁹

This Note reviews the historical background of predispute arbitration agreements between securities brokers and customers. It then focuses on the final step in the trend favoring arbitration, *Rodriguez de Quijas*, and lastly considers whether unrestricted arbitration as it now exists is a wise form of dispute resolution of conflicts between a public customer and a broker.

II. HISTORICAL BACKGROUND

A. *Wilko v. Swan: Securities Act Supersedes FAA, Rendering Predispute Arbitration Agreements Unenforceable*

In 1925, Congress reversed the common-law unenforceability of arbitration agreements by adopting the FAA, providing for specific enforcement of such agreements.²⁰ Following the stock market crash of 1929, Congress expanded securities regulation and guaranteed rights to judicial redress of disputes through the Securities Act.²¹ The interplay between these statutes was unclear for quite some time, since neither statute referred to the other or explicitly stated which would prevail in the face of a conflict between them.

1. The majority opinion

In 1953, the United States Supreme Court clarified the relationship between the FAA and the Securities Act in *Wilko v. Swan*.²² The facts involved a typical broker-customer dispute. The broker allegedly persuaded the customer to purchase stock by falsely representing that the corporation had agreed to a buy-out that would quickly increase the

17. *Id.* at 1922 (overruling *Wilko v. Swan*, 346 U.S. 477 (1953)).

18. See *infra* note 171-72 and accompanying text.

19. Exchange Act Release No. 20,397, 48 Fed. Reg. 53,404 (1983).

20. 9 U.S.C. §§ 1-14 (1988).

21. Securities Act of 1933, ch. 38, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (1988)).

22. 346 U.S. 427 (1953).

price of its stock.²³ Further, the broker allegedly failed to disclose that a director of the corporation was selling his shares.²⁴ The customer liquidated the stock two weeks later at a loss, which he sought to recover through litigation against the broker and others.²⁵

The customer sued in United States district court under section 12(2) of the Securities Act.²⁶ The defendant-broker moved to stay judicial proceedings until the matter could be arbitrated under provisions of margin agreements²⁷ with the customer, pursuant to section 3 of the FAA.²⁸ After a divided panel of the Second Circuit Court of Appeals²⁹ reversed the district court's denial of the motion to stay, the United States Supreme Court granted certiorari.³⁰

The Supreme Court framed the issue as "whether an agreement to arbitrate a future controversy is a 'condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision' of the Securities Act."³¹ In an opinion by Justice Reed, the Supreme Court held that the anti-waiver provision of the Securities Act³² voided stipulations purporting to waive any provision of the Securities Act.³³ The Court also noted the competing pro-arbitration policy established by the FAA, characterizing the FAA as setting forth a general rule that arbitration agreements should be enforced "if the parties are willing to accept less certainty of legally correct adjustment."³⁴

23. *Id.* at 428-29.

24. *Id.*

25. *Id.* at 429.

26. *Id.* at 428; 15 U.S.C. § 77I(2) (1988).

27. A margin agreement sets forth terms for what is essentially a loan transaction. L. McMILLAN, *OPTIONS AS A STRATEGIC INVESTMENT* 460 (1980). The customer is permitted to purchase stock by depositing less than the full purchase price, with the shortage loaned by the broker. *Id.* The broker is given rights to sell the stock if the customer does not repay in specified times or under specified conditions (especially where the price declines, so that the stock value approaches the amount of the loan). *Id.* at 80. The deceptive nature of arbitration agreements imposed on customers, as more fully discussed *infra* at notes 298-312 and accompanying text, is well illustrated by the placement of the arbitration clause in *Wilko*. It was not in a separate document or somewhere that the customer might otherwise expect; instead, it was hidden in a document apparently unrelated to dispute resolution. *Wilko*, 346 U.S. at 429-30.

28. *Wilko*, 346 U.S. at 429; 9 U.S.C. § 3 (1988).

29. *Wilko v. Swan*, 201 F.2d 439, 445 (2d Cir. 1953).

30. *Wilko v. Swan*, 345 U.S. 969 (1953).

31. *Wilko*, 346 U.S. at 430 n.6 (quoting section 14 of the Securities Act of 1933, 15 U.S.C. § 77n (1953)).

32. 15 U.S.C. § 77n (1988). The section provides: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." *Id.*

33. *Wilko*, 346 U.S. at 433-35.

34. *Id.* at 438.

The Court based its reasoning on the language of the Securities Act and the underlying intent of Congress.³⁵ The Securities Act included an expansive enforcement provision granting concurrent jurisdiction in state and federal courts.³⁶ The choices of forum open to an aggrieved securities customer thus go beyond those usually available in business transactions, an important right in the Court's view.³⁷ The Court was disturbed by the arbitration practice of making awards without judicial instruction in the law, especially since the arbitrators' failure to follow the law generally could not be corrected by appellate review unless the failure appeared clearly.³⁸

This and other safeguards of judicial proceedings which the Court deemed important were absent in an arbitration context.³⁹ Therefore, the Court held "the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration"⁴⁰

2. The dissent

Justice Frankfurter authored a brief dissent,⁴¹ arguing there was no showing in the record that arbitration would provide unfair or incomplete relief.⁴² Although unwilling to infer that arbitrators were less capable than judges, as the majority did, the dissent was willing to infer that arbitration was "a speedier, more economical and more effective enforce-

35. *Id.*

36. *Id.* at 432-33. The grant of jurisdiction the Court relied on is found at 15 U.S.C. § 77v(a) (1988), which states:

The district courts of the United States . . . shall have jurisdiction . . . concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections [1292-1293] and [1254] of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States"

Since this creates federal question jurisdiction under 28 U.S.C. § 1331 (1988), it is unnecessary for a customer to meet the amount in controversy requirement for diversity jurisdiction, and unnecessary that diversity exist. See 28 U.S.C. § 1332 (1988).

37. *Wilko*, 346 U.S. at 434-37.

38. *Id.* at 436; see also 9 U.S.C. § 10 (1988) (setting forth grounds for vacating arbitrator's award).

39. *Wilko*, 346 U.S. at 435-38.

40. *Id.* at 438.

41. See *id.* at 439-40 (Frankfurter, J., dissenting).

42. *Id.* at 439 (Frankfurter, J., dissenting).

ment of rights . . . than can be had by the tortuous course of litigation"⁴³ The dissent also cautioned, "These advantages should not be assumed to be denied in controversies like that before us arising under the Securities Act, in the absence of any showing that settlement by arbitration would jeopardize the rights of the plaintiff."⁴⁴

The dissent concluded by mentioning an issue not explicitly discussed by the majority, namely the voluntariness of the agreement to arbitrate.⁴⁵ The dissent assumed without analysis that if the customer had no choice in whether to sign the arbitration agreement, the agreement would be unenforceable.⁴⁶

B. Subsequent Developments Through Shearson/American Express v. McMahon: Creating Exceptions to Wilko

1. Initial reaction to *Wilko*: expanding the rule against arbitration

Although *Wilko v. Swan*⁴⁷ dealt only with complaints under the Securities Act, lower courts widely assumed many other securities disputes were not subject to compelled arbitration.⁴⁸ This assumption expanded the *Wilko* rule considerably, since securities cases typically included allegations under the Exchange Act,⁴⁹ state securities laws, common law fraud, contract theories, and later, the Racketeer Influenced Corrupt Organizations Act⁵⁰ (RICO), none of which was at issue in *Wilko*.⁵¹

The courts, however, were not alone in viewing *Wilko* as settled law. When Congress amended the Exchange Act in 1975 to give the SEC

43. *Id.* at 439-40 (Frankfurter, J., dissenting).

44. *Id.* at 440 (Frankfurter, J., dissenting).

45. *Id.* (Frankfurter, J., dissenting).

46. *Id.* (Frankfurter, J., dissenting).

47. 346 U.S. 427 (1953).

48. Many federal circuit courts of appeal following *Wilko* held that claims under the Exchange Act could not be forced into arbitration pursuant to a predispute arbitration agreement. *E.g.*, *Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023 (11th Cir. 1982); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831 (7th Cir. 1977); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); *Sibley v. Tandy Corp.*, 543 F.2d 540 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976); *In re Revenue Property Litig. Cases*, 451 F.2d 310 (1st Cir. 1971). All these cases would be overruled on this point by the later United States Supreme Court decision in *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987), discussed *infra* at notes 104-28 and accompanying text.

49. 15 U.S.C. §§ 78a-78u (1985).

50. 18 U.S.C. § 1962(d) (1985).

51. *See Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985); *Hoblin, Broker/Dealer Response to Customer Complaints in Arbitration*, in *RESOLVING SECURITIES DISPUTES*, *supra* note 2, at 327-28.

power to regulate securities arbitration, the conference report cited *Wilko* with approval and announced an intent to leave that holding intact.⁵²

2. The retreat from *Wilko* begins: *Scherk v. Alberto-Culver Co.*

In 1974, the Supreme Court created the first substantial exception to the *Wilko* rule. *Scherk v. Alberto-Culver Co.*⁵³ involved an American manufacturer's purchase of several overseas businesses and their trademarks.⁵⁴ Negotiations between the manufacturer and the seller of the businesses took place in the United States, Great Britain and Germany; the parties signed the purchase and sale contract in Austria; the deal closed in Switzerland; and the businesses conveyed in the transaction were located in Germany and Liechtenstein.⁵⁵ Disputes between the parties, however, were to be resolved by arbitration in France.⁵⁶

The *Scherk* Court distinguished *Wilko*, which clearly involved only United States law, from an international transaction. Giving great deference to the parties' choice of venue before a specific forum in a specific country, the Court held *Wilko* "inapposite" since a "parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate [the purposes for having the agreement], but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages."⁵⁷ Moreover, the Court viewed an arbitration agreement as merely "a specialized kind of forum-selection clause that posits not only the situs of the suit but also the procedure to be used in resolving the dispute."⁵⁸ The Court concluded that predispute arbitration agreements in international transactions were enforceable under the FAA, even if the matter would have fallen under the *Wilko* rule had it not been part of an international transaction.⁵⁹

52. H.R. CONF. REP. NO. 229, 94th Cong., 1st Sess. 3, reprinted in 1975 U.S. CODE CONG. & ADMIN. NEWS 321, 342, which stated in pertinent part:

It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceedings provisions in agreements entered into by persons dealing with members and participants in self-regulatory organizations.

Id.

Moreover, the SEC used its new regulatory authority in support of *Wilko* initially, as discussed *infra* at notes 61-64 and accompanying text.

53. 417 U.S. 506 (1974).

54. *Id.* at 508.

55. *Id.* at 508-09.

56. *Id.* at 508.

57. *Id.* at 516-17.

58. *Id.* at 519 (footnote omitted).

59. *Id.* at 519-20.

Although the Court created an exception to the *Wilko* rule, the *Scherk* exception was narrowly defined and dealt with a unique problem.⁶⁰ Under *Scherk*, arbitration issues in international transactions should not be decided under the *Wilko* rule since that rule was based on inapplicable American law (the Securities Act).

Although the Supreme Court in *Scherk* created no more than a specific, easily distinguishable exception to *Wilko*, contemporary attitudes were shifting in favor of arbitration. Commentators seized on *Scherk* and lower court cases as indicating a trend at least limiting *Wilko*.⁶¹

3. Pre-*McMahon* shift in attitude to favor arbitration

Despite the result in *Scherk*, not all courts and commentators thought the *Wilko* rule was discarded. Most notably, two United States district courts extended the *Wilko* reasoning to a new area of law several years after *Scherk*; neither *Fox v. Merrill Lynch & Co.*⁶² nor *Lewis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*⁶³ rejected the *Wilko* reasoning as obsolete. These cases arose from disputes over a pension plan for brokers, which stipulated that brokers forfeited pension benefits if they left the company to work for a competitor.⁶⁴ The plaintiffs in both cases were former brokers of Merrill Lynch, Pierce, Fenner & Smith, Inc. who sued in federal district court claiming the plan violated the Employee Retirement Income Security Act of 1974⁶⁵ (ERISA). Each plaintiff had agreed to be bound by the rules of the New York Stock Exchange, of which Merrill Lynch was a member, and those rules incorporated an arbitration agreement.⁶⁶

In *Lewis*, the court noted that ERISA included an anti-waiver provision⁶⁷ similar to that provided by the Securities Act in issue in *Wilko*. Both anti-waiver provisions sought to protect the public against agreements purporting to waive statutorily granted rights. The court followed the *Wilko* Court's reasoning in refusing to compel arbitration.⁶⁸

The *Fox* court reached a result opposite *Lewis*, but within the logic

60. The Court acknowledged that United States securities laws may not even apply to international transactions. *Id.* at 518.

61. *E.g.*, Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 436-38 (1987); Katsoris, *supra* note 3, at 3.

62. 453 F. Supp. 561 (S.D.N.Y. 1978).

63. 431 F. Supp. 271 (E.D. Pa. 1977).

64. *Fox*, 453 F. Supp. at 563; *Lewis*, 431 F. Supp. at 273.

65. 29 U.S.C. § 1110(a) (1976).

66. *See Fox*, 453 F. Supp. at 563-64; *Lewis*, 431 F. Supp. at 273.

67. *Lewis*, 431 F. Supp. at 276 (citing 29 U.S.C. 1110(a) (1976)).

68. *Id.* The court also noted that ERISA included provisions on jurisdiction and venue favorable to plaintiffs, as the Securities Act did in the *Wilko* case. *Id.*

of *Wilko*.⁶⁹ The court considered the applicability of ERISA's anti-waiver provision to be determinative of the enforceability of the arbitration agreement, in line with the *Wilko* reasoning.⁷⁰ Nonetheless, the court found the defendants did not fall within the anti-waiver provision in ERISA, and thus both *Lewis* and *Wilko* were inapposite.⁷¹

Despite these holdings, the *Wilko* court's distrust of arbitration⁷² was becoming increasingly out of step with shifting attitudes in the legal community, favoring arbitration as a reasonable and trustworthy means of alternative dispute resolution.⁷³ This shift in attitude evidenced itself most prominently in the 1983 Supreme Court case *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*⁷⁴ In that case, the Court spoke of the FAA as reflecting "a liberal federal policy favoring arbitration" where "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration"⁷⁵ These shifting attitudes toward arbitration were not universally presumed to foreshadow the demise of the *Wilko* rule, however.

The SEC, for one, continued to assume that the *Wilko* rule was viable. In 1979, a SEC release informed broker-dealers that using predispute arbitration agreements would be considered "inconsistent with just and equitable principles of trade" unless the agreements informed the customer of the meaning and enforceability of such a clause.⁷⁶ Then, in 1983, the SEC confirmed the broad interpretation of the *Wilko* rule implied in this release:

Wilko v. Swan 346 U.S. 427 (1953), and subsequent cases have held that Congress had determined that public customers should have available the special protection of the federal

69. See *Fox*, 453 F. Supp. at 566.

70. *Id.*

71. *Id.* at 565-66. ERISA's anti-waiver provision voided only agreements seeking to relieve a fiduciary of statutory duties. *Id.* The defendants in *Fox* were not fiduciaries, the court found, so they were outside the scope of the anti-waiver provision. *Id.*

72. The Court characterized arbitration essentially as a trade-off, noting such procedures could "secure prompt, economical and adequate solution of controversies" but only "if the parties are willing to accept less certainty of legally correct adjustment." *Wilko*, 348 U.S. at 438. The Court also assumed arbitrators were ignorant of the law in the concern expressed for arbitrators deciding cases absent judicial instruction. *Id.* at 436; see also *McMahon*, 482 U.S. at 226 (discussing the mistrust of arbitration in *Wilko*).

73. See *Rodriguez de Quijas v. Shearson/American Express*, 109 S. Ct. 1917, 1920 (1989) (citing *Alberto-Culver Co. v. Scherk*, 484 F.2d 611, 616 (7th Cir. 1973) (Stevens, J., dissenting)); *Katsoris*, *supra* note 3, at 3.

74. 460 U.S. 1 (1983).

75. *Id.* at 24-25.

76. Exchange Act Release No. 15,984, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,122, at 81,978 (July 2, 1979).

courts for the resolution of disputes arising under the federal securities laws, and that under the anti-waiver provisions of those laws, that protection may not be waived in advance by contract of the parties.⁷⁷

In order to effectuate its interpretation of *Wilko*, the SEC adopted Rule 15c2-2, which in final form provided in pertinent part:

It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.⁷⁸

Reading the rule and the SEC's interpretation of *Wilko* together reveals the SEC's firm belief that *Wilko* was well-established and viable precedent. Moreover, the SEC saw the principle of *Wilko* as broadly applicable to cases arising under various securities laws. If the SEC thought the *Wilko* rule should be limited to cases under the Securities Act, it presumably would have tailored the prohibition against the use of predispute arbitration agreements accordingly.⁷⁹ As discussed below, however, the SEC's rule had a short life.

4. *Byrd*, the SEC and *Soler Chrysler-Plymouth*

a. *the Byrd decision*

In the 1985 case of *Dean Witter Reynolds, Inc. v. Byrd*,⁸⁰ the United States Supreme Court addressed procedural questions that arose when a customer asserted both a Securities Act cause of action, which could not be arbitrated pursuant to *Wilko*, and arbitrable pendent state law claims.⁸¹

77. Exchange Act Release No. 20,397, 48 Fed. Reg. 53,404 (1983).

78. 17 C.F.R. § 240.15c2-2(a) (1986).

79. This broad interpretation appears to be very different from supposing that *Wilko* represented an outmoded disfavor of arbitration which the Supreme Court would likely reverse if presented with the opportunity, as some commentators presumed. See Lindsay, "Public" Rights and Private Forums: Predispute Arbitration Agreements and Securities Litigation, 20 LOY. L.A.L. REV. 643 (1987). Other commentators continued to view *Wilko* favorably, as eminently sensible. See, e.g., L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 1193 (1983).

80. 470 U.S. 213 (1985).

81. *Id.* at 214. For purposes of this Note, this case is significant for its treatment of *Wilko* and its view of arbitration in general.

The question arose as to whether the courts may refuse arbitration of otherwise arbitrable

The majority opinion in *Byrd* strongly supported the FAA, holding the order for arbitration mandatory even where that procedure arguably frustrated the goals of arbitration.⁸² The Court dismissed arguments that arbitration would actually defeat the purpose of the FAA to provide swift and fair resolution of disputes, because arbitrating this type of dispute would be a slower and more complex means of resolving issues in the case: "We therefore reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims."⁸³

The majority had little to say about *Wilko*, merely observing in a footnote that the *Wilko* rule "has retained considerable vitality in the lower federal courts."⁸⁴ However, Justice White thoroughly addressed the issue in his concurring opinion. He noted that the issue before the Court assumed that Exchange Act claims were arbitrable.⁸⁵ Justice White commented that this assumption was "a matter of substantial doubt"⁸⁶ even though the arbitrability of Exchange Act claims was not before the Court.⁸⁷ Before *Byrd*, federal circuit courts had unanimously found Exchange Act claims non-arbitrable on authority of *Wilko*;⁸⁸ Jus-

state law claims when they are "intertwined" with federal, non-arbitrable claims. *Id.* at 216-17.

Three federal circuit courts of appeals held that arbitration may be refused in this circumstance. *Id.* at 216 (citing *Byrd v. Dean Witter Reynolds, Inc.*, 726 F.2d 552 (9th Cir. 1984); *Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023 (11th Cir. 1982); *Miley v. Oppenheimer Co.*, 637 F.2d 318 (5th Cir. 1981)). Otherwise, the arbitration award and findings supporting it may, through collateral estoppel, effectively preclude the trial; such preclusion would be the equivalent of subjecting non-arbitrable claims to arbitration. *Id.* at 221. Moreover, such bifurcated proceedings would be lengthier and more complex than a trial, defeating the goal of the FAA to promote speedy, efficient resolution of claims. *Id.* at 218-21.

Three other federal circuits held the FAA leaves no room for discretion, and arbitration must be ordered. *Id.* at 217-21 (citing *Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 733 F.2d 59 (8th Cir. 1984); *Liskey v. Oppenheimer & Co.*, 717 F.2d 314 (6th Cir. 1983); *Dickinsen v. Heinold Sec.*, 661 F.2d 638 (7th Cir. 1981)). The *Byrd* court agreed with this position. *Id.* at 217.

This issue has been rendered obsolete by the decision in *Rodriguez de Quijas v. Shearson/American Express*, 109 S. Ct. 1917 (1989), which is the subject of this Note, since *Rodriguez de Quijas* makes all federal claims arbitrable. See *infra* notes 129-72 and accompanying text. Now that all claims are subject to arbitration, there can no longer be a question of how to handle claims which are partly arbitrable and partly non-arbitrable.

82. *Byrd*, 470 U.S. at 217.

83. *Id.* at 219.

84. *Id.* at 215 n.1.

85. *Id.* at 224 (White, J., concurring).

86. *Id.* (White, J., concurring).

87. *Id.* (White, J., concurring) (issue was not before the Court because it had not been raised in lower courts).

88. Cases are cited in *McMahon*, 482 U.S. at 248 n.6 (Blackmun, J., concurring in part and dissenting in part).

tice White found distinctions between the Securities Act (on which *Wilko* relied) and the Exchange Act (the basis for the claim in issue).⁸⁹ Justice White stopped short of declaring that these distinctions rendered Exchange Act claims arbitrable, but nevertheless emphasized "that the question remains open, and the contrary holdings of the lower courts must be viewed with some doubt."⁹⁰

b. SEC and lower court reaction

As a result of Justice White's questioning of the *Wilko* rule's applicability to Exchange Act claims,⁹¹ the SEC decided to suspend enforcement of Exchange Act Rule 15c2-2, which provided that brokers engage in a deceptive practice by offering arbitration agreements to customers.⁹²

The former unanimity of lower court findings that the *Wilko* rule implicitly prohibited arbitrating Exchange Act claims was shattered following Justice White's concurring opinion. Some courts found Exchange Act claims arbitrable;⁹³ others reaffirmed prior holdings against arbitrability, continuing to follow the *Wilko* analogy.⁹⁴ The Ninth Circuit, apparently confronting the issue for the first time, accepted the *Wilko* analogy and held Exchange Act claims non-arbitrable.⁹⁵

c. the Soler Chrysler-Plymouth case

Just five months after the *Byrd* decision, the Supreme Court further encouraged proponents of arbitration in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*.⁹⁶ In *Soler*, the issue was whether antitrust issues were arbitrable.⁹⁷ Under prior decisions, predispute arbitration agreements were consistently held unenforceable in relation to antitrust

89. *Byrd*, 470 U.S. at 224-25 (White, J., concurring).

90. *Id.* at 224 (White, J., concurring).

91. See *supra* notes 84-90 and accompanying text.

92. Fitterman, *SEC Oversight: Investor Complaints Against Broker-dealers and SRO Administered Arbitration Systems*, in *RESOLVING SECURITIES DISPUTES*, *supra* note 2, at 205, 225.

93. *E.g.*, *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 806 F.2d 291, 295 (1st Cir. 1986); *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1399 (8th Cir. 1986), *cert. denied*, 482 U.S. 931 (1987); *Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023 (11th Cir. 1982); *Sibley v. Tandy Corp.*, 543 F.2d 540 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

94. *E.g.*, *Miller v. Drexel Burnham Lambert, Inc.*, 791 F.2d 850 (11th Cir. 1986).

95. See *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520, 522-25 (9th Cir. 1986), *vacated*, 482 U.S. 923 (1987).

96. 473 U.S. 614 (1985).

97. *Id.* at 616.

claims.⁹⁸ The older cases reasoned that *Wilko* established a "public policy" exception to the FAA, under which the courts could refuse arbitration for litigation which is deemed to bear important public policy implications.⁹⁹ In language strongly approving arbitration, the Court rejected the "public policy" exception to the FAA, accepting in its place a rule favoring enforcement of arbitration agreements unless a statutory exception appears.¹⁰⁰ Of interest was the Court's reliance on *Wilko* for the proposition that exceptions to the FAA must arise from a statute,¹⁰¹ a reading inconsistent with cases which followed.¹⁰²

The Court's high regard for arbitration, the growing number of non-securities cases enforcing arbitration agreements and the emerging conflict (at Justice White's invitation) in the circuit courts of appeal as to the arbitrability of Exchange Act claims, set the stage for a direct assault on the arbitrability of securities law disputes. This Note will next discuss the case which more directly than ever before called into question the *Wilko* rule, the *Shearson/American Express v. McMahon* decision.¹⁰³

5. The *McMahon* case

In *Shearson/American Express v. McMahon*,¹⁰⁴ the plaintiffs were public customers of the defendant, a securities brokerage house. The plaintiffs brought suit alleging violations of the Exchange Act and RICO.¹⁰⁵ The defendant sought to enforce an arbitration agreement between the parties, which the plaintiffs challenged as unenforceable.¹⁰⁶ The district court, applying the "public policy" exception to the FAA,¹⁰⁷ refused to order arbitration of the RICO claim, but held other claims arbitrable.¹⁰⁸ The court of appeals agreed that RICO claims were inappropriate for arbitration under the "public policy" exception, but reversed the district court's holding, in reliance on *Wilko*, that Exchange

98. The seminal case upon which others relied was *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), which explicitly relied on *Wilko*.

99. This theory is discussed at some length in Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZO L. REV. 481 (1981).

100. *Soler Chrysler-Plymouth*, 473 U.S. at 624-26.

101. *Id.* at 627-28.

102. See *infra* notes 107, 136-38 and accompanying text.

103. 482 U.S. 220 (1987).

104. *Id.*

105. *Id.* at 222.

106. *Id.* at 223.

107. This is the same exception rejected by the *Byrd* court. See *Byrd*, 470 U.S. 213.

108. *McMahon v. Shearson/American Express*, 618 F. Supp. 384, 387-88 (S.D.N.Y. 1985), *aff'd in part and rev'd in part*, 788 F.2d 94 (2d Cir. 1986), *rev'd*, 482 U.S. 220 (1987).

Act claims were not arbitrable.¹⁰⁹

The Supreme Court's analysis began with a discussion of the federal law's approval of arbitration.¹¹⁰ The Court then turned to the Exchange Act, which includes an anti-waiver provision essentially identical to the anti-waiver provision in the Securities Act on which the *Wilko* Court relied.¹¹¹ The customers argued that since the two Acts have indistinguishable anti-waiver provisions, they must be interpreted identically, i.e., under the *Wilko* rule.¹¹² The customers further argued that the arbitration agreement was not voluntary and should not be enforced because it was an attempt to "maneuver buyers into a position that might weaken their ability to recover"¹¹³

The majority read *Wilko* as finding the right to a judicial forum non-waivable solely because the *Wilko* Court felt the arbitration practices of the day were inadequate to protect the rights guaranteed under the Securities Act.¹¹⁴ The *McMahon* Court relied on the customers' failure to carry their burden of proof on the voluntariness issue, rather than examining the arbitration process to meet this argument directly.¹¹⁵ The Court continued by evaluating arbitration in the abstract, primarily through reference to prior cases exalting the virtues of arbitration.¹¹⁶ The Court next referred to the authority to oversee securities arbitration that Congress had granted the SEC since *Wilko*.¹¹⁷ The Court relied on this relatively new authority to alleviate *stare decisis* issues in making a holding so apparently at odds with *Wilko*.¹¹⁸

Justice Blackmun, joined by Justice Brennan and Justice Marshall, issued a separate opinion concurring in part and dissenting in part.¹¹⁹ This separate opinion specifically criticized two parts of judicial process

109. *McMahon v. Shearson/American Express*, 788 F.2d 94, 98 (2d Cir. 1986), *rev'd*, 482 U.S. 220 (1987).

110. *McMahon*, 482 U.S. at 225-27.

111. *Id.* at 227-38; *Wilko*, 346 U.S. at 433 n.18.

112. *McMahon*, 482 U.S. at 227-29.

113. *Id.* at 231-34 (quoting *Wilko v. Swan* 346 U.S. 427 (1953)).

114. *Id.* at 243-58. The *Rodriguez de Quijas* Court interpreted *Scherk* as not based on the applicability of American securities law to international transactions, but rather based on the Court's judgment that arbitration was an adequate forum on the facts of the case. See *Rodriguez de Quijas*, 109 S. Ct. at 1920.

115. *McMahon*, 482 U.S. at 230-31.

116. *Id.* at 232-34.

117. *Id.* at 233-34.

118. *Id.* at 234 ("While *stare decisis* concerns may counsel against upsetting *Wilko's* contrary conclusion under the Securities Act, we refuse to extend *Wilko's* reasoning to the Exchange Act in light of these intervening regulatory developments.").

119. *Id.* at 242 (Blackmun, J., concurring and dissenting).

which brought the issue before the Court.¹²⁰ First, Justice White's separate opinion in *Byrd* cast doubt on a well-settled area of law.¹²¹ Second, the Court disregarded the reasoning behind and overturned the unanimous holding of the circuit court of appeal.¹²²

Justice Blackmun also disagreed with two premises of the majority's reasoning.¹²³ First, the majority was said to have given *Wilko* "an overly narrow reading."¹²⁴ The majority viewed *Wilko* as based on an obsolete suspicion of arbitration, but, as Justice Blackmun explained, *Wilko* was not based solely on the *Wilko* Court's disfavor of arbitration.¹²⁵ Rather, *Wilko* relied on the Court's interpretation of the intent behind the Securities Act and whether enforcing arbitration was consistent with that intent.¹²⁶

Second, Justice Blackmun examined existing arbitration practices closely and found them inadequate.¹²⁷ The *Wilko* Court had noted several inadequacies of arbitration, which Justice Blackmun thought still existed.¹²⁸

The *McMahon* case indicated a poor prognosis for the *Wilko* rule, which it indirectly challenged. Just three years later, the Court was presented with a direct challenge to *Wilko* in *Rodriguez de Quijas*.

III. RODRIGUEZ DE QUIJAS: STATEMENT OF THE CASE

In *Rodriguez de Quijas v. Shearson/American Express*,¹²⁹ the plaintiffs were public customers of the defendant broker, Shearson/American Express (Shearson).¹³⁰ Shearson's standard customer agreement, which the plaintiffs had signed, included a predispute arbitration agreement.¹³¹ The dispute arose from the plaintiffs' investment of approximately \$400,000 with Shearson, which subsequently "turned sour."¹³² The

120. *Id.* at 243-49 (Blackmun, J., concurring and dissenting).

121. *Id.* at 248-49 (Blackmun, J., concurring and dissenting).

122. *Id.* at 243-49 (Blackmun, J., concurring and dissenting).

123. *See id.* at 249-66 (Blackmun, J., concurring and dissenting).

124. *See id.* at 249 (Blackmun, J., concurring and dissenting).

125. *See id.* (Blackmun, J., concurring and dissenting).

126. *See id.* at 250-57 (Blackmun, J., concurring and dissenting).

127. *See id.* at 257-66 (Blackmun, J., concurring and dissenting).

128. *Id.* at 259 (Blackmun, J., concurring and dissenting). These inadequacies were similarly overlooked by the Court in *Rodriguez de Quijas*. *See infra* notes 199-206 and accompanying text.

129. 109 S. Ct. 1917 (1989).

130. *Id.* at 1918-19.

131. *Id.*

132. *Id.* The opinion does not clarify how much of the investment was lost. Since the suit presented a federal question allowing jurisdiction pursuant to 28 U.S.C. § 1331 (1988), *id.* at

plaintiffs sued Shearson and the individual broker in charge of the accounts on various legal theories under both state and federal law, alleging the losses occurred through unauthorized and fraudulent transactions.¹³³ The complaint alleged violations of the same statute that was at issue in *Wilko v. Swan*,¹³⁴ section 12(2) of the Securities Act of 1933.¹³⁵ The United States District Court felt bound by *Wilko*, and accordingly ordered the parties into arbitration on all claims except those arising under the Securities Act.¹³⁶

The Fifth Circuit Court of Appeals reversed as to the holding that the Securities Act claims were not arbitrable, even though it acknowledged that *Wilko* was directly on point and required a contrary result.¹³⁷ The appellate court stated that the development of case law since *Wilko* had reduced *Wilko's* precedential value to "obsolescence."¹³⁸ The United States Supreme Court seemed to agree.

IV. REASONING OF THE COURT

A. Majority Opinion

The Supreme Court began its analysis with a discussion of *Wilko v. Swan*,¹³⁹ which was described as resolving the competing legislative policies in the Securities Act and the FAA.¹⁴⁰ In *Wilko*, a predispute arbitration agreement was held to constitute a stipulation in violation of the Securities Act prohibition against stipulations to "waive compliance with any provision" of the Act.¹⁴¹ The *Rodriguez de Quijas* Court noted that this resolution was not an obvious conclusion compelled by statutory language, which the Court felt could reasonably be read as prohibiting only waivers of substantive provisions.¹⁴² The Court discerned two reasons why *Wilko* rejected such a reading: (1) the *Wilko* Court did not accept arbitration as a form of trial, so that a predispute arbitration agreement

1919, rather than depending on diversity, the amount involved could even have been less than the \$50,000 required for diversity jurisdiction under 28 U.S.C. § 1332 (1988).

133. *Rodriguez de Quijas*, 109 S. Ct. at 1919.

134. 346 U.S. 427, 428-29 (1953).

135. *Rodriguez de Quijas*, 109 S. Ct. at 1919 (citing 15 U.S.C. § 771(2) (1990)).

136. *Id.*

137. *Rodriguez de Quijas v. Shearson/Lehman Bros.*, 845 F.2d 1296 (5th Cir. 1988), *aff'd*, 490 U.S. 477 (1989).

138. *Id.* at 1299.

139. 346 U.S. 427 (1953).

140. *Rodriguez de Quijas v. Shearson/American Express*, 109 S. Ct. 1917, 1919-20 (1989). For a discussion of *Wilko*, see *supra* notes 20-46 and accompanying text.

141. *Wilko*, 346 U.S. at 434.

142. *Rodriguez de Quijas*, 109 S. Ct. at 1919.

was an impermissible waiver of “ ‘the right to select a judicial forum’ ”¹⁴³ and (2) this right to a wide choice of courts and venues is particularly valuable in securities litigation because customers are in an unequal bargaining position with securities dealers.¹⁴⁴

The *Rodriguez de Quijas* Court disagreed with *Wilko*'s reasoning, which was viewed as a product of “ ‘the old judicial hostility toward arbitration.’ ”¹⁴⁵ The Court then presented three reasons why the *Wilko* rule was incorrect. First, the majority observed that judicial attitudes toward arbitration had shifted to favor arbitration.¹⁴⁶ Moreover, the majority observed, recent cases before the Court uniformly endorsed arbitration as affording a means of resolving matters without sacrifice of substantive rights.¹⁴⁷ Therefore, the Court considered *Wilko* outdated in its view that arbitration is an inadequate forum to uphold significant substantive rights.¹⁴⁸ The *Wilko* view was considered especially outmoded since the SEC had gained regulatory authority over arbitration procedures, and thus could assure fair arbitration procedures.¹⁴⁹

Second, the Court disagreed with *Wilko*'s conclusion that only a judicial forum could preserve essential rights granted the buyer of securities, and that consequently, a statutory prohibition against waiving rights granted by the statute should be construed to include a right to a judicial forum.¹⁵⁰ The Court noted two post-*Wilko* cases holding similar anti-waiver provisions in other statutes did not prevent enforcement of a predispute arbitration agreement.¹⁵¹

*Shearson/American Express v. McMahon*¹⁵² was particularly persuasive since it dealt with an anti-waiver provision in a securities statute, the Exchange Act, which was essentially the same as the anti-waiver provision in *Wilko*.¹⁵³ The only potentially relevant difference between the Acts examined in *Wilko* and *McMahon* was the extent of jurisdiction

143. *Id.* (quoting *Wilko v. Swan*, 346 U.S. 427 (1953)).

144. *Id.* at 1919-20.

145. *Id.* at 1920 (quoting *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d Cir. 1942)). It is interesting that the Supreme Court criticizes its own precedent, *Wilko*, as outdated by reference to a case that predates *Wilko*.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.* at 1921.

150. *Id.* at 1920.

151. *Id.* at 1920-21 (citing *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985)).

152. 482 U.S. 220 (1987).

153. *Rodriguez de Quijas*, 109 S. Ct. at 1921. Compare 15 U.S.C. § 77v(a) (1990) (anti-waiver provision of Securities Act) with 15 U.S.C. § 78aa (1990) (anti-waiver provision of Exchange Act).

created by the underlying statutes. The Securities Act, construed in *Wilko*, allowed suits in state and federal court and prohibited removal;¹⁵⁴ the Exchange Act, construed in *McMahon* created exclusive federal jurisdiction.¹⁵⁵ The *Rodriguez de Quijas* Court found this difference insignificant, but explained that since an arbitration agreement merely provided an additional choice of venue, enforcing an arbitration agreement would *further* the statutory purpose of the Securities Act to provide a choice of forums.¹⁵⁶

The third and final reason cited for the *Rodriguez de Quijas* Court's disagreement with *Wilko* was the strong policy in favor of arbitration established by the FAA.¹⁵⁷ The Court found in the record no showing that arbitration would be an inadequate forum and felt compelled to conclude that arbitration would provide an adequate forum.¹⁵⁸ Thus, the Court placed a new burden of proof on the party opposing arbitration: to demonstrate that arbitration is inadequate.¹⁵⁹ Moreover, the majority noted that arbitration agreements are subject to contract defenses under state or federal law, which the Court felt provided adequate protection for buyers.¹⁶⁰ Having thus set forth its disagreement with *Wilko*, the Court turned to a discussion of *stare decisis* issues involved in overruling *Wilko*. The first of these was the propriety of the decision of the circuit court of appeals.¹⁶¹ As noted above, that court elected not to follow *Wilko*, even though it was a Supreme Court precedent squarely on point, on the ground that subsequent Supreme Court cases made *Wilko* obsolete.¹⁶² The Supreme Court disapproved of the circuit court's action in

154. *Rodriguez de Quijas*, 109 S. Ct. at 1921.

155. *Id.*

156. *Id.*

157. *Id.*

158. Under the FAA, the Court declared, "the party opposing arbitration carries the burden of showing that Congress intended in a separate statute to preclude a waiver of judicial remedies, or that such a waiver of judicial remedies inherently conflicts with the underlying purposes of that other statute." *Id.*

159. *Id.* at 1921-22. Before this case, arbitration would have been considered inadequate as a matter of law under *Wilko*, of course.

160. *Id.* at 1921. The Court did not consider the possibility that a broker would seek to avoid arbitration. While it is true that a broker could simply never offer an arbitration agreement to customers if the dealer wishes to avoid arbitration, this only applies to brokers who wish to avoid arbitration in general. It does not apply to a broker who favors arbitration in general but perceives an advantage in a particular case by proceeding in court. By assuming only customers would seek to avoid arbitration, the Court implicitly acknowledged that the usual case arises from a dealer seeking to force arbitration on an unwilling customer. The Court did not address why this should be so if arbitration is equivalent to a judicial forum, as the Court assumed in its reasoning. See *infra* notes 214-23 and accompanying text.

161. *Rodriguez de Quijas*, 109 S. Ct. at 1921-22.

162. See *infra* notes 188-98 and accompanying text.

disregarding precedent, stating that lower courts should leave to the Supreme Court "the prerogative of overruling its own decisions."¹⁶³

The Court's second *stare decisis* issue concerned its general reluctance to overrule its own decisions.¹⁶⁴ The Court found several compelling justifications for overturning *Wilko*. First, decisions interpreting statutory language are appropriately overruled to obtain uniform interpretation of similarly worded provisions.¹⁶⁵ *McMahon* dealt with an anti-waiver provision essentially identical to the provision of the Securities Act at issue in both *Wilko* and *Rodriguez de Quijas*, and held the anti-waiver provision was no bar to specific enforcement of predispute arbitration agreements. The *Rodriguez de Quijas* Court emphasized that the Exchange Act (in issue in *McMahon*) was to be construed consistently with the statute in *Wilko*.¹⁶⁶ The *Rodriguez de Quijas* Court, which had decided *McMahon* only two years before, not surprisingly found that if one of these two cases should be overruled, it should be *Wilko*.¹⁶⁷

Second, the Court noted that decisions which interpret statutes contrary to congressional policies, as established in other legislation, should be overturned to bring construction of the statute in line with congressional policy.¹⁶⁸ Because the FAA expressed such a strong congressional policy, the majority concluded that *Wilko* should be overruled.¹⁶⁹

B. *The Dissent*

Justice Stevens authored a fairly brief dissent in *Rodriguez de Quijas*, joined by Justices Brennan, Marshall, and Blackmun.¹⁷⁰ The dissent observed that in the more than thirty-five years *Wilko* was law, Congress rewrote no laws implying dissatisfaction with the *Wilko* rule.¹⁷¹ The dissent suggested that Congress should be the source of changes that the Court was making in overruling *Wilko*. Justice Stevens noted that

163. *Rodriguez de Quijas*, 109 S. Ct. at 1922.

164. *Id.*

165. *Id.* (citing *Commissioner v. Estate of Church*, 335 U.S. 632, 649-50 (1949)).

166. *Id.*

167. *Id.*

168. *Id.* (citing *Boys Markets v. Retail Clerks*, 398 U.S. 235, 240-41 (1970) (overruling *Sinclair Refining Co. v. Atkinson*, 370 U.S. 195 (1962))).

169. *Id.* at 1921. The Court did not make entirely clear which congressional policy was referenced. Although the FAA was not explicitly stated to be the congressional policy which the Court felt encouraged overruling *Wilko*, it appears to be the only statute the Court could be referring to in light of its discussion of the FAA. *See id.*

170. *Rodriguez de Quijas v. Shearson/Lehman Bros.*, 109 S. Ct. 1917, 1922-23 (1989) (Stevens, J., dissenting).

171. *Id.* at 1923 (Stevens, J., dissenting).

valid arguments could be made on both sides of the issue, none of which were so compelling as to justify overturning such a well-established rule.¹⁷²

V. ANALYSIS

In *Rodriguez de Quijas v. Shearson/American Express*,¹⁷³ the United States Supreme Court set a new course for litigation of securities customer disputes. Arbitration agreements, which a few years earlier appeared clearly unenforceable,¹⁷⁴ had now received the Supreme Court's imprimatur.

This section begins with a critique on the reasoning of the *Rodriguez de Quijas* Court. This section will then analyze the postulate central to the Court's rationale, that arbitration is a suitable alternative means of resolving securities disputes.

The majority in *Rodriguez de Quijas* questioned *Wilko v. Swan*¹⁷⁵ and then presented three grounds for disagreeing with *Wilko* to justify overruling it.¹⁷⁶ The following subsections suggest that neither the majority's questioning of *Wilko*, nor the Court's grounds for overruling *Wilko* can be logically justified.

A. The Majority's Questioning of *Wilko*

The *Rodriguez de Quijas* majority questioned the *Wilko* Court's interpretation of the Securities Act anti-waiver provision.¹⁷⁷ The majority noted that the anti-waiver provision of the Securities Act could be read as applying only to *substantive* rights, and not to the procedural rights at issue in *Wilko*.¹⁷⁸ The Court then slighted the *Wilko* Court's resolution of the inconsistency between the FAA and the Securities Act as one not

172. *Id.* at 1922-23 (Stevens, J., dissenting). Justice Stevens noted that a weighing of both sides was already accomplished in *Wilko*. See *id.* at 1923 n.3 (Stevens, J., dissenting). It appears that his point is that precedents of this sort, involving close questions of non-constitutional dimensions, will have little value if the Court demonstrates a willingness to overturn such decisions whenever it feels the scales tip one way or the other.

173. 109 S. Ct. 1917 (1989).

174. The issue seemed so clear that the SEC considered the simple act of offering an arbitration agreement to a customer unethical. The SEC noted at least as early as 1977 that offering arbitration agreements to public customers was questionable since the agreements were unenforceable under current law, and offering the agreement could be seen as suggesting the agreement was binding. Exchange Act Release No. 13,470, 17 C.F.R. § 240.15c2-2(a) (1986), *rescinded in* Exchange Act Release No. 25,034, 52 Fed. Reg. 39,216 (1987).

175. 346 U.S. 427 (1953).

176. *Rodriguez de Quijas*, 109 S. Ct. at 1922.

177. *Id.*

178. *Id.*

obviously required by the language of the statute.¹⁷⁹ The clear implication was that the decision of the *Wilko* majority should be afforded no more weight than a coin toss, but the Court's reasoning was vague and unsupportable.

The *Rodriguez de Quijas* majority failed to elucidate why a statute prohibiting waiver of "any provision"¹⁸⁰ should be read as prohibiting only waivers of any *substantive* provision.¹⁸¹ Surely, the Court was not suggesting that procedural issues could never be important, as such matters are of sufficient import to determine the outcome of many cases. In fact, two famous cases in the evolution of the *Erie* doctrine recognized the importance of procedural issues by accordingly modifying the "outcome determinative" procedural/substantive test.¹⁸² Thus, the Court's

179. *Id.*

180. 15 U.S.C. § 77n (1989) (emphasis added). Although the Court did not clearly explain this point, commentators have made an argument against *Wilko* which reaches the same conclusion. See, e.g., Fletcher, *supra* note 61, at 406-07.

Fletcher argues that the anti-waiver provision cannot be interpreted literally to prohibit waiving any rights whatsoever. *Id.* Rather, since the statute voids waiving *compliance* with any provision, it should be read as preventing waivers of those provisions with which the broker must *comply*, i.e., the substantive provisions of the Securities Act. *Id.* at 406. The argument also attempts to refute the logic of the *Wilko* position by carrying it to (or perhaps beyond) its logical extreme, to show that it leads to absurd results. Thus, Fletcher offers the example that if the customer cannot contractually surrender the right to litigate in court, the customer could never settle a case. *Id.* at 407. What is settlement, he argues, if not a contractual agreement to waive the right to proceed with litigation? *Id.*

Proponents of this position correctly contend that the blanket rule of *Wilko* is unjustified; but, they fail to establish that the blanket prohibition of arbitration under *Wilko* should be replaced by a blanket rule favoring arbitration. See *infra* notes 296-330 and accompanying text.

The argument that *Wilko* is illogical because it would prevent settlements seems to be based upon a false analogy between predispute arbitration agreements and post-dispute settlements. Settlements are usually agreed upon *after* the threat of litigation. 15A AM. JUR. 2D *Compromise & Settlement* § 1 (1976). *Wilko* does not prohibit agreements to arbitrate at that point in time. See, e.g., Gardner v. Shearson, Hammill & Co., 433 F.2d 367, 368 (5th Cir. 1970), *cert. denied*, 401 U.S. 978 (1971); Moran v. Paine, Webber, Jackson & Curtis, 389 F.2d 242, 246 (3d Cir. 1968).

Moreover, while it may be inconceivable that Congress could have intended to prohibit settlements agreed upon freely by the parties, it is not at all unlikely that Congress could have wished to prevent brokers from avoiding the Securities Act by contracting for a forum not bound to follow the law, such as arbitration.

181. *Rodriguez de Quijas*, 109 S. Ct. at 1922.

182. See *Hanna v. Plumer*, 380 U.S. 460 (1965); *Byrd v. Blue Ridge Rural Elec. Coop.*, 356 U.S. 525 (1958). Earlier cases had suggested federal procedural rules must be considered substantive, and hence give way to state law in diversity cases whenever the rule could be "outcome determinative." See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949); *Woods v. Interstate Realty Co.*, 337 U.S. 535 (1949). In *Hanna* and *Byrd*, the Supreme Court acknowledged that procedural rules can determine outcome by abandoning strict adherence to the old "outcome determinative" rule. See *Hanna*, 380 U.S. at 467-68; *Byrd*, 356 U.S. at 538.

reading of *Wilko* is insupportable.

B. *The Court's Grounds for Overturning Wilko*

1. Judicial attitudes toward arbitration

The first of the three reasons for overturning *Wilko* that the majority offered was the shift in judicial attitudes toward favoring arbitration.¹⁸³ The majority viewed *Wilko* as a product of "the old judicial hostility to arbitration."¹⁸⁴ Having dismissed the *Wilko* Court's holding as the result of an outdated bias, the Court substituted its more modern bias in favor of arbitration by unreasoned exhortation.

Commentators on legal process have sometimes contended that legal reasoning is based largely on value judgments, but the process still rests on logical reasoning from statutes and precedent.¹⁸⁵ If changes in judicial attitudes are accepted as a sound basis for overruling precedent, however, the Court should decide cases by opinion polls rather than opinions.

2. Arbitration as an adequate forum

Whether arbitration can adequately protect the customer's statutory rights calls for reasoned analysis, but the majority offered none. Instead, the Court contented itself with citation to other, equally uncritical analyses of the process.¹⁸⁶

The Court's citation to numerous cases lauding arbitration cannot relieve the Court of the duty to follow precedent interpreting the laws of Congress. If *Wilko* correctly analyzed the intent of Congress in resolving the conflict between the FAA policy in favor of arbitration and the Securities Act anti-waiver provision policy,¹⁸⁷ it should hardly matter

183. *Rodriguez de Quijas*, 109 S. Ct. at 1920.

184. *Id.* (quoting *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d Cir. 1942)).

185. For example, Justice Holmes commented in 1897:

The language of judicial decision is mainly the language of logic. And the logical method and form flatter that longing for certainty and repose which is in every human mind. But certainty generally is an illusion, and repose is not the destiny of man. Behind the logical form lies a judgment as to the relative worth and importance of competing legislative grounds, often an inarticulate and unconscious judgment, it is true, and yet the very root and nerve of the whole proceeding.

Address by Justice Holmes (Mar. 25, 1897), reprinted in Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 465-66 (1897).

186. *Rodriguez de Quijas*, 109 S. Ct. at 1919-20 (citing *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983)).

187. *Wilko*, 346 U.S. at 438.

whether a majority of the Supreme Court agrees with the way Congress wrote the laws.

Viewing *Rodriguez de Quijas* in its historical context raises more basic issues as to the intellectual honesty of the opinion. The Court's reasoning relied heavily on *Shearson/American Express v. McMahon*, which the Court found so inconsistent with *Wilko* that both decisions could not stand together.¹⁸⁸ The Court had decided *McMahon* only two years before; the Court therefore justified overruling *Wilko* because of an inconsistency which the Court, itself, had recently created, despite the fact that the Court ignored the same inconsistency in deciding *McMahon*. The process leading the Court to *Rodriguez de Quijas* resembles that of a doctor seeking to euthanize a patient whose ill health arose from the physician's neglect. Likewise, the Court justified overruling *Wilko* as a precedent in poor health when *Wilko's* infirmity was of the Court's own making. If *Wilko* and *McMahon* are so fatally inconsistent, perhaps the Court should have considered the matter in writing *McMahon*.

A closer comparison of *Wilko* and *McMahon* reveals an important distinction between them, not discussed by the majority. Both cases dealt with statutes designed to regulate securities that included provisions nullifying agreements which avoid the protection afforded by the statutes.¹⁸⁹ But the Securities Act includes broad jurisdiction and venue provisions that give customers the right to choose between state and federal court, by granting concurrent jurisdiction in each and prohibiting removal.¹⁹⁰ The Exchange Act, by contrast, merely provides for federal jurisdiction.¹⁹¹

The different jurisdictional grants call for differing treatment of the two Acts. The broader jurisdiction under the Securities Act, together with the prohibition on removal to federal court, evidences a congressional desire to afford the customer a choice of forum at the outset of litigation.¹⁹² The Exchange Act, at issue in *McMahon*, involves no sug-

188. *Rodriguez de Quijas*, 109 S. Ct. at 1922.

189. See *Shearson/American Express v. McMahon*, 482 U.S. 220, 222 (1987) (addressing the Exchange Act); *Wilko*, 346 U.S. at 434 (addressing the Securities Act).

190. See 15 U.S.C. § 77v(a) (1989).

191. 15 U.S.C. § 78aa (1989).

192. The Court noted in *Rodriguez de Quijas* the usual rule that the Securities Act and the Exchange Act are interpreted harmoniously. *Rodriguez de Quijas*, 109 S. Ct. at 1922 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976)). Since customer complaints frequently include counts under both Acts, e.g., *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 214 (1985), inconsistent interpretations of the two Acts could lead to attempts to frame pleadings under one or the other Act to take advantage of any differences in interpretation the Court allows.

Of course, this should not be of concern when there could be no conceivable advantage to

gestion of congressional intent to empower aggrieved securities customers to select between different forums.¹⁹³ The jurisdictional provision in the Exchange Act evidences no more than an intent to open the federal courts to enforce rights granted by the Act without requiring diversity of citizenship.¹⁹⁴ The FAA would be reduced to little effect if the Court were to hold that this very ordinary grant of federal question jurisdiction renders arbitration agreements unenforceable despite the FAA. On the other hand, the special power to choose a forum to litigate afforded aggrieved securities customers under the Securities Act, is more easily seen as an intended exception to the FAA, as the *Wilko* Court saw it.¹⁹⁵

The *Rodriguez de Quijas* majority avoided considering whether the broader grant of jurisdiction in the Securities Act distinguished *Wilko* from *McMahon* by presuming that a predispute arbitration agreement represents a *broadening* of customer forum choices rather than a vehicle for *narrowing* choices.¹⁹⁶ The suggestion of the *Rodriguez de Quijas* majority that predispute arbitration agreements are merely "a specialized kind of forum selection clause . . . allowing buyers of securities a broader right to select the forum for resolving disputes"¹⁹⁷ is plainly wrong in most cases. Predispute arbitration agreements are a one-way street because they give the customer no new options; only the broker gains through such agreements. The customer usually has a right to compel the broker to arbitrate regardless of the existence of a predispute agreement.¹⁹⁸

such adept pleading maneuvers. This need for consistency in interpretation therefore has no application in the *Rodriguez de Quijas* factual scenario. Claims subject to arbitration would be arbitrated whether or not Securities Act claims were arbitrable. Under *Byrd*, the district court would be required to stay court proceedings pending resolution of the arbitration, which would leave nothing to litigate in court if the Securities Act claims were a sham designed to somehow take advantage of the fact that such claims are not subject to compelled arbitration. See *Byrd*, 470 U.S. at 218-21. Since the customer would gain nothing by sham pleadings designed to take advantage of a difference in arbitrability of claims, there is less apparent reason to insist that the Acts be interpreted harmoniously.

193. See *McMahon*, 482 U.S. at 227-28.

194. See 15 U.S.C. § 78aa (1988).

195. *Wilko*, 346 U.S. at 437.

196. *Rodriguez de Quijas*, 109 S. Ct. at 1921.

197. *Id.* (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 (1974)).

198. For instance, because most securities trading is done through exchanges, such as the New York Stock Exchange, members agree to be bound by the rules of the exchange. See FIFTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, reprinted in RESOLVING SECURITIES DISPUTES, *supra* note 2, at 110 app. B. Major exchanges are participants in the Securities Industry Conference on Arbitration, and many have formed SROs as an arbitration forum. *Id.* Such SROs in 1979 and 1980 accepted the Uniform Code of Arbitration as their procedural rules, which provides that any dispute between a customer and a member is subject to arbitration initiated either by demand of the broker pursuant to a written

3. Arbitration policy issues

After questioning *Wilko* with an unworkable distinction, substituting a judicial popularity contest in the guise of "judicial attitudes" for reasoned analysis, and ignoring critical distinctions between the Securities Act and the Exchange Act, the *Rodriguez de Quijas* majority touted congressional policy as evidenced by the FAA to justify its holding.

The Court ignored the fact that the *Wilko* Court had considered congressional policies,¹⁹⁹ as well, so that the majority was merely expressing a disagreement with *Wilko* in this discussion rather than covering new ground. While the *Wilko* majority unquestionably had a less auspicious view of arbitration,²⁰⁰ *Wilko* recognized more than *Rodriguez de Quijas* that the Court's decision should be the outgrowth of legal reasoning rather than the personal views of the Justices.²⁰¹ The *Wilko* majority appreciated the strong federal policy favoring arbitration as evidenced by the FAA, but it also appreciated that "[t]his hospitable attitude of legislatures and courts toward arbitration, however, does not solve our question"²⁰² In both *Rodriguez de Quijas* and *Wilko*, the issue was not whether arbitration was favored or disfavored by the courts, but rather whether Congress intended to create an exception to the FAA through the anti-waiver provision of the Securities Act.²⁰³ Thus, the *Rodriguez de Quijas* majority's homage to federal pro-arbitration policy was inapposite.

The *Rodriguez de Quijas* majority's reliance on federal pro-arbitration policy appears all the more misplaced in light of its silence in response to the dissent's inferences of congressional intent.²⁰⁴ In the thirty-six years between *Wilko* and *Rodriguez de Quijas*, Congress had not seen fit to rise to the defense of the FAA; to the contrary, Congress had approved of *Wilko* by name and had stated an intent to leave the *Wilko* rule undisturbed.²⁰⁵

predispute arbitration agreement or by demand of the customer. *Id.* Thus, the only disputes the customer could not resolve through arbitration, even in the absence of a predispute agreement, are the relatively rare transactions outside of any exchange.

199. See *Wilko*, 346 U.S. at 431-35.

200. See *id.* at 431-32.

201. *Id.* at 433-34.

202. *Id.* at 432.

203. *Rodriguez de Quijas*, 109 S. Ct. at 1919-20; *Wilko*, 346 U.S. at 431-33.

204. See *Rodriguez de Quijas*, 109 S. Ct. at 1920; *id.* at 1923 (Stevens, J., dissenting).

205. H.R. CONF. REP. NO. 229, 94th Cong., 1st Sess. 3, reprinted in 1975 U.S. CODE CONG. & ADMIN. NEWS 321, 342. ("It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration procedural provisions in agreements entered into by persons dealing with members and participants in self-regulatory organizations.").

The *Rodriguez de Quijas* majority respect for congressional intent *vis-a-vis* the FAA also appears misplaced when compared to the failure to respect or even discuss congressional policies underlying the Securities Act. While *Wilko* recognized that the issue involved two competing federal policies,²⁰⁶ the *Rodriguez de Quijas* majority's discussion of federal pro-arbitration policy turned a deaf ear to one side of the issue.

The *Rodriguez de Quijas* majority adopted a similarly one-sided approach in its willingness to argue from principles not proven in the record before the Court. The majority embraced the assumption, stated without reference to supporting evidence, that arbitration offers "prompt, economical and adequate solution of controversies."²⁰⁷ The majority's willingness to accept these unproven assumptions²⁰⁸ favorable to arbitration was very different from its treatment of the arguments raised by the customer/petitioners. While freely accepting postulates supporting arbitration, the majority relied on the silence in the record in concluding that the petitioners had failed to carry "their burden of showing that arbitration agreements are not enforceable under the Securities Act."²⁰⁹ The majority offered no suggestion as to what the customer/petitioners should have done to meet this burden, beyond their reliance on Supreme Court precedent which had stood as good law for over thirty-five years and was squarely on point: the *Wilko* case.

The *Rodriguez de Quijas* majority showed a similar aversion to looking beyond the record in brushing aside petitioners' arguments that agreements to arbitrate in this context were adhesive in nature.²¹⁰ The majority's reasoning thus displays a marked asymmetry in the Court's openness to assumptions beyond the record and suggests that the majority's defense of its decision was more of an after-the-fact rationalization than an explanation of the basis for its opinion.

The recurring theme in the *Rodriguez de Quijas* majority opinion is clearly the perceived strength of federal policy in favor of arbitration as a fair and suitable substitute for judicial protection of rights. Without the majority's strong defense of the arbitration process, *Wilko* would still be good law.

206. *Wilko*, 346 U.S. at 438.

207. *Rodriguez de Quijas*, 109 S. Ct. at 1919 (quoting *Wilko v. Swan*, 346 U.S. 427, 438 (1953)).

208. These assumptions appear to be more controversial than the *Rodriguez de Quijas* majority suggests. See *infra* notes 211-305 and accompanying text.

209. *Rodriguez de Quijas*, 109 S. Ct. at 1921.

210. *Id.* ("Although petitioners suggest that the agreement to arbitrate here was adhesive in nature, the record contains no factual showing sufficient to support that suggestion.")

C. *Suitability of Arbitration as an Alternative Means in Securities Disputes*

The *Rodriguez de Quijas* majority joined certain commentators in the opinion that arbitration offers swift, simple and efficient resolution of disputes through informal and streamlined procedures.²¹¹ Neither the Court nor these commentators, however, have explained why the Court has failed to adopt such procedures in the federal courts, if the procedures are, indeed, both fair to all and more efficient.²¹²

It is no answer to declare that those who dislike arbitration may refuse to agree to arbitrate, exercising their right to the more formal procedures available in the courts; if judicial procedure offers only inefficient, needless formalities compared to arbitration, the right to a judicial forum is pointless. The alternatives, then, are to conclude that existing judicial procedure is a collection of nonsensical formalities promoting inefficiency, or to admit that whatever the merits of arbitration, it lacks some of the safeguards of litigation.²¹³

If it is conceded that arbitration lacks the safeguards available in court, the question of the inherent fairness of arbitration becomes more important. There is no reason to impose the formality of court upon litigants where the nature of the dispute does not require it, especially where litigants are willing to accept the possibility of a less safeguarded resolution in exchange for the efficiencies of arbitration. This Note next examines the arbitration process itself.

1. Customer resistance to arbitration

The *Rodriguez de Quijas* majority praised arbitration primarily by reference to *Shearson/American Express v. McMahon*.²¹⁴ Throughout its

211. Compare *id.* at 1920 with Fletcher, *supra* note 61, at 458 and Katsoris, *supra* note 3, at 3 (presenting similar arguments favoring arbitration of securities disputes).

212. The Supreme Court is vested with limited rule-making power under which it promulgates, *inter alia*, the Federal Rules of Civil Procedure. See 28 U.S.C. § 2072 (1988). Even if limits on rule-making authority may prevent the Court from replacing the federal judicial system with a set of arbitration-like proceedings, the Court could at least urge Congress to change conflicting statutes.

213. The *Wilko* Court recognized that arbitration does not and can not offer all the safeguards of judicial process, but rather offers an alternative to litigation "if the parties are willing to accept less certainty of legally correct adjustment." *Wilko v. Swan*, 346 U.S. 427, 438 (1953).

214. 482 U.S. 220 (1987). The *Rodriguez de Quijas* Court stated:

And in *McMahon* we explained at length why we rejected the *Wilko* Court's aversion to arbitration as a forum for resolving disputes over securities transactions, especially in light of the relatively recent expansion of the Securities and Exchange Commission's authority to oversee and to regulate those arbitration procedures. We need not repeat those arguments here.

opinion, the majority presumed that disputes over arbitration of customer-broker disputes arise only in the factual context of a broker seeking to force a reluctant customer out of court and into arbitration.²¹⁵ If arbitration is deserving of the confidence the majority bestowed upon it, why are customers so uniformly resistant to it?

Justice Blackmun, joined by Justices Brennan and Marshall, offered one answer in their separate opinion to *McMahon*:

[T]here remains the danger that, *at worst*, compelling an investor to arbitrate securities claims puts him in a forum controlled by the securities industry. . . . The uniform opposition of investors to compelled arbitration and the overwhelming support of the securities industry for the process suggest that there must be *some* truth to the investors' belief that the securities industry has an advantage in a forum under its own control.²¹⁶

Justice Blackmun continued by quoting the more blunt assessment by Sheldon H. Elsen, Chairman of the American Bar Association Task Force on Securities Arbitration: "The [brokerage] houses basically like the present system because they own the stacked deck."²¹⁷

Commentators favoring arbitration claim that these criticisms are mere suspicions, unjustified by the facts.²¹⁸ They argue that since industry statistics show that customers win approximately fifty percent of the disputes submitted to industry arbitration forums (called self-regulated organizations, or SROs), the procedure must be fair to customers.²¹⁹

This reasoning fails to offer comparison statistics, and thus proves little about the fairness of arbitration. Certainly, these statistics show that industry SROs are not a sham forum in which the customer cannot win, but without statistics from alternative forums these statistics show little more than that. For example, if the customers would have won ninety percent of the same cases before a judicial forum, arbitration sta-

Rodriguez de Quijas, 109 S. Ct. at 1921 (citation omitted).

215. *Rodriguez de Quijas*, 109 S. Ct. at 1921-22. All reported cases seem to arise this way. See Lindsay, *supra* note 79, at 665 n.127.

216. *McMahon*, 482 U.S. at 260-61 (Blackmun, J., concurring and dissenting).

217. *Id.* at 261 (Blackmun, J., concurring and dissenting) (quoting N.Y. Times, Mar. 29, 1987, § 3, at 8, col. 1).

218. See Fletcher, *supra* note 61, at 452-53; Katsoris, *supra* note 3, at 3.

219. See, e.g., Fletcher, *supra* note 61, at 452. Fletcher relies very heavily on this argument: "The most important indicator that arbitration before the exchanges [the securities industry SROs] is a fair mechanism for customers is that customers win their disputes in those arbitration proceedings." *Id.* at 452-53. The author fails to offer any argument or authority that the customers winning those arbitrations received an award comparable to what they would have received in a judicial forum, and similarly fails to advance any support for the proposition that an approximate 50% win level for customers is fair. *Id.*

tistics prove the opposite of what the commentators claim the numbers demonstrate.

Moreover, this argument fails to address the quantum of recovery in arbitration. If the customer does not gain full compensation before an arbitral forum, the process works an obvious injustice.

The greatest problem with this statistical argument is that it fails to address the real issue, namely that "[i]t is not of some importance but is of fundamental importance that justice should not only be done, but should manifestly and undoubtedly be seen to be done."²²⁰ Securities arbitration cases typically involve a customer seeking to avoid a broker's attempt to force arbitration, strongly implying that customers perceive arbitration as so disadvantageous compared with judicial proceedings that the difference justifies extensive litigation.²²¹

The lack of public trust in arbitration presents no less a problem if it could somehow be proven undeserved.²²² This mistrust has implications beyond the litigants: "The public's perception of fairness, however, must be zealously guarded, for it extends far beyond the issue of arbitration. It goes to the very heart of the public's trust in the securities markets themselves; and, this trust must be preserved for those markets to stay healthy."²²³

Questions about the potential fairness of arbitration as an alternative forum do not arise solely through inferences from the procedural context of these cases. More serious questions flow from a closer examination of

220. *King v. Sussex Justices*, 1 K.B. 256, 259 (1924).

221. Even commentators who favor arbitration acknowledge that whether or not deserved, arbitration does not enjoy the customers' trust. See, e.g., Robbins, *A Practitioner's Guide to Securities Dispute Resolution*, in *RESOLVING SECURITIES DISPUTES*, *supra* note 2, at 17.

222. This is probably beyond scientific proof. Statistics offered by arbitration proponents do not adequately resolve the issue. See Fletcher, *supra* note 61, at 452-53. Scientifically rigorous proof should require submission of a significant number of randomly selected disputes to both arbitration and litigation, followed by statistical analysis of the results for any significant differences. Alternatively, a large number of disputes could be randomly assigned to resolution in either arbitration or litigation, and the results compared. Neither experiment appears feasible.

Absent advance, random assignment of disputes to one forum or the other, only a retrospective study of the results of litigation versus arbitration is possible. Any such study would face the difficult task of demonstrating that the forum for resolving the dispute is the only variable that could explain any differences found. For example, how could the authors of such a study exclude the possibility that differences in the nature of the disputes, themselves, lead to both the parties' agreement to arbitrate and differences in the results in each forum?

Katsoris reports an informal survey finding that not all brokerage houses require arbitration agreements. Katsoris, *supra* note 3, at 4 n.4. A study comparing results of one house in litigation with another that arbitrates all customer disputes would appear profitable, particularly if the litigation history of each house and other factors suggested each house in the study was comparable except in the choice of forum for dispute resolution.

223. Katsoris, *supra* note 3, at 15.

the arbitration process itself in resolving securities disputes between customers and brokers.

2. Unavailability of discovery in arbitration

Discovery procedures which are a vital part of judicial proceedings are limited or even unavailable in arbitration.²²⁴ Commentators favoring arbitration point to this as an advantage, denying that it is a hardship on the customer:

Extensive pretrial discovery permitted in the courts (e.g., depositions, written interrogatories, bills of particulars, production of documents or other things) is not available in securities arbitration proceedings. Why not? Because such discovery "tools" can be expensive and burdensome, a stalling tactic, a nuisance, an effort to wear down one's opponent, and, in short, contrary to the objective of arbitration as an expeditious, cost-effective alternative to the courts.²²⁵

This argument proves too much; all the same criticisms may be made against discovery under federal rules,²²⁶ even though such abuses of discovery are equally contrary to the objective of the federal rules.²²⁷ The logical conclusion from these arguments is that the prevailing practice of allowing discovery without direct court supervision should be scrapped, not that arbitration's lack of discovery is generally an advantage over litigation.

Seen in this light, the argument of these commentators that limiting discovery to whatever the arbitrators see fit to approve²²⁸ becomes a radi-

224. See Neville, *The Enforcement of Arbitration Clauses in Investor-Broker Agreements*, *ARB. J.*, Mar. 1979, at 5, 9.

225. D. ROBBINS, *AN INSIDER'S GUIDE TO SECURITIES ARBITRATION* 14 (1985); accord Fletcher, *supra* note 61, at 453-54.

226. FED. R. CIV. P. 26. The same point may be made under state discovery rules. See, e.g., CAL. CIV. PROC. CODE §§ 2016, 2023 (West 1988).

227. Under the Federal Rules of Civil Procedure, rules (including the discovery provisions of Rule 26) "shall be construed to secure the just, speedy, and inexpensive determination of every action." FED. R. CIV. P. 1. Moreover, Rule 11 requires discovery requests to be signed, and "[t]he signature . . . constitutes a certificate . . . that [the discovery] is not interposed for any improper purpose such as to harass or to cause unnecessary delay or needless increase in the cost of litigation." FED. R. CIV. P. 11.

228. The typical extent of discovery in arbitration is what the arbitrator(s) allow(s) plus whatever the other side will voluntarily agree upon. See, e.g., 9 U.S.C. § 7 (1970); UNIF. CODE OF ARBITRATION § 20 (1986), reprinted in *RESOLVING SECURITIES DISPUTES*, *supra* note 2, at 101 app. A; AMERICAN ARBITRATION ASS'N, *SECURITIES ARBITRATION RULES* 8-9 (1989) [hereinafter *ARBITRATION RULES*]. But see NATIONAL ASS'N OF SEC. DEALERS, *A CODE OF ARBITRATION PROCEDURE* 22-5 (1989) (providing for "information request" proceeding requiring neither prior approval of arbitrator(s) nor agreement of opponent, and re-

cal proposal to retreat from the presently prevailing right to very broad discovery,²²⁹ in which the court becomes involved only after disputes arise.²³⁰ The requirement that parties in arbitration seek prior approval of discovery requests bears more resemblance to the common law limitations on discovery than to modern practice.²³¹ Particularly restrictive is the fact that arbitration discovery provisions typically provide only for documentary exchanges, with no provision for interrogatories, depositions, or other discovery devices.²³²

Such limitations on discovery work to the disadvantage of the customer. The customer bears the burden of proof, although the broker usually has the larger quantity and variety of discoverable material.²³³ Thus, when commentators refer to the burden, expense, and inconvenience of discovery, they speak from the broker's perspective.²³⁴ The broker bears the greater burden under freer discovery, not only in the effort

quiring service on opponent of documents each party intends to use at the arbitration hearing even without affirmative request).

Despite the urging in arbitration rules to cooperate in discovery and voluntarily exchange documents, practice falls short of this ideal. "One failing of some brokerage firms in arbitration proceedings is to refuse to turn over documents unless ordered to do so by the panel [of arbitrators]." D. ROBBINS, *supra* note 225, at 67. If brokers resist voluntary discovery exchanges, the limit of discovery becomes equal to the willingness of the arbitrator(s) to order discovery. See Fletcher, *supra* note 61, at 453.

229. "While an arbitration panel may subpoena documents or witnesses, the litigating parties have no comparable privilege." *Burton v. Bush*, 614 F.2d 389, 390 (4th Cir. 1980).

As to the extent of discovery in federal courts, see FED. R. CIV. P. 26(b); 8 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE: CIVIL* §§ 2007-2015 (1970 & Supp. 1990).

230. R. HAYDOCK & D. HERR, *DISCOVERY: THEORY, PRACTICE AND PROBLEMS* 2 (1983).

231. See *Sinclair Ref. Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689 (1933); Comment, *Developments in the Law—Discovery*, 74 HARV. L. REV. 940 (1961).

232. For a list of typical discovery provisions in arbitration, see *supra* note 228.

As to the necessity of other forms of discovery in securities disputes, it is possible that other devices would be of limited usefulness. Presumably, a substantial portion of the evidence, at least, will be documentary, and this form of discovery may be all that is required in most cases. This is probably of little consolation to those who feel they need broader discovery to present their case.

As to the advantages of depositions as a discovery device, see R. HAYDOCK & D. HERR, *supra* note 230, at 87-88.

233. *RESOLVING SECURITIES DISPUTES*, *supra* note 2, at 66-69. The author suggests a list of eight categories of information that the securities customer should request from the broker, some of which may include relatively numerous documents (such as the suggested request for all trading confirmations and monthly statements). *Id.* at 67-68. The list of suggestions to brokers includes only five items. *Id.* at 68-69. None appears to call for extensive or burdensome production, with the possible exception of the request for documents on trading activity with other brokers (if investor sophistication is at issue). *Id.*

234. This is all the more true since the customer may be required to set forth the entire claim at the initial pleading stage. See *infra* notes 235-40 and accompanying text. Thus, the

required to comply with discovery requests, but also in the potential improvement in the former customer's ability to present a case through discovered data. It appears clear that the broker has little to gain and much to lose through extensive discovery in most cases and, therefore, may expect to gain in the long run from a general rule restricting discovery.

Undoubtedly, there may be cases in which more open discovery will make no difference, or will make a difference for the worse through harassment, increased expense, and other potential abuses. Nevertheless, it is difficult to conclude that this potential for abuse justifies wholesale repeal of discovery rights, particularly when it appears the customer consistently is more likely to suffer from more restrictive discovery.

3. Prerequisites to initiating a claim

In court, a plaintiff may file suit even though not yet in possession of sufficient facts or evidence to prove the case.²³⁵ Such hospitality toward the right to pursue compensation is not necessarily shared by arbitration, where rules may require a party to state all the facts they intend to rely upon in the document initiating proceedings.²³⁶

Arbitrators could allow a party to later amend the initial claim forms so as to modify a claim to match the results of further investigation.²³⁷ However, this fails to correct the problem for two reasons. First, amending the claim is discretionary, and the arbitrators may refuse to allow expansion of a claim.²³⁸ Second, and more importantly, arbitration limitations on discovery²³⁹ may prevent a customer from ever unearthing the evidence necessary to give the customer a reason to require the ability to amend.²⁴⁰ The unnecessary burden of arbitration rules requiring cus-

broker probably has little need for discovery; the broker already has all the information he needs in the customer's initial pleading.

235. See, e.g., FED. R. CIV. P. 10(b) (allows party to plead inconsistent, alternative, or hypothetical facts, so that party may proceed with discovery and clarify claim later); see also R. HAYDOCK & D. HERR, *supra* note 230, at 9-11 (stating that one purpose of discovery is to substantiate claim with facts and evidence not available to the party otherwise).

236. See, e.g., UNIF. CODE OF ARBITRATION, § 612, *reprinted in* 2 N.Y.S.E. Guide (CCH) ¶ 2612 (Nov. 1989) (as adopted by the New York Stock Exchange).

237. See, e.g., ARBITRATION RULES, *supra* note 228, at 7 (allowing changes in claim as a right until an arbitrator is appointed, but only in arbitrators' discretion thereafter).

238. *Id.*

239. See *supra* notes 223-34 and accompanying text.

240. One commentator reverses this logic:

Investors are not disadvantaged by limited discovery because it is largely unnecessary under the arbitration rules used by the securities exchanges. A claimant must, in the initial statement of a claim, set out all the facts on which he intends to rely. . . . Any facts [or] claims . . . left out . . . may not be used at the hearing itself. . . . Thus, at least with respect to arbitrations before the major securities exchanges, formal discovery has become largely unnecessary.

tomers to state their entire case at initial pleading stages, in tandem with the limitations on discovery in arbitration after the initial pleading stage, strike a double blow against the customer with a claim against a securities broker.

4. Arbitrator bias

Even if arbitration procedures are not sufficiently rigorous to prevent unfairness from occurring within the bounds of the rules, the arbitration system ultimately depends on the arbitrators themselves to make the system function fairly.²⁴¹ Can the customer expect arbitrators to be fair and impartial? While the answer must ultimately depend on the persons involved, an examination of the structure of the arbitral process and the means of selecting arbitrators validates customer distrust of arbitration.

A review of arbitration rules discloses two systems for selecting arbitrators. The first is the party-arbitrator system,²⁴² and the second is appointment from a roster of potential arbitrators.²⁴³ Under either system, a majority of the arbitrators must be from outside the securities industry.²⁴⁴

In the party-arbitrator system, each side chooses an arbitrator, and the two sides agree²⁴⁵ on a third, neutral arbitrator. This system has

Fletcher, *supra* note 61, at 453-54.

This effort to justify one handicap the customer suffers by reference to another barrier unique to arbitration is rather like the dieter who justifies overeating at dinner because he or she overate at lunch, and hence was off the diet anyway.

241. Of course, there are obvious limits to the extent a dispute resolution system may rely on the good faith and sense of justice of participants to make the system fair. Why bother having any rules of procedure if the judges or arbitrators may be trusted to do justice unerringly? Approaching the question from the opposite perspective, there appears to be no serious argument that the Federal Rules of Civil Procedure are needed solely out of mistrust of the federal judiciary to do justice. Rules define the parties' duties and rights, so all know what to expect. This tends to increase the all-important *perception* of fairness in the system. See *supra* notes 220-23 and accompanying text.

242. *E.g.*, ARBITRATION RULES, *supra* note 228, at 10-11 (allowing each party to choose an arbitrator, and directing the two selected party arbitrators to select a third, "neutral" arbitrator).

243. *E.g.*, *id.* at 9-10 (American Arbitration Association (AAA) system of appointing arbitrators when arbitration agreement silent on the subject). When the SRO appoints arbitrators, it may seek input from parties. See, *e.g.*, *id.* Other SROs simply allow parties a right to challenge a selected arbitrator. See, *e.g.*, FIFTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, *supra* note 198, at 121-22.

244. See, *e.g.*, ARBITRATION RULES, *supra* note 228, at 11.

245. The parties' counsel may deal with each other directly, or the party-arbitrators (at least nominally) may select the neutral arbitrator. See *id.* at 10-11.

been used in international arbitrations²⁴⁶ and is common in other contexts as well.²⁴⁷ The party-arbitrator system has been criticized and is generally disfavored by experts in alternative dispute resolution.²⁴⁸ It is said to needlessly increase the expense of arbitration and complicate the proceeding, while adding nothing to the value of the end product. There is no requirement that party-arbitrators be neutral,²⁴⁹ and they may even be openly recognized and tolerated as biased on the assumption that the biases of the party-arbitrators will cancel each other out.²⁵⁰ If it is true that the party-arbitrators merely cancel each other out, they apparently add nothing to the dispute resolution process, and the neutral arbitrator effectively decides the case.

The second method of choosing arbitrators, appointment from an approved roster, does not solve arbitrator selection problems. To begin with, the roster itself may be carefully selected to reflect partiality toward the securities industry and its practices. From the standpoint of customer perception, the problem is probably worse. Why would a customer, who already feels so wronged by a professional in the securities industry as to initiate legal action, entrust the New York Stock Exchange, Inc., the National Association of Securities Dealers, Inc., or any other SRO to act impartially in a dispute between a dues-paying SRO member (the broker) and an investor?²⁵¹

246. Elsen, *Evaluation of Self-Regulatory Organization Administration of Securities Disputes*, in *RESOLVING SECURITIES DISPUTES*, *supra* note 2, at 483 (presenting interim findings and evaluation of "The Arbitration Project" of the American Bar Association Subcommittee on Civil Liabilities and Litigation).

247. Substantial case law has developed around the use of arbitration agreements calling for party-arbitrator tripartite arbitration between the Kaiser-Permanente organization, a large health maintenance organization in California and Hawaii, and the member patients. Werchick, *Arbitration and Good Faith*, 19 *CTLA F.* 319, 321-25 (1989).

248. *See id.*

249. *See* M. DOMKE, *THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION* § 20.03 (1968). This is not to suggest party-arbitrators may casually ignore the evidence:

Our decision that an arbitrator may not be disqualified solely because of a relationship to his nominator or to the subject matter of a controversy does not, however, mean that he may be deaf to the testimony or blind to the evidence presented. Partisan he may be, but not dishonest.

Astoria Medical Group v. Health Ins. Plan of Greater N.Y., 11 *N.Y.2d* 128, 137, 182 *N.E.2d* 85, 89, 227 *N.Y.S.2d* 401, 407 (1962).

250. *See, e.g.*, *Tipton v. Systron Donner Corp.*, 99 *Cal. App. 3d* 501, 506, 160 *Cal. Rptr.* 303, 305 (1979) ("[T]he arbitrators representing the parties frequently behave more like advocates than arbitrators. A special relationship between the non-neutral arbitrator and his client is implicit in the tripartite format here freely adopted by the parties."). The court's choice of words is particularly interesting, referring to a party as the "client" of the party-arbitrator.

251. At least three U.S. Supreme Court Justices have recognized current procedures, despite SEC oversight, have corrected neither the perception nor the fact of arbitrator bias in securities arbitration: "the investor has the impression, frequently justified, that his claims are

Some commentators argue this suspicion is unfounded, because arbitration agreements give the customer a choice of arbitral forums, including the American Arbitration Association and other non-profit organizations with no ties to the securities industry.²⁵² This argument confuses actual fairness²⁵³ with the perception of fairness.²⁵⁴ The argument is also flawed in its assumption that SROs not owned or operated directly by the securities industry must *ipso facto* be completely fair to customers.

It must be remembered that this whole issue arises from a broker presenting to a customer an arbitration agreement *before* any dispute arises. If the securities industry decided that arbitration was unwise, it could simply stop offering customers such agreements.²⁵⁵ In contrast, customers have no such power to halt the use of arbitration through their opposition.²⁵⁶ Thus, assuming the SROs wish to stay in business, they

being judged by a forum composed of individuals sympathetic to the securities industry. . . ." Shearson/American Express v. McMahon, 482 U.S. 220, 260). (Blackmun, J., dissenting (1987)).

252. *E.g.*, Fletcher, *supra* note 61, at 448-50.

253. Fletcher fails to discuss the more philosophical question involved in this distinction, namely, how to analytically separate the concept of *actual* fairness from *perceived* fairness. *See id.* It is easy to imagine hypothetical cases in which the result would have only one of these two. In considering whether a *system* is "fair," it becomes more difficult to imagine determining how a system operated in good faith could have one without the other. Logically, such a determination would require a study from an unattainable, omniscient viewpoint to determine who was "really" right, and compare this with how well the system correctly decided for the "right" party. Such a view presumes an unrealistically black-and-white view of disputes; who is "right" between a broker following usual business customs and a customer who loses large sums out of misplaced trust in an unskillful (or unlucky) broker? The "right" answer appears to arise more from one's sympathies in this David-and-Goliath struggle than from an objective standard.

Fletcher argues at length against the perceptions of unfairness in the existing system, listing "myths" about securities arbitration and attempting to demonstrate each is baseless. *Id.* at 455-58. He ignores his own conclusion later in the same article that the securities industry needs investor confidence to survive, and that arbitration similarly requires public confidence to work. *Id.* at 460.

254. *See supra* notes 220-23 and accompanying text.

255. Indeed, predispute arbitration agreements are not universal in the securities industry. *See* Katsoris, *supra* note 3, at 2 n.4. No source has been found as to whether this is due to SEC Rule 15c2-2, *see supra* notes 76-79 and accompanying text, the impression that arbitration agreements are unenforceable pursuant to *Wilko v. Swan*, 346 U.S. 427 (1953), or some other reason. Obviously, the *Rodriguez de Quijas* case will lead to increased use of such agreements now that there is no question of their enforceability, if it has any impact at all.

256. Customers frequently are unaware of the existence or significance of an arbitration agreement when it is presented. *See* *Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 64 Cal. App. 3d 899, 135 Cal. Rptr. 26 (1977). It is therefore unrealistic to argue that customers can eliminate arbitration by refusing to sign the agreements. Moreover, brokers may decline to do business with customers who refuse to agree to arbitration.

face a party with the power to make their existence obsolete²⁵⁷ (the securities industry) versus a party with essentially no control over the existence of arbitration agreements. Whether the SROs may be motivated by a corrupt desire to service the securities industry or a benevolent belief in the arbitral process, it remains difficult to suppose SROs do not prefer self-preservation. It is also difficult to imagine that SROs fail to perceive that their existence²⁵⁸ depends on the continued good will of the securities industry.²⁵⁹

The existence of bias becomes more probable as the parties become more involved in the process of selecting arbitrators. When the parties

257. This may appear to be an empty threat, because customers enjoy a unilateral right to compel arbitration through exchange rules even without an arbitration agreement. *See supra* note 198 and accompanying text. The customer's ability to force arbitration even in the absence of an agreement exists through the rules of stock exchanges, whose rules are formed by the securities industry. Katsoris, *supra* note 3, at 2 n.4. The solicitation of arbitration agreements by the securities industry is also built from the securities industry's favor of arbitration. If the industry came to disfavor arbitration, it could not only stop offering customers arbitration agreements, but could also change the rules of the exchanges within their control. Thus, the securities industry possesses the power to remove securities disputes from SROs (or any particular disfavored SRO) if the industry's attitude on arbitration were to shift.

258. This would at least be true for SROs providing a forum only for securities disputes, such as the arbitration services provided by exchanges. It may be less literally true for forums such as the AAA which provide arbitration services for a wider range of disputes. Even in such instances, the desire to promote arbitration as an alternative means of dispute resolution, paradoxically, can provide motivation that makes the process unfair. Arbitrators with a strong belief in the process may lean toward favoring the side which, like the arbitrators, favors arbitration and requires customers to sign the agreements which make arbitration possible on a widespread basis. It would seem to ask much of frail human nature to expect arbitrators to be completely unmoved where a customer has fought arbitration in the courts (perhaps, as with the customers in *Rodriguez de Quijas*, all the way to the Supreme Court). Can arbitrators avoid feeling this is an attack on their personal integrity?

The analysis offered in the text would conceivably be untrue for an arbitral forum in which securities arbitration is a trivial source of business. If the arbitrators in such a forum were truly indifferent to whether the securities industry would continue to employ their services, they would lack a reason to favor either side. If such a forum exists, the very fact that makes it so impartial, i.e., that securities arbitrations are such a small part of its caseload, makes it an insignificant exception.

259. It might also be argued that because arbitration is less expensive than litigation, the securities industry would prefer arbitration even if the ultimate losses were the same as court awards. This is true, but if the economic perspective is assumed to be the only reason for choosing one forum over another, the whole economic picture must be reviewed. The securities industry is obviously aware of the time value of money concept, i.e., that it is less costly to pay debts later so one can earn added interest on funds due to others, but held and invested. From the purely economic perspective, the speed of arbitration is actually a *disadvantage* for the party that claims are made against. The lower cost of arbitration must be weighed against the time value of the money involved to choose one system over the other from a financial viewpoint. The literature in this area speaks much of the lower cost of arbitration, *see, e.g., Fletcher, supra* note 61, at 397, but no source was found that quantifies the difference. Thus, no general conclusion balancing these competing pecuniary factors is possible.

affirmatively must agree on arbitrators, each side will wish to choose an arbitrator favorable to its own position.²⁶⁰

Counsel for the broker may have an edge in this process, because such an attorney will probably have greater experience with the process and more familiarity with the arbitrators available.²⁶¹ Arbitrators may not view the party who repeatedly brings cases before a particular forum the same as a nonrepeat party, the customer. The arbitrators chosen presumably will be aware that the broker's counsel is likely to be involved in choosing arbitrators again on other cases, perhaps quite soon. They also are likely to realize that most (if not all) attorneys for customers probably have no such power. The arbitrator, therefore, will proceed with the knowledge that the "wrong" decision could mean that he or she will never again have the opportunity to sit as an arbitrator.²⁶² Even assuming an individual arbitrator is actually uninfluenced by such considerations, the customer may remain justifiably suspicious of the process.

Moreover, arbitrator selection problems are not the only bias issue. Even if the selection process had no independent problems, the rules of arbitration call for a built-in bias on the arbitration panel by requiring panels to be composed of two "public" arbitrators (allegedly without ties to the securities industry), and one arbitrator from the securities industry.²⁶³ Courts have been troubled by the prospect of asking an arbitrator to fairly decide a matter involving the industry upon which the arbitrator

260. There appears to be no reason to suppose that advocates for each side would view arbitrator selection any differently than jury selection. It is well recognized that voir dire is not used to select the most unbiased jury possible. See J. JEANS, TRIAL ADVOCACY § 7.7 (1975). Each side wants the jurors perceived as most inclined towards that party's case. *Id.*

261. See Werchick, *supra* note 247, at 322.

262. See *id.* This is a concept quite similar to the pressure on the arbitration process as a whole. See *supra* notes 251-59 and accompanying text. The point here is that the *individual arbitrators* suffer from a comparable pressure at each and every arbitration. The very fact that arbitration is a voluntary process, chosen by the securities industry over customer objection, implies that the industry could also choose not to arbitrate.

263. See, e.g., ARBITRATION RULES, *supra* note 228, at 9. As to whether such industry arbitrators are disinterested, it has been suggested that such panelists are actually harder on fellow brokers out of a desire to maintain the public image of the industry. See D. ROBBINS, *supra* note 225, at 89. Most commentators perceive arbitrators from the industry as presenting a significant conflict of interest. See, e.g., Exchange Act Release No. 13,470, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,136, at 87,906 (Apr. 26, 1977).

The Arbitration Project of the American Bar Association Subcommittee on Civil Liabilities and Litigation specifically found "that industry arbitrators inevitably have business relations with the [brokerage] house which is involved in the arbitration" and that "[i]ndustry arbitrators frequently engage in the same practices that are challenged in an arbitration and, as such, have difficulty in being even moderately impartial." Elsen, *supra* note 246, at 483.

depends for a livelihood.²⁶⁴

Proponents of arbitration argue this is an advantage because it provides the panel with the necessary expertise.²⁶⁵ This suggestion is quite radical²⁶⁶ when examined for what it is—deciding a case in significant part based on a witness who is sequestered with the triers of the matter, whose testimony on expert subjects goes to the heart of the case, but whose testimony is never even heard by the parties, let alone subjected to cross-examination.

Nevertheless, arbitration proponents deny that the presence of an industry arbitrator is a problem because the lone industry arbitrator would always be in a minority.²⁶⁷ This argument fails for two reasons.

First, the expertise of the industry arbitrator places that arbitrator in a position of influence over the other two arbitrators, and the industry arbitrator need only persuade one fellow arbitrator in order to carry the day for the securities industry.²⁶⁸

Second, "industry arbitrator" is a term that is either undefined or defined in a way that does not include all those whose relationship to the securities industry would give them at least the appearance of bias.²⁶⁹

264. In *American Safety Equip. Corp. v. J.P. McGuire & Co.*, the court reversed an order to arbitrate on the grounds, *inter alia*, that commercial arbitrators, usually businessmen themselves, could not be called on to implement policies designed to regulate the business community. 391 F.2d 821, 827-28 (2d Cir. 1968).

The court went even further in *Hope v. Superior Court*, where the court held a predispute arbitration agreement with a customer unconscionable because it allowed arbitration before the New York Stock Exchange. 122 Cal. App. 3d 147, 154, 175 Cal. Rptr. 851, 852-53 (1981). The court found that the New York Stock Exchange "is presumptively biased in favor of [securities industry] management" and "that there exists a presumptive institutional bias in favor of member firms and members . . ." *Id.*

265. See, e.g., Masucci & Morris, *Securities Arbitration at Self-Regulatory Organizations: Administration and Procedures*, in *RESOLVING SECURITIES DISPUTES*, *supra* note 2, at 251; Robbins, *supra* note 225, at 52.

266. It is, of course, the norm in court cases that the decision is based on evidence adduced during trial, and neither a juror's general knowledge pertaining to a dispute nor any expertise a juror may have about the subject matter of the litigation should be allowed to interfere with the decision-making process. See, e.g., *Edelstein v. Roskin*, 356 So. 2d 38 (Fla. Dist. Ct. App. 1978); *Downing v. Farmers' Mut. Fire Ins. Co.*, 158 Iowa 1, 138 N.W. 917 (1912). *But see Solberg v. Robbins Lumber Co.*, 147 Wis. 259, 133 N.W. 29 (1911) (approving jury instruction that jurors may pool their expertise to help them decide a case).

267. See, e.g., Fletcher, *supra* note 61, at 449-50.

268. See Elsen, *supra* note 246, at 483.

269. The AAA rules, for example, specify that one of the three arbitrators (the usual number unless the matter is a small claim) shall be "affiliated with the securities industry." *ARBITRATION RULES*, *supra* note 228, at 9. The rules contain no definition of what degree of relationship amounts to "affiliation," a failing common to SRO arbitration rules. Brown, Shell & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 35 n.94 (1987); Katsoris, *The Arbitration of a Public Securities Dispute*, 53 *FORDHAM L. REV.* 279, 309-12 (1984).

Justice Blackmun observed in *McMahon* that “[a]ccordingly, it is often possible for the ‘public’ arbitrators to be attorneys or consultants whose clients have been exchange members or SROs.”²⁷⁰ The few SRO rules which attempt to define an “industry arbitrator” exclude only the most obvious conflicts, leaving many suspect categories to be public arbitrators.²⁷¹

Whether securities arbitration as it presently exists is *actually* fair is probably a philosophical question that cannot be answered.²⁷² It is human nature that many losing parties will feel the adverse outcome could only be explained by arbitrator bias. As to the critical *appearance of impropriety*, however, it is clear present practices leave much room for public skepticism on the impartiality of arbitrators.

This Note next examines whether judicial review of arbitrators’ decisions is a sufficient safeguard to neutralize any arbitrator bias.

5. Judicial review to counteract problems with arbitration

After an arbitration award is rendered, the litigating parties may return to court to confirm the award and to have judgment entered accordingly.²⁷³ The court may vacate the award, but only on the very narrow grounds that: (1) “the award was procured through corruption, fraud, or undue means”²⁷⁴; (2) “there was evident partiality or corrup-

270. *McMahon*, 482 U.S. at 261 (Blackmun, J., concurring and dissenting).

271. See, e.g., Masucci & Morris, *supra* note 265, at 238. The authors offer a typical definition:

No one may serve as a public arbitrator who has been an employee or partner of a member organization or subsidiary thereof, or a shareholder of a non-publicly owned member organization or subsidiary thereof for a period of three years immediately preceding his or her appointment as a public arbitrator.

Id.

This definition fails to exclude the types of arbitrator listed by Justice Blackmun, see *supra* note 270 and accompanying text. Further, it fails to exclude spouses, retirees (retired over three years), and others whose positions or relations to the industry may suggest a conflict of interest.

Conversely, the National Association of Securities Dealers uses a fairly good definition: An arbitrator will be deemed as being from the securities industry if he or she:

- (1) is a person associated with a member or other broker/dealer, municipal securities dealer, government securities broker, or government securities dealer, or
- (2) has been associated with any of the above within the past three (3) years, or
- (3) is retired from any of the above, or
- (4) is an attorney, accountant, or other professional who has devoted twenty (20) percent or more of his or her professional work effort to securities industry clients within the last two years.

NATIONAL ASS’N OF SEC. DEALERS, *supra* note 228, at 13 (1989).

272. See *supra* notes 220-23 and accompanying text.

273. 9 U.S.C. §§ 9-13 (1988).

274. *Id.* § 10(a).

tion in the arbitrators, or either of them"²⁷⁵; (3) the arbitrators were guilty of misconduct or misbehavior;²⁷⁶ (4) the arbitrators "exceeded their powers, or so imperfectly executed them" that no final award could be made;²⁷⁷ or (5) consistent with the ground developed in case law, the arbitrators acted with "manifest disregard" for the law.²⁷⁸

Certainly, the advantage of the speed of arbitration would be lost if the court, on motion to confirm the award, had full power to review the matter on the merits.²⁷⁹ The *Rodriguez de Quijas* Court, through its adoption of the *McMahon* discussion of arbitration, viewed limited review as sufficient.²⁸⁰ An examination of the restrictive review powers of the court in deciding a motion to confirm an arbitration award reveals that broader review of the arbitrators' award is necessary but not generally obtainable.

Wider powers to review arbitration awards are necessary to protect the customer's statutory rights. The *Rodriguez de Quijas* Court thought that arbitration would not diminish customer rights under securities laws because an agreement to arbitrate would not surrender any substantive rights, but would act merely as a selection of an alternative forum for adjudication of those rights.²⁸¹ In adopting this position, the Court overlooked a strong line of decisions holding that arbitrators are not bound to decide in accordance with the law.²⁸² Even more pertinent to the ques-

275. *Id.* § 10(b).

276. *Id.* § 10(c).

277. *Id.* § 10(d).

278. See *Wilko v. Swan*, 346 U.S. 427, 436 (1953); *Fairchild & Co. v. Richmond, F. & P.R.R.*, 516 F. Supp. 1305, 1315 (D.D.C. 1981). As the *Wilko* Court noted, however, it is necessary to distinguish between faulty interpretation of the law and manifest disregard. *Wilko*, 346 U.S. at 436-37. This standard of review prevents courts from serving as a route of appeal from an award based on a simple error of law. As the *Fairchild* court noted, manifest disregard requires that the arbitrator correctly state the law, and disregard it nevertheless. *Fairchild*, 516 F. Supp. at 1315; accord *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1214 (2d Cir. 1972); *San Martine Compania de Navegacion v. Saguenay Terminals*, 293 F.2d 796, 801 (9th Cir. 1961).

279. R. COULSON, *BUSINESS ARBITRATION — WHAT YOU NEED TO KNOW* 10 (3d ed. 1987).

280. *Rodriguez de Quijas*, 109 S. Ct. 1920-21 (1989). The *McMahon* Court had said that "although judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute." *McMahon*, 482 U.S. at 231.

281. *Rodriguez de Quijas*, 109 S. Ct. at 1920. "By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Id.* (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 628 (1985)).

282. This principle was well settled in New York at an early date. See *S.A. Wenger & Co. v. Propper Silk Hosiery Mills*, 239 N.Y. 199, 203, 146 N.E. 203, 204 (1924). More recently, a California court termed the principle "well established" and expanded it into a new area.

tion of whether arbitrators do, in practice, follow the law is the fact that arbitrators generally do not believe they are bound by the law, but rather that they are bound only to do what they think is fair.²⁸³ Obviously, what a particular panel of arbitrators feels is fair will not necessarily correspond with a customer's rights under securities laws.²⁸⁴ The *Rodriguez de Quijas* majority rejected the argument that arbitration could be a ruse to avoid these customer rights granted in the securities laws.²⁸⁵ Nevertheless, it appears that arbitration may deny customer rights absent judicial oversight to correct mistakes and abuses. Does the present system permit such oversight?

Despite the FAA's limitations on review,²⁸⁶ there is no reason to suppose courts are reluctant to overturn arbitration awards based on a clear denial of customer rights as guaranteed under the securities laws. The problem with existing procedures is that they fail to ensure that the court will have an opportunity to assess the arbitration. For example, arbitration rules generally do not provide for a transcript of proceedings unless one is requested and paid for by the parties.²⁸⁷ Hence, the customer who proceeds confidently to arbitration, and sees no need to pay for a costly record, may find no way to substantiate a later claim in court that the award should be overturned.²⁸⁸

Nogueiro v. Kaiser Found. Hosps., 203 Cal. App. 3d 1192, 1194-95, 250 Cal. Rptr. 478, 479 (1988).

283. See Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 860-62 (1961). The author surveyed the American Arbitration Association arbitrator panel, and found that although 80% believed they ought to follow substantive law, 90% felt free to disregard substantive law mandates if they desired. *Id.* at 861.

284. This is particularly true because at least one of the arbitrators will be from the securities industry, and may be sympathetic towards a broker who takes a shortcut around the securities law protection guaranteed the customer. See *supra* notes 242-44 and accompanying text.

285. *Rodriguez de Quijas*, 109 S. Ct. at 1920.

286. See *supra* notes 273-77 and accompanying text.

287. See, e.g., ARBITRATION RULES, *supra* note 228, at 12. Essentially, the rules merely grant all parties the right to have a stenographer present at the hearing, at the party's own expense. *Id.*

But see NATIONAL ASS'N OF SEC. DEALERS, *supra* note 228, at 26 (requiring either a stenographic or tape recorded verbatim record of arbitration hearings, the only expense being transcription costs split between any parties requesting the transcribed record).

288. Arguably, because a customer has the right to have a record transcribed, there is no injustice in denying relief because a customer chooses to forego the record. This argument is based on the flawed assumption that it is just to penalize persons with just positions when they fail to have foresight of acuity equal to hindsight. Why would a customer with a strong case and faith in the fairness of arbitration diminish full recovery by the expense of having a stenographer present throughout the arbitration hearing? The stronger the case, the more likely it is that a customer will elect to forego a transcript as an unnecessary expense. However, these customers have a greater need for judicial review in the event of an arbitration loss, because it

A full transcript of proceedings is not the only material a court might profitably review to determine if an award should be overturned. A written opinion from the arbitrators summarizing the evidence, findings of fact, legal conclusions, and rationale could be more useful than a transcript.²⁸⁹ Just as formal arbitration rules inhibit parties from obtaining a transcript, informal arbitration practice inhibits arbitrators from drafting opinions.²⁹⁰ Not only is there generally no requirement that arbitrators give written opinions justifying their decision,²⁹¹ arbitrators are actively discouraged from rendering written opinions.²⁹² The President of the AAA has advised arbitrators that "[w]ritten opinions can be dangerous because they identify targets for the losing party to attack."²⁹³ Thus, the losing party at arbitration has no guarantee that even the very limited grounds for overturning an award will actually be available in a later court hearing because the rules and customs of arbitration act to suppress evidence that might upset an award.²⁹⁴ As a result, the courts are rendered impotent to rectify denials of customer rights at the hands of arbitration.²⁹⁵

is more likely that an injustice was done. It would therefore seem that transcripts are needed most when they are least likely to be seen as a worthwhile investment.

289. Especially after a lengthy arbitration, it could be an onerous task for a court to sift through hundreds or thousands of pages of transcript. Having done so, the court might find no convincing evidence of whether the arbitrators were corrupt, acted in disregard of the law, or otherwise conducted themselves in a way justifying reversal of the award. Conversely, a relatively brief opinion may reveal the basis for overturning an improper award. Particularly if the arbitrators' statement of applicable law is compared to a brief submitted by the customer, disregard of the law otherwise hidden could become manifest. *See Fletcher, supra* note 61, at 454-55 (parties' briefs may help make disregard of law manifest).

290. *See SECURITIES INDUS. CONF. ON ARBITRATION, ARBITRATION PROCEDURES* 16 (1989) [hereinafter *ARBITRATION PROCEDURES*] (decision is based solely on material provided by parties); *see also United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960) (arbitrators need not explain basis of award); M. DOMKE, *COMMERCIAL ARBITRATION* § 29:06, at 435-36 (rev. ed. 1984) (arbitrators not required to write opinions).

291. *See ARBITRATION PROCEDURES, supra* note 290, at 16.

292. *Id.*

293. R. COULSON, *supra* note 279, at 20 -21.

294. *Id.* One commentator cogently observes that arbitration as we know it requires this state of affairs. *See Sterk, supra* note 99, at 484-85. If arbitrators are required to follow the law, make full records of proceedings, and issue formal opinions with findings of fact, all subject to appellate scrutiny, arbitration will have come essentially full circle to imitate the court system. *Id.*

295. The customer's problems are illustrated by the customer who submitted his dispute to arbitration in *Sobel v. Hertz, Warner & Co.*, 338 F. Supp. 287 (S.D.N.Y. 1971), *rev'd*, 469 F.2d 1211 (2d Cir. 1972). The customer alleged market manipulation and fraud. *Id.* at 289-92. Arbitrators dismissed without elaboration, after one of the brokerage house employees was convicted of criminal charges in connection with the same activity. *Id.* at 290-92. The district court remanded the matter to the arbitrators for an explanation of the basis for the dismissal. *Id.* at 297. The Second Circuit Court of Appeals reversed the order, holding arbitrators had

6. SEC oversight

The *Rodriguez de Quijas* majority touted the power granted the SEC in 1975²⁹⁶ to regulate arbitration as safeguarding customers' rights under securities laws.²⁹⁷ The majority's faith in the SEC may be misplaced for three reasons.

First, the SEC's oversight is limited to procedural rules affecting arbitrations as a whole and gives the SEC no power to review or reverse an individual case no matter how unfair the result.²⁹⁸ The SEC is impotent to correct indefensible arbitration results, except through rule modifications designed to prevent recurrences in future arbitrations. Indeed, SEC policy is to inform complaining customers (even before arbitration) that the SEC "may not interpose itself between private parties in their disputes."²⁹⁹

Second, it is questionable whether the SEC's limited resources allow for effective regulation, particularly in light of the burdens imposed by growth in the securities marketplace.³⁰⁰

Third, the SEC's oversight has, in fact, left much room for improvement.³⁰¹ As noted above,³⁰² a customer seeking recovery from a broker still faces numerous unresolved procedural hurdles.³⁰³ Industry SROs

no duty to explain their actions. *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1215-16 (2d Cir. 1972).

296. See 15, 15A, 19, 15 U.S.C. §§ 78f, 78o, 78s (1983).

297. *Rodriguez de Quijas*, 109 S. Ct. at 1921 (citing with approval *Shearson/American Express v. McMahon*, 482 U.S. 220, 231-34 (1987)).

298. The *McMahon* minority observed:

The [SEC] does not pretend that its oversight consists of anything other than a general review of SRO rules and the ability to require that an SRO adopt or delete a particular rule. It does not contend that its "sweeping authority" . . . includes a review of specific arbitration proceedings. It thus neither polices nor monitors the results of these arbitrations for possible misapplications of securities laws or for indications of how investors fare in these proceedings.

McMahon, 482 U.S. at 265 (Blackmun, J., concurring and dissenting).

299. Fitterman, *supra* note 92, at 209 (comments of Mark O. Fitterman, Associate Director, Office of Inspections and Financial Responsibility, Division of Market Regulation, SEC Washington, D.C., office).

300. See *Oversight, Authorization, and Other Matters: Hearings on H.R. 1602 Before the Subcomm. on Telecommunications, Consumer Protection, and Finance*, 99th cong., 1st Sess. (1986).

301. Even proponents of arbitration agree that the system needs improved procedures. See, e.g., Katsoris, *supra* note 3, at 9-15.

302. See *supra* notes 224-40 and accompanying text.

303. This is not to say the SEC has been totally dormant. To the contrary, the SEC itself realized its oversight had been inadequate after Justice Blackmun's criticism and skepticism of the SEC's activity in this area expressed in *McMahon*, 482 U.S. at 261-66 (Blackmun, J., concurring and dissenting). The most significant changes in arbitration practice, however, have come from the industry itself. For example, in 1989, the Securities Industry Conference

are still perceived as biased, and attorneys for customers are still calling for improvements in the system.³⁰⁴

The SEC's oversight of SRO arbitration procedural rules has undoubtedly improved arbitration practices, and it has made rules more uniform between SROs.³⁰⁵ Nonetheless, expecting such limited oversight to ensure justice in securities arbitration seems wildly optimistic.

7. Conclusion: the present system of securities arbitration is a seriously flawed alternative to dispute resolution in the courts

It is clear that the present practices of securities arbitration has many flaws. These practices justify the *perception*, at least, that the system is designed to unfairly circumvent the customer's rights under the securities laws by forcing the customer into a forum where those rights may be disregarded and the right to appeal is restricted to the point of impotence.

VI. RECOMMENDATIONS

The *Rodriguez de Quijas v. Shearson/American Express*³⁰⁶ case has completed an historical shift in the law: from the anti-arbitration positions of *Wilko v. Swan*,³⁰⁷ and the SEC rule forbidding brokers and dealers from entering agreements with customers³⁰⁸ to the elimination of legal barriers to arbitration and the enforcement of predispute arbitration agreements.³⁰⁹ If unresolved legal questions prior to *Rodriguez de Quijas* hindered the more widespread use of arbitration agreements, such agreements are likely to become more common in the wake of the *Rodriguez de Quijas* decision. An increased use of arbitration adds urgency to the process of reforming arbitration practices because wider use of arbitration could effect a repeal of protections guaranteed investors since the

on Arbitration, an industry organization formed to frame uniform arbitration rules between the SROs, required highlighting predispute arbitration clauses so that they could no longer be buried in fine print. Metropolitan News-Enterprise (Los Angeles), Jan. 24, 1990, at 11.

304. Metropolitan News-Enterprise, *supra* note 303, at 11 (noting, *inter alia*, comments of Theodore Eppenstein, counsel for the customers in *McMahon*, advocating changes in present arbitration practice).

305. See FIFTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, *supra* note 198, at 110-11.

306. 109 S. Ct. 1917 (1989).

307. 346 U.S. 427 (1953).

308. See 17 C.F.R. § 240.15c2-2(a) (1986).

309. *Rodriguez de Quijas*, 109 S. Ct. at 1921.

Great Depression if arbitration fails to safeguard those rights as effectively as the courts.

This Note proposes the following four changes to address weaknesses in the present practice. First, the burden of proof should be shifted to the broker to show that the arbitration agreement was knowingly and voluntarily reached.³¹⁰ Second, discovery should be allowed as a matter of right.³¹¹ Third, arbitrators should be free from securities industry ties.³¹² Finally, arbitrators should be required to render written opinions conforming to specified standards.³¹³

A. *Shifting the Burden of Proof to the Broker*

Reform of securities arbitration should begin where arbitration has its genesis, the initial agreement to arbitrate. The *Wilko v. Swan*³¹⁴ majority was clearly concerned with this issue,³¹⁵ although the explicit grounds for the decision ultimately rested elsewhere.³¹⁶ The *Wilko* Court's explicit reasoning that the Securities Act voids all attempted waivers of the customer's right to a judicial forum cannot be applied literally, however, as it would require absurd results in many situations.³¹⁷

310. See *infra* notes 314-32 and accompanying text.

311. See *infra* notes 333-37 and accompanying text.

312. See *infra* notes 338-44 and accompanying text.

313. See *infra* notes 345-46 and accompanying text.

314. 346 U.S. 427 (1953).

315. *Id.* at 432, 435-37. This issue is discussed at length in Lindsay, *supra* note 79, at 664-69. That commentator considered the whole discussion of voluntariness to be superfluous in light of the Court's holding that the Securities Act prohibited customer waivers of judicial forums, thus providing an implied exception to the FAA. *Id.* at 664-65. The *Wilko* Court's discussion of voluntariness is better seen as the true basis of the decision. The statutory argument was merely a formal attempt to avoid usurping the legislative function through establishing a judge-made exception to the FAA, since the FAA states that exceptions are to be found only in congressional pronouncements. See 9 U.S.C. §§ 3-4 (1988).

316. *Wilko*, 346 U.S. at 348 (congressional intent underlying Securities Act is better carried out by invalidating arbitration agreement).

317. For example, if a customer cannot waive the judicial forum, even by a voluntary act, why can a customer do so *after* initiating litigation? Clearly, courts are not disturbed by arbitration agreements in this context. See *supra* note 4.

Likewise, how can securities cases be settled short of trial? The customer's dismissal of litigation, surely a part of nearly every settlement, is clearly a waiver of the right to proceed to trial. Here again, the law is contrary to what the *Wilko* reasoning might suggest, favoring settlements even though the customer waives the right to proceed in a judicial forum. See Lindsay, *supra* note 79, at 647. The reason securities laws permit settlement despite *Wilko* is that "Congress did not take away from the citizen 'his inalienable right to make a fool of himself.' It simply attempted to prevent others from making a fool of him." L. LOSS, SECURITIES REGULATION 36 (1983) 1028-34 (1988).

The distinction between these situations and *Wilko* rests in the voluntariness and knowing nature of these situations. In each, the customer is acutely aware of the real possibility of litigation and the need to protect the customer's own interests, but voluntarily chooses a

The more rational application of the *Wilko* rule is for the courts to refuse to enforce arbitration agreements whenever enforcement would be inconsistent with the purposes of the securities laws, to protect the customer from broker overreaching and place the customer on equal footing with the broker.³¹⁸

This approach, when applied to refuse enforcement of predispute arbitration agreements, is consistent with the spirit of the FAA,³¹⁹ but goes beyond the protections of the FAA alone. Predispute arbitration agreements are presented to the customer at a moment when a decision to invest has been made and the customer has decided to repose trust in a given broker to handle the investment. This is a time in the sales transaction when the customer is most vulnerable,³²⁰ and least likely to notice that papers being signed include an arbitration agreement.³²¹ Even if the customer notices the arbitration agreement without benefit of counsel, the customer probably has little understanding of the nature and impact of the agreement.³²²

The problem with arbitration agreements in this context is not that they are unenforceable contracts of adhesion in the traditional sense.³²³ Rather, the problem is that such agreements are presented to the customer at a point in the investment process when the customer is least likely to appreciate the existence and meaning of the agreement.

The solution to this problem is to require the broker bringing a motion to compel arbitration to shoulder the burden of proof in resolving

course. In the situation where the customer is presented with an arbitration agreement at the outset (perhaps along with, or as a part of, many other documents), it is unlikely as a matter of common sense that the customer is concerned with litigation against the broker. Moreover, it is less likely the customer knows the implications of agreeing to arbitrate, and the customer may believe he or she is merely engaging in a formality without realizing that he or she is agreeing to arbitrate.

318. *Shearson/American Express v. McMahon*, 482 U.S. 220, 243 (1987) (Blackmun, J., concurring and dissenting); *Wilko*, 346 U.S. at 435-36.

319. The FAA would void arbitration agreements when they are unconscionable contracts of adhesion such as would ordinarily void contracts of any sort. 9 U.S.C. § 2 (1970).

320. R. DAWSON, *YOU CAN GET ANYTHING YOU WANT — BUT YOU HAVE TO ASK* 6 (1985).

321. *See* D. ROBBINS, *supra* note 225, at 97.

322. Even the businessperson-investor, generally familiar with arbitration but lacking specific familiarity with securities industry arbitration practices, is not likely to know that the arbitration agreement may benefit only the broker, since the customer would ordinarily be able to force the broker into arbitration, if desired, regardless of whether the customer signs the arbitration agreement. *See supra* note 198 and accompanying text.

323. Traditionally, a contract of adhesion is an agreement forced on a party of lesser bargaining power, who is left with the choices of adhering to the contract or rejecting it. *See, e.g., Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 818, 623 P.2d 165, 171-72, 171 Cal. Rptr. 604, 610-11 (1981).

whether the arbitration agreement was *knowingly* and *voluntarily* signed.³²⁴ "The public policy involved when one party is in a position to impose an arbitration clause on the other is a basic one: No one should be deprived of access to the courts unless that party has satisfactorily demonstrated a willingness to give up such access."³²⁵ This approach is consistent with other securities laws that shift the burden of proof to benefit the customer.³²⁶

The broker might satisfy this burden in a number of ways. That the arbitration agreement was on a separate form and clearly titled, rather than buried in fine print, would certainly carry some evidentiary value.³²⁷ The arbitration agreement could be accompanied by a standardized warning in bold type and simple language, informing the customer that the agreement waives the right to go to court if a dispute arises.³²⁸ The warning should also inform the customer that the broker may be forced into arbitration regardless of the existence of the arbitration agreement for purchases through major exchanges.³²⁹

Apart from using a clear form for the agreement, the broker may prove the customer was a sophisticated investor, who knew the implications of the arbitration agreement. A similar proposal was advanced before *Rodriguez de Quijas* as an exception to the then-viable *Wilko* rule.³³⁰

324. Sterk discusses a similar proposal, that the legal presumption be reversed, but would give the presumption such force as to render this class of disputes non-arbitrable. See Sterk, *supra* note 99, at 517-19.

325. *Id.* at 518.

326. For example, the Securities Act shifts the burden of proof to the broker accused of making untrue or misleading statements, to prove his lack of scienter, rather than forcing the customer to prove the broker knew of the untrue or misleading nature of the statements. See 15 U.S.C. § 77f (1981).

327. At least two commentators have suggested that a separate agreement to arbitrate should be the industry norm. See Elsen, *supra* note 246, at 486; D. ROBBINS, *supra* note 225, at 97. Such is the norm in commodities trading. See 17 C.F.R. § 180.3 (1990).

328. This approach is taken by statute in California, for example, when a health care provider offers an agreement to arbitrate to patients. CAL. CIV. PROC. CODE § 1295 (West 1982). The law calls for a warning in large, red print immediately before the signature space. *Id.* Trading in commodities is similarly regulated to require an extensive, boldly printed warning. See 17 C.F.R. § 180.3.

329. It may be asked why anyone would sign an agreement if informed that the agreement, in effect, is for the broker's benefit. A customer may elect to sign knowing that some transactions planned would fall outside major exchanges, or otherwise may not be arbitrable absent an agreement. If customers begin routinely refusing arbitration, this is hardly a reason to withhold truthful full disclosure. Indeed, should the securities industry argue that information must be withheld because otherwise no one would agree to arbitrate, the industry would implicitly admit that arbitration is such an unfair arrangement that informed customers would not agree to it.

330. See Fletcher, *supra* note 61, at 427-31.

Many potential problems with securities arbitration are cast in a new light when the customer entered into the arbitration agreement with open eyes. If the customer who freely agreed to arbitration decides the process was unfair upon seeing the result, this reaction seems no more than a losing litigant's "sour grapes," the same as might have occurred after losing a jury trial. The reaction no longer arouses a sense of injustice that calls for changing the system of arbitration.

Any system of resolving securities disputes, however, has implications for the marketplace beyond the immediate litigants. The performance of the overall system for the resolution of securities disputes may influence the public's faith on which the securities industry depends.³³¹ It is not sufficient to ensure that the customer enters into arbitration knowingly and freely. The system must also work.³³² This Note will next turn to improvements in the arbitral process itself.

B. *Allowing Discovery as a Matter of Right*

The customer should not be at the mercy of arbitrators for access to information needed to prove a valid claim. Parties to an arbitration should have rights to self-executing discovery, subject to the opposing party's right to seek relief from abuses from the arbitrator(s).

Because arbitration is somewhat less adversarial in nature than litigation,³³³ a party is likely to be ill-advised to proceed as if fighting a battle of attrition.³³⁴ The party seeking unreasonable, burdensome discovery, the true purpose of which is clearly to wear down the opponent,³³⁵ will be called to explain that conduct before the same arbitrators who will ultimately decide the case.³³⁶ It appears less likely, therefore, that discovery rights will be more abused in arbitration than in litigation.³³⁷

331. See Sterk, *supra* note 99, at 519.

332. "So long as arbitration is not compulsory, but is based instead on the consent of the parties, parties will only consent to arbitrate if they have faith in the arbitral process." *Id.* at 484 n.9. The more free and informed the customer's decision on arbitration is, the more the system depends on the public's perception of fairness. *Id.* There may be little sense of outrage inspired by a customer who loses arbitration, even unfairly, when the customer entered the arrangement with open eyes; however, when the system itself is perceived as unfair, in the long run, it cannot survive. Katsoris, *supra* note 3, at 15.

333. See D. ROBBINS, *supra* note 225, at 66 (arbitration seen as an expeditious, cost-effective alternative to court).

334. *Id.*

335. *Id.*

336. *Id.* at 67.

337. *Id.* Robbins noted, with regard to uncooperative tactics in arbitration discovery: "This inevitably backfires because the last thing an arbitration panel wants to do is to take time

C. *Selecting Arbitrators Free of Industry Ties*

Expert witnesses may play a very special role in resolving disputes.³³⁸ Because advocates must carefully select experts, it is inappropriate to delegate this function to the SROs method of selecting the industry arbitrator.³³⁹ While advocates may select "hired gun" experts whose opinions are more influenced by their fees than their beliefs, this does not imply that there is only one right answer to every expert question. In many cases requiring expert testimony, parties will call expert witnesses who disagree in good faith. The choice of an expert in support of a client's position is a legitimate function of advocacy,³⁴⁰ and it is unfair that an expert should be selected by the SRO, solely because he or she has agreed to serve as an industry arbitrator, and then sequestered with the arbitrators during deliberations.³⁴¹ It is no answer that a party may still bring in an expert; parties are encouraged to rely on the industry arbitrator to inform the panel of industry practices.³⁴² Even the party who brings an expert cannot hope a hired expert witness will be as influential as the "neutral" industry arbitrator.

Because industry practices may not be controversial in many cases, there is no need to prohibit industry arbitrators familiar with the standards relevant in a particular dispute. There should be a right to demand, however, that the industry arbitrator have no particularized expertise in the subjects at issue. An arbitrator with such knowledge might be perceived as an expert who may unduly influence the other arbitrators.

As to the non-industry arbitrators, there should be defined stan-

away from their busy days and attend a non-substantive hearing on document production." *Id.*

338. See J. JEANS, *supra* note 260, §§ 12.1-12.9.

339. D. ROBBINS, *supra* note 225, at 27, noted that the public perceives SRO arbitration panels to be more partial to the broker-dealer in a dispute, because that broker-dealer is a member of that SRO and at least one arbitrator is from a member organization.

340. J. JEANS, *supra* note 260, § 12.8.

341. Sometimes, there is more than one correct approach to a professional question, such as the judgment as to what type of investment is appropriate to a given investor's circumstances. Professional liability may be established only by showing the professional's conduct was not within any accepted approach. See, e.g., W.P. KEETON, D. DOBBS, R. KEETON, D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 32 (5th ed. 1984); CALIFORNIA JURY INSTRUCTIONS—CIVIL CALJIC 6.03 (7th ed. 1986).

There appears to be no justification for secreting away with the arbitrators a proponent of one point of view on a disputed issue of expert testimony. Of course, the current practice may favor either side. The point is not that this practice favors the broker, but that by deciding arbitrations based on the view of the industry arbitrator rather than on the evidence it introduces an almost random element.

342. See Masucci & Morris, *supra* note 265, at 251.

dards for this category that exclude all whose backgrounds might contribute to the appearance of partiality.³⁴³ Impartial, non-industry arbitrators should be actively sought. They may include retired judges, retired SEC personnel, professors, and other disinterested persons.³⁴⁴

D. *Establishing Standards for Written Opinions*

If all else fails, the customer should not be deprived of court relief for lack of ability to prove what occurred in arbitration or why the arbitrators decided as they did. The SROs should develop standards for the content of the award, including a statement of the issues, the legal points found relevant, the arbitrators' resolution of each issue, and at least a brief reference to supporting evidence.

This requirement need not be unduly burdensome to the arbitrators. Some SROs already provide a fill-in-the-blank form for awards,³⁴⁵ and it would seem quite feasible to expand on such a form. More routine cases may even be susceptible to a simple check-the-box form for much of the information that should be included. Even a brief but carefully prepared explanation of what happened in arbitration, and why, could provide all the needed information.³⁴⁶

VII. CONCLUSION

The *Rodriguez de Quijas v. Shearson/American Express*³⁴⁷ case opens a new era in resolving securities disputes, in which the industry is freed of legal restraints on using arbitration. The securities industry faces the choice of using arbitration fairly to escape the expense of litigation for the long-term gain of all, or using it to escape from the industry's public duties for the industry's short-term gain. Arbitration may hold many advantages over litigation, but these do not justify forcing unwilling customers out of court and into an apparently biased forum whose procedures are inadequate to guarantee the rights assured under securities laws. The industry must recognize that academic arguments that the

343. For rules of the National Association Securities Dealers that address this concern, see *supra* note 228.

344. See Elsen, *supra* note 246, at 483-84 for a discussion of this problem with recommendations. That author notes the availability of impartial arbitrators is especially a problem outside large, metropolitan areas, since the local securities-affiliated persons who could be arbitrators are likely to know one another. *Id.* at 484.

345. The standard form of the New York Stock Exchange is reproduced in Masucci & Morris, *supra* note 265, at 303.

346. Such explanations may also *discourage* fighting an award in court. A clear, unambiguous, and well-supported award would leave the losing party no grounds for challenge.

347. 109 S. Ct. 1917 (1989).

system is fair will do nothing for the viability of an arbitration system perceived as unfair because it fails to act to correct its own image. Arbitration must guarantee speedy justice, and not just speed.

*Lydia A. Hervatin**

* I dedicate this Note to my husband, Thomas V. O'Hagan, whose inspiration, counsel and love has truly blessed me in this effort. I also wish to express my gratitude to my mother and father for working so hard to provide me with opportunities they never had.

