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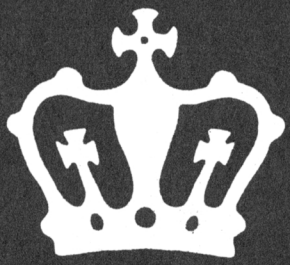

Securities Law and Arbitration:
The Enforceability of Predispute
Arbitration Clauses in
Broker-Customer Agreements

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SECURITIES LAW AND ARBITRATION: THE ENFORCEABILITY OF PREDISPUTE ARBITRATION CLAUSES IN BROKER - CUSTOMER AGREEMENTS

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INTRODUCTION

This article explores the alternative dispute resolution technique of arbitration as it is employed in broker-customer securities disputes. Historically, such disputes have been resolved in judicial forums, but increasingly courts are compelled to turn over such cases to arbitration associations. In the typical scenario involving arbitration of securities disputes, the investor/customer loses money on an investment in publicly traded securities, and later brings an action in federal district court attempting to recoup losses. The brokerage house will then seek a stay of the litigation and an order compelling arbitration as per the predispute arbitration agreement executed by the parties upon the opening of the account.

I. THE CONFLICT

Securities disputes usually involve excessive trading (*i.e.*, "churning" of customer accounts), fraud and misrepresentations, unauthorized trading, and racketeering activity, as well as deceptive and unfair trade practices. For such violations, the customer typically seeks to recover damages under the following statutory provisions: Section 12(2) of the Securities Act of 1933 ("Securities Act")[1]; Section 10(b)

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[1] *See* 15 U.S.C.A. § 77l(2) (West 1981 & Supp. 1988) (seller of securities who commits fraud, omits material facts, or misstates material facts and fails to prove lack of scienter is liable to purchaser in federal or state court). *See generally* Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296. 1297 (5th Cir. 1988) (customers alleged fraud in the purchase of securities through broker).

and Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act")[2]; the Racketeer Influenced and Corrupt Organizations Act ("RICO Act")[3]; or possibly on a pendent state law theory such as unfair trade practices.[4] Under each of these causes of action, there exists the right of a private remedy—the right to resolve allegations in a judicial forum. Each theory allows the customers standing in state and/or federal court to resolve the controversy.[5]

The customer, however, has signed the brokerage firm's standardized agreement as a precondition to trading in securities.[6] Customer agreements in virtually all instances contain a predispute arbitration clause providing that any controversy relating to the account shall be settled by arbitration, in accordance with the rules of an agreed upon exchange or association.[7] The arbitration clause is construed as

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[2] *See* 15 U.S.C.A. § 78j(b) (West 1981 & Supp. 1988); 17 C.F.R. § 240.10b-5 (1988) (unlawful to use any means of interstate commerce to use fraud or manipulative practices in the purchase or sale of any registered securities). *See generally* Shearson/ American Express, Inc. v. McMahon, 482 U.S. 220, 223 (1987)(customers alleged broker engaged in "fraudulent, excessive trading," made false statements and omitted material facts).

[3] *See* 18 U.S.C.A. §§ 1961-1968 (West 1981 & Supp. 1988) (prohibited racketeering activities in securities cases typically involve charges of mail and wire fraud). *See generally* Shearson/ American Express, Inc. v. McMahon, 482 U.S. 220 (1987) (RICO Act contains both criminal and civil provisions, the latter being at issue in securities cases, and provides treble damages for violations); Wall St. J., Jan. 11, 1989, at A1, col.1, & A8, col.1 (dramatic increase in RICO indictments relating to securities matters).

[4] *See* Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296, 1297 & n.1 (5th Cir. 1988) (customers charged violations of state securities fraud statute, the Texas Deceptive Trade Practices Act, and common law breaches of contract, fraud and misrepresentation). *Cf.* Margaret Hall Found., Inc. v. Atlantic Fin. Mgmt, 572 F. Supp. 1475, 1483 (D. Mass. 1983) (no private right of action for violations of state securities statutes); Cabot Corp. v. Baddour, 394 Mass. 720, 477 N.E.2d 399 (1985) (chapter 93A consumer protection statute not applicable to securities transactions). *But cf.* Securities Indus. Ass'n v. Connolly, 883 F.2d 1114 (1st Cir. 1989) (state securities regulations preempted by Federal Arbitration Act).

[5] Each of the statutes provides customers with a right of action, except for the Exchange Act, for which such a right has been implied. *See* Scherk v. Alberto Culver Co., 417 U.S. 506, 513-14 (1974). The securities laws were designed to be pro-investor as President Roosevelt noted when he signed the Acts. *See* N.Y. Times, Dec. 3, 1989, § 6 (Business), at 166, col. 1.

[6] Customers must sign the broker's agreement, indicating that they accept all conditions, fees and terms set forth. *See infra* note 129 and accompanying text (discussing standardized agreements).

[7] *See, e.g.*, Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 222-24 (1987) (Shearson customer agreement contained provisions requiring industry-sponsored arbitration of all account controversies); Wilko v. Swan, 346 U.S. 427, 429-30 (1953) (Hayden, Stone and Company's customer margin agreement contained clause requiring AAA or industry sponsored arbitration of future controversies); Sacco v.

a contract, with each party promising to settle controversies arising under the broker-customer relationship in an arbitral, rather than judicial forum.[8] Therein lies the conflict: the customer, in order to invest in publicly traded securities, must surrender the right to pursue Congressionally created causes of action in court, and is forced instead to seek redress in arbitration.[9]

II. ARBITRATION

Arbitration has been defined as the process of submitting a disagreement to one or more agreed upon impartial persons with the understanding that the parties are bound by that person's decision.[10] This alternative dispute resolution technique was historically met with hostility by jurists.[11] Only in 1925 did Congress finally address the issue of arbitration by enacting the Federal Arbitration Act ("FAA"). Congress had two goals in mind: to avoid the costliness of litigation, and to place arbitration agreements on the same footing as other private contracts.[12] The FAA provides that agree-

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Prudential Bache Securities, Inc., 703 F. Supp. 362, 363-64 (E.D. Pa. 1988) (account controversies to be resolved through arbitration under AAA or NYSE rules as customer elects). *See generally* Di Fiore, *Problems in Alternative Dispute Resolution: Arbitration Agreements as Contracts of Adhesion in Consumer Securities Disputes*, 93 COM. L.J. 259, 259 (1988) (brokerage firms avoid litigation costs by requiring arbitration of disputes); Letter from David S. Ruder to Joseph R. Hardiman at 2 (July 8, 1988) (serious policy questions exist when brokerage industry conditions access to its services on execution of mandatory arbitration clauses). Chairman Ruder noted that 96% of margin accounts, 95% of options accounts and 39% of cash accounts currently contain PDAAs. *Id.*

[8] *See supra* note 7 and accompanying text (discussing contents of customer agreements); *see also* Shearson/American Express v. McMahon, 482 U.S. 220, 225-26 (1987) (Federal Arbitration Act requires enforcement of arbitration agreements even if claim founded on statutory right, unless contract resulted from fraud). The practical effect, therefore, is to deny customers their right to standing in court.

[9] This is true in spite of the fact that the Securities, Exchange, and RICO Acts (allowing customers to sue in court for securities violations) were enacted *after* the Federal Arbitration Act. *See* Securities Indus. Ass'n v. Connolly, 883 F.2d 1114, 1121 (1st Cir. 1989) (Congress's failure to resolve conflict between FAA and securities laws impels court to determine "proper boundaries").

[10] *See* R. Coulson, BUSINESS ARBITRATION - WHAT YOU NEED TO KNOW 12 (1980) (arbitration agreement is a binding commitment by both parties to resort to arbitration in disputes or to clarify meaning or application of contract); BLACK'S LAW DICTIONARY 96 (5th ed. 1979) (arbitration is submission of dispute to private unofficial parties).

[11] *See* Wilko v. Swan, 346 U.S. 427 (1953) (even after FAA enactment, Court suspicious of arbitration).

[12] *See* H.R. Rep. No. 96, 68th Cong., 1st Sess. 1, 2 (1924); *see also* Shearson/Ameri-

ments to arbitrate even statutory claims are enforceable, so that litigation must be stayed, during which time the court shall order the parties to arbitration.[13] This federal policy favoring arbitration may be defeated by evidence of fraud or overreaching, or by a contrary congressional command.[14] In other words, the parties' agreement to arbitrate, like any other contract, is revocable on these grounds alone. The FAA is codified at 9 U.S.C.A. §§ 1-14.[15]

Predispute arbitration agreements ("PDAAs") usually allow customers the option to bring claims before the independent American Arbitration Association ("AAA"), or before one of the securities industry's self-regulatory organizations ("SROs").[16] Typically each major exchange sponsors an arbitration tribunal. Commentators believe that arbitrators are likely to be more knowledgeable than judges in securities law.[17]

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can Express, Inc. v. McMahon, 482 U.S. 220, 225-27 (1987) (FAA meant to reverse hostility to arbitration agreements by establishing federal policy favoring arbitration); Di Fiore *supra* note 7, at 260 (purpose of FAA policy to eliminate court expense and delay in effort to expedite case disposition under less restrictive conditions). *See generally* Volt Info. Sciences v. Board of Trustees, 109 S. Ct. 1248, 1255 (1989) (Congress motivated by desire to enforce agreements which parties made).

[13] *See* 9 U.S.C.A. §§ 1-14 (West 1981 & Supp. 1988); *see also* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226 (1987) (duty to enforce arbitration agreements not diminished when statutory rights at stake).

[14] *Id.* (fraud or excessive economic power invalidates arbitration argument as does clear Congressional directive to make exception to FAA). *But see id.* at 250 (Blackmun, J., dissenting) (Court correctly states exceptions to FAA, but then fails to acknowledge that "Exchange Act, like the Securities Act, constitutes such an exception").

[15] Section 1 of the Act provides the general enabling language. 9 U.S.C.A. § 1 (West 1981 & Supp. 1988). Section 2 provides that any provision to settle by arbitration a controversy arising thereunder is valid under contract law theory. Section 3 provides that any litigation over issues referable to arbitration shall be stayed until the arbitration is completed. Section 4 provides that the arbitration agreement may be enforced by petitioning a federal district court. Section 5 provides for the appointment of an arbitrator. Sections 6-14 are provisions relating to procedures to be followed under the FAA.

[16] *See generally* Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296, 1297 n.2 (5th Cir. 1988) (arbitration shall be in accordance with rules of the National Association of Securities Dealers ("NASD"), the New York Stock Exchange ("NYSE"), or the American Stock Exchange ("AMEX"); Friedman, *Arbitrating Your Case Under the Securities Rules of the AAA*, 43 ARB. J. (no. 2) 23, 26 (1988) (customer typically has option to pursue claim before AAA or an SRO such as the NYSE or the NASD). There are nine SROs which offer arbitration services. N.Y. Times, Dec. 21, 1989 at D 8, col. 1.

[17] Bedell, Harrison & Harvey, *The McMahon Mandate: Compulsory Arbitration of Securities and RICO Claims*, 19 LOY. U. CHI. L.J., 77-78 (1987) (arbitrators very knowledgeable in securities law); Note, *The Arbitrability of Federal Securities Claims: Wilko's Swan Song*, 42 U. MIAMI L. REV. 203, 224 (1987) (arbitrators more

The number of cases being decided in arbitration has reached staggering proportions. In 1986, 2,734 cases went to arbitration and that figure jumped to 6,213 cases in 1988.[18] The arbitration clauses are most likely to be included in margin and options accounts, and to a lesser extent, cash accounts.[19] Approximately 80% of the cases going to arbitration are handled by SROs, with the remainder decided by the AAA.[20]

Under the AAA securities arbitration rules one arbitrator, who is chosen by the parties, decides cases when the claim is for less than $20,000.[21] If the dispute is for a greater amount, three arbitrators are chosen for the case.[22] In the smaller cases, the arbitrator may not be affiliated with the securities industry.[23] In the larger cases, not more than one arbitrator may be affiliated with the securities industry.[24] An affiliation with the securities industry has generally been defined as "persons who have been directly or indirectly within the last five years employed by or acted as counselors, consultants, or advisors to any securities organization or affiliate."[25]

A 1985 AAA survey of forty cases involving securities arbitration found that twenty seven of these resulted in customer awards, with four awards of punitive damages.[26] The National Association of Securities Dealers (NASD) has reported awards to customers in fifty-five percent of its cases.[27] Although the *McMahon* Court observed that judicial review of arbitration awards is sufficient to ensure that arbitrators comply with the Securities and Exchange Acts, questions remain.[28] Securities arbitration awards are typically made without

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expert than judges in securities law).

[18] *See It's Time to Ban Forced Arbitration*, Money, July, 1989, at 7; *Wall Street's Other Arb's*, Forbes, March 20, 1989, at 196-97.

[19] *See* Forbes, *supra* note 18; The Boston Globe, Jan. 28, 1990, at 77, 80, col. 4 (40% of cash accounts contain PDAAs).

[20] *See* Forbes, *supra* note 18.

[21] *See* Friedman, *supra* note 16, at 28.

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] *Id.* at 29. *See infra* note 144 and accompanying text (discussing arbitrators' affiliations).

[26] *See* Bedell, Harrison & Harvey, *supra* note 17, at 9; *see also infra* note 137-44 and accompanying text.

[27] *Id.*; *see also* Securities Industry Conference on Arbitration ("SICA") Rept. No. 5, at 6 (April 1986).

[28] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 232 (1987) (judicial scrutiny necessarily limited but sufficient). *But see id.* at 259 (Blackmun, J., dissenting) (judicial scrutiny insufficient). *See infra* notes 121-54 and accompanying text (discussing present state of securities arbitration).

explanation of principles of law which may have been applied.[29] The arbitration system does not provide oversight as to relevant issues of arbitral decisionmaking or as to information that may or may not be presented.[30] The customer agreement may provide for arbitration before an independent association such as the AAA, but more likely it requires arbitration before an industry-sponsored association. Further, judicial grounds for vacating an arbitration award are severely limited. Vacating decisions only upon a showing of "manifest disregard" for the law means that arbitrators do not have to strictly comply with the securities laws.[31] Arbitrators, therefore, are not as accountable for their decisions as judges are. Perhaps, not too surprisingly, arbitration has developed an image problem.[32] The current state of arbitration is more fully discussed in Part V.

III. CASE LAW

Courts' attempts to reconcile the FAA with the Securities and Exchange Acts have been both frequent and inconsistent.[33] The Court first addressed this issue thirty-seven years ago in *Wilko v. Swan*.[34]

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[29] *See* Lipton, *The Standard on Which Arbitrators Base Their Decisions: The SROs Must Decide*, 16 SEC. REG. L. J. 3, 13-14 (1988) (securities arbitration awards typically made without any explanation); *cf.* N.Y. Times, Oct. 25, 1989 at D1, col. 3 & D10, col. 2 (key to maintaining investor confidence is for SEC to enforce securities laws).

[30] *See* Lipton, *supra* note 29, at 13.

[31] *See* 9 U.S.C.A. §§ 10, 11 (West 1981 & Supp. 1988). Judicial interpretations of these sections resulted in the development of the "manifest disregard" standard. *See* Wilko v. Swan, 346 U.S. 427, 436 (1953); Lipton, *supra* note 29, at 8 (manifest disregard standard allows arbitrators great latitude in decisionmaking).

[32] *See* The Boston Globe, *supra* note 19; *see also*, *It's Rough Out There*, Forbes, Dec. 26, 1988, at 85 (investors think current system is stacked against them).

[33] *See* McLaughlin, *Resolving Disputes in the Financial Community: Alternatives to Litigation*, 41 ARB. J. 16, 22 (1986) (arbitration of securities fraud claims a controversial topic); Nelson, *Section 10(b) and Rule 10b-5 Federal Securities Law Claims: The Need for the Uniform Disposition of the Arbitration Issue*, 24 SAN DIEGO L. REV. 199, 212-13 (1987) (strong federal arbitration policy purportedly conflicts with securities laws' investor protection policies); Note, *The Enforceability of Pre-Dispute Arbitration Agreements Under 10(b) and 10b-5 Claims*, 43 WASH. & LEE L. REV. 923, 928 (1986) (FAA policies arguably conflict with Securities acts). *Compare* Ketchum v. Bloodstock, 685 F. Supp. 786, 793 (D. Kan. 1988) (Securities Act claims not arbitrable), *overruled by*, Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917 (1989), *with* Ryan v. Liss, Tenner & Goldberg Securities Corp., 683 F. Supp. 480, 484 (D.N.J. 1988) (plaintiff's Securities Act claims arbitrable). As for Exchange Act claims, *McMahon* laid to rest any controversy by upholding PDAAs. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987).

[34] 346 U.S. 427 (1953). The court granted certiorari to review the "important and novel federal question affecting both the Securities Act and the United States Arbi-

Wilko brought suit in federal district court against a securities brokerage firm.[35] The customer sought to recover damages under § 12(2) of the Securities Act, alleging that the brokerage firm defrauded him in the purchase of common stock.[36] Notably, the SEC participated as *amicus curiae*, and shared the customer's burden in presenting the case to the Court.[37] Pursuant to the parties' PDAA, the broker moved to stay litigation until the matter had been arbitrated.[38]

Finding that the predispute agreement to arbitrate was a "stipulation" under § 14 of the Securities Act,[39] and that the right to select a judicial forum was the kind of provision which could be waived under § 14, the Court invalidated the parties' agreement to arbitrate.[40] The Court tried to reconcile the policies of both Congressional acts, and decided that the intent of Congress regarding the sale of securities was better effectuated by staying the arbitration.[41]

While the Court acknowledged that Congress sought to present arbitral forums as a speedier, less expensive alternative, it felt that securities disputes were inherently more complex than other dis-

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tration Act." *Id.* at 430. *Wilko* has been overruled by *Rodriguez De Quijas*, 109 S. Ct. 1917 (1989). *See infra* notes 92-100 and accompanying text.

[35] Wilko v. Swan, 346 U.S. 427, 428 (1953).

[36] *See* 15 U.S.C.A. § 77l(2) (West 1981 & Supp. 1988) (seller of securities who makes material untrue statements or omissions and fails to prove lack of scienter is liable to purchaser who may sue in any court).

[37] *See* Wilko v. Swan 346 U.S. 427, 428 (1953). This of course is completely at odds with the SEC's present position, which endorses wholeheartedly the concept of securities arbitration. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 262 n.21 (1987) (Blackmun, J., dissenting) (SEC's position, until it filed *amicus* brief in *McMahon*, was consistent with *Wilko*); *see also infra* notes 155-56 and accompanying text (discussing SEC's position).

[38] *See* Wilko v. Swan, 346 U.S. 427, 429 (1953); *see also* 9 U.S.C.A. §§ 1, 3 (West 1981 & Supp. 1988) (courts shall stay litigation if any issue referable to arbitration).

[39] *See* 15 U.S.C.A. § 77n (West 1981 & Supp. 1988) (§ 14 provides that any stipulation or provision requiring security buyer to waive compliance with any part of Securities Act shall be void). The Court reasoned that since the Securities Act provided defrauded purchasers with the right to maintain an action in any court, an agreement to arbitrate such disputes impinged on this Congressionally granted right. *See* Wilko v. Swan, 346 U.S. 427, 434-45 (1953).

[40] *Id.* The Court refused to allow securities customers the option of bargaining away their right to litigate claims. *Id. Cf.* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 228-30 (1987) (enforcement of PDAA does not effect waiver of compliance with Exchange Act provisions). *But see* Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296, 1299 (5th Cir. 1988) (arbitration of Securities Act claims mandatory), *aff'd sub nom.*, Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917 (1989).

[41] *See* Wilko v. Swan, 346 U.S. 427, 438 (1953).

putes, and that securities customers operated under unique disadvantages.[42] Further, the Court found that arbitral forums lacked suitable oversight and safeguards to ensure a fair and just resolution of the issues.[43] Claims under the Securities Act, therefore, could be litigated notwithstanding the presence of a PDAA.[44] The Court treated harshly the process of arbitration, implying that it was useful only for simple disputes, and called into question the procedures used in arbitration.

The next major arbitration case to reach the Court was *Scherk v. Alberto-Culver Company*.[45] The Court considered a PDAA in the context of Exchange Act violations in an international business transaction.[46] Declining to follow the exception to the FAA "carved out by *Wilko*,"[47] the Court upheld the parties' PDAA, reasoning that policy concerns were totally different in the international business arena.[48] The Court, even at this early stage, had begun to dis-

[42] *Id.* at 435, 438 (securities buyer at special disadvantage and arbitration better suited for commercial controversies); *cf.* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 232-34 (1987) (arbitration adequate to remedy Exchange Act violations). *But see* Wilko v. Swan, 346 U.S. 427, 439 (1953) (Frankfurter, J., dissenting) (absolutely no evidence that arbitral system is inadequate to vindicate Securities Act violations). *See generally* Note, *Enforceability of Predispute Arbitration Agreements Under The Federal Securities Laws: Shearson/American Express, Inc. v. McMahon*, 8 PACE L. REV. 193, 201 (1988) (*Wilko* Court carved out exception to FAA).

[43] *See* Wilko v. Swan, 346 U.S. 427, 436-37 (1953) (arbitrator's power almost unlimited, and judicial review extremely limited); Di Fiore, *supra* note 7, at 262 (Court reasoned Securities Act's protective provisions required judicial rather than arbitral resolution); Lipton, *supra* note 29, at 13-14 (securities arbitration awards made without explanation or enunciation of principles of law and judicial oversight lacking). *But see* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 232 (1987) (judicial review sufficient to ensure arbitrators comply with requirements of statute).

[44] Wilko v. Swan, 346 U.S. 427, 438 (1953); *see also* Chang v. Lin, 824 F.2d 219, 222 (2d Cir. 1987) (customer has right to litigate Securities Act claims in spite of PDAA); Ketchum v. Bloodstock, 685 F. Supp. 786, 793 (D. Kan. 1988) (court refused to restrict customer's right to litigate Securities Act claims). These cases have since been overruled by Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917 (1989).

[45] 417 U.S. 506, *reh'g denied*, 419 U.S. 885 (1974).

[46] *Id.* at 508-09. The American Company, Alberto-Culver, alleged that German businessperson Fritz Scherk's fraudulent representations regarding his trademark rights violated the Exchange Act. *Id. See supra* note 2 and accompanying text (discussing Exchange Act).

[47] 417 U.S. 506, 517 (1974).

[48] *Id.* at 515-20. The Court observed that an international business deal "involves considerations and policies significantly different from those found controlling in *Wilko*." *Id.* at 515. The Court worried that disallowing the arbitration agreement would imperil international business. *Id.* at 516-17, 519. *But see id.* at 533-34 (Douglas, J., dissenting) (American investors had heretofore assumed *Wilko* protected them and only Congress has power to make exceptions to securities laws). This was the

tance itself from *Wilko* in its oft-quoted observation that "a colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the case before us."[49] The Court distinguished the Exchange Act from the Securities Act, noting that the provisions under the former are much more narrow than those under the latter.[50] Finally, the Court reasoned that arbitration clauses in international agreements were indispensable to the achievement of predictability in determining the applicable law.[51]

The next two Supreme Court cases addressing arbitration clauses seem to be quite a departure from the suspicions expressed in *Wilko*.[52] *Dean Witter Reynolds, Inc. v. Byrd*[53] involved a broker-customer dispute, although the issue centered on the arbitrability of pendent state claims. Byrd alleged that Dean Witter engaged in excessive trades, many done without consent, and that misrepresentations were made.[54] Taking the opportunity to note that many lower courts applied *Wilko* to Exchange Act claims, thereby disallowing arbitration agreements, the Court declined to resolve that question which was not directly before it.[55] Instead, a unanimous Court concluded that the strong federal policies reflected in the FAA require arbitration of pendent arbitrable claims, even if the proceedings would become bifurcated.[56]

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.[57] in-

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argument later used, to an extent, by Justice Stevens in *McMahon*. *See* Shearson/American Express Co. v. McMahon, 482 U.S. 220, 268-69 (Stevens, J., dissenting).

[49] Scherk v. Alberto-Culver Co., 417 U.S. 506, 513 (1974).

[50] *Id.* 513-15. First, the Court noted that the Securities Act provides a special right of action, while the Exchange Act provides only an implied right of action. *Id.* at 513-14. Second, the Court found that, although the nonwaiver provision of the two Acts are similar, the jurisdictional provisions of the Exchange Act are more restricted than those of the Securities Act. *Id.* at 514.

[51] *Id.* at 529-30.

[52] *Cf.* Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536 (3d Cir.) (SEC even at this date opposed construction of NYSE arbitration rule which would make it applicable to Exchange Act disputes), *cert. denied*, 429 U.S. 1010 (1976).

[53] 470 U.S. 213 (1985).

[54] *Id.* at 214.

[55] *Id.* at 215-216 & n.1. Indeed, the securities industry urged the Court to resolve the applicability of *Wilko* to Exchange Act claims. *Id.* Many of the circuit courts already believed that *Wilko* applied to Exchange Act claims. *See* Shearson/American Express, Inc., v. McMahon, 482 U.S. 220, 268 (1987) (Stevens, J., concurring in part and dissenting in part) (following *Wilko*, each circuit addressing issue applied it to Exchange Act claims).

[56] Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 217 (1985).

[57] 473 U.S. 614 (1985).

volved claims arising under the Sherman Act, but this opinion paved the way for *McMahon* and further placed in doubt the validity of *Wilko*.[58] The *Mitsubishi* Court found that even Sherman Act claims were arbitrable pursuant to the "emphatic federal policy in favor of arbitral dispute resolution."[59] The Court declared it was "well past the time when judicial suspicion of . . . arbitration . . . inhibited the development of arbitration."[60]

Recent guidance from the Supreme Court relating to arbitration of Exchange Act claims was given in the June, 1987 decision of *Shearson/American Express, Inc. v. McMahon*.[61] The McMahons proved, *inter alia*, fraud by Shearson under Section 10(b) and Rule 10b-5 of the Exchange Act.[62] Noting the conflict among circuit courts, the Court upheld the validity of PDAAs in resolving controversies arising under the Exchange Act.[63] This important opinion, written by Justice O'Connor for a badly split and transitional Court, has received widespread notice by commentators, the security industry, and its regulators.[64]

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[58] *Id.* at 616-19. The Court relied heavily upon *Mitsubishi* in its *McMahon* decision. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226, 229-30 (1987).

[59] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc., 473 U.S. 614, 631 (1985). The Court mandated arbitration of federal statutory rights, even though an explicit private right of action existed. *Id.*

[60] *Id.* at 626-27. *Compare* Wilko v. Swan, 346 U.S. 427 (1953) (Court concluded arbitration adequate for only simple proceedings and failed to envisage arbitration of complex statutory disputes).

[61] 482 U.S. 220 (1987) (5-4 decision). The Court granted certiorari to determine whether claims brought under the Exchange Act as well as those brought under the RICO Act must be arbitrated in accordance with the terms of their agreement. *Id.* at 222-27. *Cf.* Securities Indus. Ass'n. v. Connolly, 883 F.2d 1114 (1st Cir. 1989) (Massachusetts state securities regulation preempted by FAA as interpreted by Supreme Court).

[62] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 224 (1987). *See supra* note 2 and accompanying text (discussing contents of section 10(b) and Rule 10b-5).

[63] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 225 & n.1 (1987). *See also id.* at 238 (agreement to arbitrate Exchange Act claims enforceable as per explicit provisions of FAA). *But see id.* at 256-57 (Blackmun, J., dissenting) (Exchange Act, like Securities Act is an exception from mandate of FAA). The Court thereby agreed with the First, Third and Eighth circuits, and disagreed with the Second, Fifth, Sixth, Ninth, and Eleventh circuits. *Id.* at 225 n.1. *See also* Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 841 F.2d 508 (3d Cir. 1988).

[64] The Court unanimously agreed that civil RICO claims are arbitrable. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 238-42 (1987). However, it split 5-4 on the issue of arbitrability of Exchange Act claims. *Id.* at 242. Justice O'Connor was joined by Chief Justice Rehnquist, and Justices White, Powell and Scalia. Justice Blackmun dissented and was joined by Justices Brennan and Marshall.

First, the Court pointed out that the FAA mandates judicial enforcement of agreements to arbitrate statutory claims absent a contrary Congressional demand.[65] Second, the Exchange Act's nonwaiver provision does not include its jurisdictional provisions providing district courts with the exclusive right to hear violations thereunder.[66] The Court reasoned that the waiver clause prohibits waiver of *substantive* obligations, and that simple jurisdictional provisions do not by their nature require such compliance.[67] The Court thereby pared down *Wilko*, declaring that it now merely stands for the proposition that waiver of the right to select a judicial forum "was unenforceable *only* because arbitration [in 1953] was judged inadequate to enforce Securities Act rights."[68]

Third, the Court disagreed with the customers' arguments that mandatory arbitration of Exchange Act claims weakens their ability to recover for violations thereof.[69] The Court systematically rejected each of the grounds cited by *Wilko* in its decision, as being out of step with the current policy favoring arbitration.[70] Justice O'Connor

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Since this opinion, Justice Kennedy has replaced retired Justice Powell, and Chief Justice Rehnquist has completed three years as head of the Court. Additionally, three of the four dissenters, Justices Brennan, Blackmun and Marshall, widely regarded as the liberal core of the Court, are now in their 80's.

McMahon has been written about widely. *See, e.g.*, Note, *supra* note 42, at 193; Bedell, Harrison, & Harvey, *supra* note 17 , at 1; Note, *supra* note 17, at 203. The securities industry viewed *McMahon* as a major victory. *See* N.Y. Times, Nov. 15, 1988, at D1, col. 8 (*McMahon* outstanding victory for securities firms). Moreover, the SEC has initiated a review of SRO arbitration since the decision. *See* Letter from Richard G. Ketchum to James E. Buck (Sept. 10, 1987) (need for thorough review of arbitration in light of *McMahon*).

[65] *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 227 (1987).

[66] *Id.* at 230. *See also* 15 U.S.C.A. § 78cc(a) (West 1981 & Supp. 1988) (Any condition, stipulation or provision binding anyone to waive compliance with any rule or regulation is void).

[67] *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) (Exchange Act's anti-waiver provision prohibits waiver of substantive obligations and since jurisdiction section of Act does not impose statutory duties, it may be waived) (emphasis added).

[68] *Id.* at 228-29 (*Wilko* bars waiver of "judicial forum only where arbitration is inadequate to protect the substantive rights at issue") (emphasis added). The Court, later in its opinion, admitted *McMahon* is difficult to reconcile with *Wilko*. *Id.* at 231-32 (emphasis added).

[69] *Id.* at 230-31. Absent a PDAA, Exchange Act violations may be vindicated in federal district courts which have exclusive jurisdiction over such claims. *See* 15 U.S.C.A. § 78aa (West 1981 & Supp. 1988) (federal courts shall have exclusive jurisdiction to hear allegations of Exchange Act violations).

[70] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 229-30 (1987) (*Wilko* rationale mostly rejected in subsequent opinions). *See generally* Wilko v.

then proceeded to enthusiastically describe the virtues of arbitration and "refuse[d] to extend *Wilko's* reasoning to the Exchange Act in light of the intervening . . . developments."[71]

Lastly, the Court found that the 1975 Congressional amendments to the Exchange Act were not dispositive on the issue of arbitrability of Exchange Act claims, thus leaving the *Wilko* issue for judicial resolution.[72]

Justice Stevens, in a separate opinion, strongly disagreed with this last conclusion, arguing that the Court departed from a settled construction of the Exchange Act.[73] The Justice concluded that such a different interpretation ought to originate in the legislature, rather than in the judiciary.[74]

The leading dissent, written by Justice Blackmun, attacked the Court's opinion on all points.[75] Reviewing securities arbitration cases as well as legislative history, Justice Blackmun observed that *McMahon* "effectively overrules *Wilko*. . . ."[76] The Justice found two

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Swan, 346 U.S. 427 (1953). *Cf.* Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296, 1298 (5th Cir. 1988) (*McMahon* completely undermines *Wilko* without expressly overruling it).

[71] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 231-34 (1987) (*Wilko* mistrust of arbitration difficult to reconcile with more recent assessments of its effectiveness). *See* Note, *supra* note 17, at 232 (new era has clearly emerged favoring arbitration). *Cf.* SEC Rule 15C2-2, 17 C.F.R. § 240.15C2-2 (1986) (fraudulent and deceptive act for broker to bind customers to PDAA), *repealed by*, SEC Release No. 34-25034, 52 Fed. Reg. 59, 216 (1987). *But see* Wall St. J., Dec. 1, 1988, at C1, col.3 & C24, col. 6 (citing example of failure of arbitration system). Justice Blackmun, in dissenting, chastised the majority on this point. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 250 (1987) (Blackmun, J., dissenting) (Court accepts *uncritically* securities firm arguments that problems with arbitration no longer exist) (emphasis added).

[72] *Id.* at 238 (contrary to customers' argument that amendments voided such agreements, Congress simply meant to enhance self-regulatory function of SROs). The Court declined to read any substantive meaning into the Conferee's statement that "this amendment did not change existing law as articulated in *Wilko*. . . ." *Id.* at 237. *See also* H.R. Rep. No. 94-229, 94th Cong. 1st Sess., 111 (1975). *But see* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 256-57(1987) (Blackmun, J., dissenting) (language, legislative history, and purposes of Exchange Act mandate exception from FAA in same way Securities Act is excepted).

[73] *Id.* at 268-69 (Stevens, J., concurring in part and dissenting in part) (strong judicial presumption that *Wilko* applies to Exchange Act claims is best rebutted by legislative rather than judicial branch).

[74] *Id.*

[75] *Id.* at 242-68. *See supra* notes 64-72 and accompanying text (discussing *McMahon* holding and rationale).

[76] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 243 (1987) (Blackmun, J., dissenting). *See also* Petterson v. Shearson/American Express, Inc., 849 F.2d 464, 466 (10th Cir. 1988) (*McMahon* Court essentially overruled *Wilko*); Osterneck v.

fundamental problems with the majority opinion: First, it gave *Wilko* an overly narrow reading, and second, it accepted unconditionally the SEC's newly adopted position that its oversight and procedures have so improved as to ensure the adequacy of arbitration.[77] Justice Blackmun concluded that abuses in the securities industry are not adequately vindicated in arbitration and expressed hope that Congress would "give investors the relief that the Court denie[d] them. . . ."[78]

Since the *McMahon* decision upholding PDAAs for Exchange Act claims, and the October, 1987 stock market crash, many customers who would otherwise be litigating in court are now relegated to arbitral forums.[79] In an effort to avoid *McMahon's* reach, investors alleged violations of the Securities Act so that they would fall under the protection of *Wilko*, which allowed for judicial resolution of claims notwithstanding the presence of a PDAA.[80]

Indeed, after *McMahon* the Commonwealth of Massachusetts

Merrill Lynch, Pierce, Fenner & Smith, Inc., 841 F.2d 508, 511 (3d Cir. 1988) (*Wilko* of questionable vitality in light of later decisions); Noble v. Drexel Burnham Lambert, Inc., 823 F.2d 849, 850 (5th Cir. 1987) (formal overruling of *Wilko* imminent). *But cf.* Shearson/ American Express, Inc. v. McMahon, 482 U.S. 220, 234 (1987) (Court refused to extend *Wilko* to Exchange Act claims); McCowan v. Dean Witter Reynolds, Inc., 682 F. Supp. 741, 744 (S.D.N.Y. 1987) (*McMahon* involved Exchange Act and did not go so far as to overrule *Wilko*).

[77] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 250, 262-64 nn.21-23 (1987).

[78] *Id.* at 266-67.

[79] *See* Letter, *supra* note 7, at 2 (96% of margin and options accounts subject to predispute arbitration clauses which raises serious policy issues); The Boston Globe, Dec. 20, 1988, at 57, col. 2 & 59, col. 1 (wave of arbitration filings following *McMahon* and October 1987 stock market crash); *cf.* letter from James E. Buck to David S. Ruder at 2 (Oct. 14, 1988) (notwithstanding arbitration's benefits, NYSE recognized process can be improved); Letter from Richard G. Ketchum to James E. Buck (Sept. 10, 1987) ("need for change in SRO arbitration derives directly from the limits inherent in the current arbitration rules").

[80] *See, e.g.*, Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc, 841 F.2d 508, 508-09 (3d Cir. 1988); Chang v. Lin, 824 F.2d 219, 220-21 (2d Cir. 1987); Ketchum v. Bloodstock, 685 F. Supp. 786, 788 (D. Kan. 1988). These cases have been overruled by Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917 (1989). *Wilko* extended only to claims arising under the Securities Act, which specifically protects purchasers of securities. *See* 15 U.S.C.A. § 771(2) (West 1981 & Supp. 1988). Section 10(b) of the Exchange Act affords relief for a much broader class of defrauded investors. *See* 15 U.S.C.A. § 78j(b) (West 1981 & Supp. 1988). *Compare* Araim v. PaineWebber, Inc., 691 F. Supp. 1415 (N.D. Ga. 1988) (Court unwilling to anticipate demise of *Wilko*) *with* Peterson v. Shearson/American Express, Inc., 849 F.2d 464, 466 (10th Cir. 1988) (parties may arbitrate Securities Act claims).

went so far as to adopt regulations governing PDAAs.[81] The regulations barred firms from requiring PDAAs as a nonnegotiable condition to investing.[82] They further ordered that if such a clause was used, it had to be brought to the attention of the customer and explained in full.[83] The Court of Appeals for the First Circuit, however, ruled that the FAA preempted the state securities regulations since the latter were in direct conflict with federal law and policy "embedded therein."[84]

Inevitably, a challenge to the thirty-seven year old *Wilko* decision reached the Court in the case of *Rodriguez De Quijas v. Shearson/Lehman Brothers, Inc.*[85] On November 14, 1988, the Court granted certiorari to reconsider *Wilko* and to resolve the enforceability of PDAAs as applied to the Securities Act.[86] The customers were from Brownsville, Texas, including the Rodriguez De Quijas family and others who suffered financial losses, while the firm generated commissions for itself.[87] The customers alleged violations of state and federal securities laws.[88] As per the standardized PDAA, Shearson moved to stay litigation and compel arbitration of their claims.[89]

The district court concluded that *Wilko* controlled the disposition of Securities Act claims and exempted these from arbitration.[90] The Court of Appeals for the Fifth Circuit reversed, concluding that *McMahon* "completely undermined *Wilko*" such that *all* federal securi-

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[81] Securities Indus. Ass'n v. Connolly, 883 F.2d 1114, 1117 & App. (1st Cir. 1989) (Secretary of State enacted regulations one year after *McMahon*).

[82] *Id.*

[83] *Id.*

[84] *Id.* at 1123. *See infra* notes 109-111.

[85] 845 F.2d 1296, 1297 (5th Cir, 1988). The court considered whether claims brought under § 12(2) of Securities Act are subject to PDAAs. *Id.*

[86] Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296 (5th Cir. 1988), *cert. granted*, 109 S. Ct. 389 (1988). *See generally* N.Y. Times, Nov. 15, 1988, at D1, col. 6 & D13, col. 1 (Court agreed to hear predispute challenge to §12(2)); Wall St. J. Nov. 15, 1988, at B12, col. 2 (Court granted certiorari to decide whether disputes between brokers and purchasers alleging fraud must be resolved by arbitration).

[87] *See* Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296, 1297 (5th Cir. 1988); *see also* Wall St. J., *supra* note 86 (Shearson generated commissions while causing losses for customers).

[88] *See* Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296, 1297 & n.1 (5th Cir. 1988) (customers claimed violations of Securities and Exchange Acts, civil RICO Act, state securities and deceptive trade practices acts, and common law breaches of contract, fraud and misrepresentation).

[89] *Id.* at 1297 & n.2.

[90] *Id.* at 1297. The appeals court noted that the district court correctly followed *Wilko*, which barred arbitration of §12(2) claims. *Id.*

ties claims are now subject to valid PDAAs.[91] The court thereby ordered arbitration of Exchange Act as well as Securities Act claims. The United States Supreme Court was then left to decide if anything remained of *Wilko*, and thereby resolve the split among the lower courts.[92]

The Court took the unusual step of overruling itself and declared that *Wilko* was incorrectly decided.[93] In an opinion written by Justice Kennedy for a badly split Court, the majority held that predispute agreements to arbitrate claims arising under the Securities Act are enforceable.[94] This decision, therefore, requires judges to stay litigation of Securities Act claims until the arbitration process has been completed.[95]

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[91] *Id.* at 1297-99 (emphasis added). The court so held despite the fact that *McMahon* did not address the issue of arbitrability of § 12(2) claims. *Id.* at 1298 & n.4.; *see also* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 230-31 (1989); Di Fiore, *supra* note 7, at 270 (virtually all brokerage firms will now require customers to agree to PDAAs). *Compare* Chang v. Lin, 824 F.2d 219, 22 (2d Cir. 1987) (plaintiff has right to litigate Securities Act claims despite arbitration agreement) *and* Ketchum v. Bloodstock, 685 F. Supp. 786, 792-93 (D. Kan. 1988) (Congress ratified *Wilko* and court will not extinguish rights under it), *both overruled by*, Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917 (1989), *with* Noble v. Drexel, Burnham Lambert, Inc., 823 F.2d 849, 850 (5th Cir. 1987) (formal overruling of *Wilko* apparent and imminent) *and* Ryan v. Liss, Tenner & Goldberg Securities Corp., 683 F. Supp. 480, 484 (D.N.J. 1988) (plaintiff's claim under Securities Act arbitrable).

[92] *See* Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917 (1989), *aff'g sub nom.*, Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296 (1988).

[93] *Id.* at 1922. The Court was reluctant to overrule *Wilko*, but did so in order to "achieve a uniform interpretation of similar statutory language." *Id.* The Court also took the opportunity to criticize the fifth circuit for failing to follow Supreme Court precedent when it overruled *Wilko* on its own. *Id.* at 1921-23 & n.1.

[94] *Id.* at 1920, 1922. As it voted in *McMahon*, the Court ruled 5-4 to allow arbitration of securities disputes. *See generally* Wermiel, *Suing Brokers is Now Even More Difficult*, Wall St. J., May 16, 1989, at C1, col. 2 (*Rodriguez De Quijas* represents end of Court resolution of securities frauds disputes); Greenhouse, *High Court Backs Brokerages on Arbitration*, N.Y. Times, May 16, 1989, at D8, col. 1 (completing process began by *McMahon*, Court ruled in 5-4 decision firms may enforce PDAAs).

It is interesting to note that the use of PDAAs in the contract markets is voluntary, and that access to commodities and futures markets may not be conditioned upon the signing of a PDAA. *See* 17 C.F.R. § 180.3 (1989).

[95] See 9 U.S.C.A. §3 (West 1981 & Supp. 1988) (provision requires litigation to be stayed pending outcome of arbitration); Wermiel, *supra* note 94 (investors typically less satisfied with arbitration, which is now their only recourse in disputes with brokers). *See generally* Golann, *Taking ADR to the Bank: Arbitration and Mediation in Financial Services Disputes*, 44 Arb. J. 3, 4 (Dec. 1989) (recent Supreme Court decisions have spurred ADR trend).

In its opinion, the Court documented the *Wilko* decision, and its subsequent erosion. First, the Court swept aside *Wilko*'s "outmoded presumption of disfavoring arbitration proceedings."[96] Second, the Court found that the right to select the judicial forum and the wider choice of courts are "not such essential features of the Securities Act" that they cannot be waived.[97] Finally, the Court acknowledged that the FAA mandates enforcement of arbitration agreements.[98] Justice Kennedy also noted that it would be undesirable for *Wilko* to continue to exist with *McMahon*, since the Securities and Exchange Acts should be construed "harmoniously."[99] Justice Stevens, in his dissent, again pointed out that the Court acted in a legislative capacity by taking away rights which Congress had granted.[100]

IV. Effect of *McMahon* and *Rodriguez De Quijas*

It certainly cannot be said that either opinion enjoyed strong support.[101] Indeed, both opinions were written with the smallest of majorities.[102] This would seem to indicate that the law on arbitration of securities disputes is not fully settled at this time.[103] There are two

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[96] Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917, 1919-20 (1989). The Court noted that *Wilko* is out of step with its current policy of encouraging alternative dispute resolution. *Id. See generally* Petterson v. Shearson/American Express, Inc., 849 F.2d 464, 466 (10th Cir. 1988) (*Wilko* essentially overruled by *McMahon*). Indeed the demise of *Wilko* had been widely anticipated.

[97] Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917, 1920-21 (1989) (these rights not so essential or critical that they cannot be waived). This rationale does not have a clear mandate from precedent. It appears that the Justices made this determination to satisfy or bolster a result that they had already reached. Quite simply, Section 14 of the Securities Act and Section 29(a) of the Exchange Act prohibit waiver of the provisions in each respective Act. Yet, the *Rodriguez De Quijas* Court has reasoned that some provisions of each Act are not so critical, and may thereby be excepted from the nonwaiver provisions.

[98] Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917, 1921 (1989) (FAA must govern absent contrary congressional intent or if inherent conflict exists with purposes of securities statutes).

[99] *Id.* at 1922 (Securities and Exchange Acts should be construed harmoniously because they are interrelated). *See also* Greenhouse, *supra* note 94 (1933 and 1934 Acts are twin foundations of securities regulation).

[100] Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917, 1922-23 (1989) (Court failed to consider views of legislators on this nonconstitutional matter). Indeed, *Wilko* represented a settled interpretation of the Securities Act which Congress declined to change. *See* Money, *supra* note 18 (Court reaffirmed practice that diminishes investors' rights).

[101] *See supra* notes 64 and 94 and accompanying text (discussing *McMahon* & *Rodriguez De Quijas*).

[102] *See supra* notes 61 and 94.

[103] The proposition that PDAAs are valid in spite of securities laws granting dis-

points to keep in mind, however. First, the *McMahon* majority voted the same way in the *Rodriguez De Quijas* decision.[104] Apparently, none of the Justices had second thoughts when given an opportunity to reconsider virtually the same issue. Second, the advanced age of the dissenting justices who represent the liberal core of the court, combined with the present Administration, indicate that the dissenters will be replaced by Justices more likely to vote with the present majority.[105] Therefore, although each case was decided by a 5-4 vote, it appears that the law is settled with respect to arbitration of securities disputes.

Response to the decisions has varied greatly. Investor reaction to the decisions has been mixed. Reports indicate that although arbitration does not overwhelmingly favor brokers, customers perceive it this way.[106] The securities industry, on the other hand, has enthusiastically embraced the *McMahon* and *Rodriguez De Quijas* decisions.[107] The Supreme Court has most certainly cleared the path for enforcement of PDAAs in the securities industry.[108]

One possible challenge remains to the *McMahon-Rodriguez De Quijas* doctrine in the form of state regulation of PDAAs. In response to the *Connolly* challenge, the Court has asked the Justice Department for "its view on whether stockbrokers may be forced to give investors the option of suing rather than resolving fraud disputes in arbitration."[109] The Court of Appeals for the First Circuit

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trict courts original jurisdiction has been embraced by just five Members of the Court.

[104] The *McMahon* majority included Chief Justice Rehnquist, and Justices O'Connor, Powell, Scalia and White. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 221 (1987). The *Rodriguez De Quijas* majority consisted of Chief Justice Rehnquist and Justices Kennedy, O'Connor, Scalia and White. *See* Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917, 1918 (1989). Justice Kennedy replaced Justice Powell, in the interim between the two cases. Justices Blackmun, Brennan, Marshall and Stevens dissented in both cases.

[105] *See supra* note 64 and accompanying text (discussing Court in transition).

[106] *See* Greenhouse, *supra* note 94 and accompanying text (*McMahon* and *Rodriguez De Quijas* viewed as important victories for securities industry); *see also infra* notes 137-43 and accompanying text (discussing customers' perceptions of arbitration proceedings and their results).

[107] *See* Greenhouse, *supra* note 94 and accompanying text (securities firms favor "arbitration preferring to defend themselves before arbitrators who operate under rules written by the industry, not before judge and juries"); N.Y. Times, *supra* note 5 (arbitration now the only game in town).

[108] *But cf.* Utley v. Goldman Sachs & Co., 883 F.2d 184, 185 (1st Cir. 1989) (plaintiff allowed to litigate Title VII sex discrimination claims notwithstanding the PDAA she signed), *cert. denied*, 58 U.S.L.W. 3446 (Jan. 16, 1990).

[109] Securities Indus. Ass'n v. Connolly, 883 F.2d 1114 (1st Cir. 1989). *See* The Bos-

employed a traditional preemption analysis and concluded that the FAA preempted Massachusetts state regulations which impaired operation of federal law. The court reasoned that although Congress granted states permission to concurrently regulate securities transactions, they are still subject to the preemptive effect of the FAA.[110] The court invalidated the regulations which sought to regulate the formation of PDAAs in a way that basically prohibited them altogether.[111] In closing, the court observed that while PDAAs ought to be arrived at with greater negotiation and disclosure, any remedial measures must come from Congress rather than the state.[112]

The permissible scope of state regulation of PDAAs may be resolved by the Court in the near future beginning with *Connolly*.[113] Some general principles have been established though, relating to state regulation of PDAAs in other areas of law. In *Volt Information Sciences v. Board of Trustees*, the United States Supreme Court upheld a California law permitting courts to stay arbitration pending resolution of related litigation with parties not bound by the PDAA.[114] The Court reasoned that since the parties agreed to abide by state rules of arbitration, enforcement of those rules is "fully consistent with the FAA, "even if the result is to stay arbitration.[115] The Court felt it could give effect to the parties' contract without conflicting with the FAA.

A recent district court case considered the validity of a Virginia law which regulated arbitration agreements between automobile

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ton Globe, Jan. 23, 1990, at 49-50, col. 4. Thirty states are watching *Connolly* to determine the fate of their securities laws. *See* The Boston Globe, *supra* note 19.

[110] Securities Indus. Ass'n v. Connolly, 883 F.2d 1114, 1117-22 (1st Cir. 1989) at 1117-22. The court found that since the Regulations actually conflicted with federal law, there was no choice but to conclude they were preempted. *Id.* at 1124. *But cf.* Utley v. Goldman Sachs & Co., 883 F.2d 184 (1st Cir. 1989) (plaintiff allowed to litigate Title VII sex discrimination claims notwithstanding employment PDAA, because Supreme Court found Congressional intent for such exception to FAA), *cert. denied*, 58 U.S.L.W. 3446 (Jan. 16, 1990).

[111] Securities Indus. Ass'n v. Connolly, 883 F.2d 1114, 1124 (1st Cir. 1989).

[112] *Id.*; Rodriguez De Quijas v. Shearson/American Express, Inc., 109 S. Ct. 1917, 1923 (1989) (Stevens, J., dissenting) (Court has duty to respect Congress' work product).

[113] *See* The Boston Globe, *supra* note 19.

[114] 109 S. Ct. 1248, 1254-55 (1989) (6-2 decision). Chief Justice Rehnquist wrote the opinion of the Court.

[115] *Id.* at 1255-56. First, the Court noted that the FAA was designed to combat the judiciary's hostility towards arbitration, and to place such agreements on the same footing as other contracts. *Id.* at 1255. More importantly, it found that Congress was motivated by a desire to enforce agreements into which parties had entered according to their terms. *Id.* at 1255-56.

dealers and manufacturers.[116] Finding that the state did not "subject arbitration clauses to burdens not felt by other" contracts, and that the law did not stand as an obstacle to the FAA, the state law could be maintained along with the federal law.[117]

This case has been distinguished from *Connolly*, whereby in the latter case, the state admitted the regulations singled out securities PDAAs, while in the former case the law regulated in the same manner all PDAAs which were already formed. The author observes at this point, that there is room for state regulation of securities PDAAs, and urges states to continue providing protection for investors.[118] The state regulatory scheme, however, must stay within the parameters of the previously discussed cases if it is to withstand challenge. In other words, state regulations will survive challenge if they do not single out PDAAs for different treatment and burden them with conditions not part of the generally applicable state contract law. [119] The courts must be vigilant in ensuring that these adhesion contracts are not unconscionable or otherwise unenforceable.

Congress has not made a public statement on the issue since *Rodriguez De Quijas* was decided. However, Representative Edward J. Markey (D.Mass.), Chairman of the Subcommittee on Telecommunications and Finance of the Energy and Commerce Committee, called the ruling a blow to the rights of investors who are forced into a "Faustian bargain" of giving up the right to litigate in order to gain the right to invest in the markets.[120] Congress has held hearings on this matter, and a bill is being proposed which would permit customers to take brokers to court.

V. The Present State of Securities Arbitration

The history of securities (and other) arbitration cases since *Wilko* makes that decision appear to be an aberration, and indicates an uncontrovertible trend in favor of arbitration. This is so despite the fact that Congress passed the Securities and Exchange Acts specifi-

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[116] Saturn Distr. Corp. v. Williams, 717 F. Supp. 1147, 1148-49 (E.D. Va. 1989).

[117] *Id.* at 1150-53.

[118] *See supra* notes 114-117.

[119] *See* Securities Indus. Ass'n v. Connolly, 883 F.2d 1114, 1120 (1st Cir. 1989) (FAA prohibits states from taking more stringent action specifically addressed to arbitration contracts). The court, though, suggested that it is permissible for the state to regulate evenhandedly all types of arbitration contracts, and even declare that all adhesion contracts are presumptively unenforceable. *Id.* at 1120-21. *See supra* notes 114-117.

[120] *See* Greenhouse, *supra* note 94.

cally to protect investors and provide them with judicial remedies for securities violations.

Customers, upon finding little difference between the Acts, and upon thoroughly reviewing *McMahon* and *Rodriguez De Quijas*, will either have to formulate a state law claim along with a RICO claim, or submit their claims to an arbitral forum.

If arbitration is to be the exclusive method for securities dispute resolution, the question becomes the degree to which these statutory rights may be vindicated in arbitration.

Supporters of arbitration point to AAA and SRO procedures as evidence that the system is procedurally fair to both customers and brokers.[121] The securities industry contends that negative media coverage has fostered the perception that arbitration is unfair.[122] They further point out that arbitration offers privacy, lower costs and greater speed.[123] These latter two advantages, however, may be misleading. It would be more accurate to state that, to a great degree, the parties in an arbitration proceeding set both the cost and the pace. In securities disputes, both parties could fairly be portrayed as relatively sophisticated and with ready financial resources. Since the resources do exist, the parties will probably obtain the services of a stenographer, pursue extensive discovery, and retain counsel, all of which militate against an inexpensive and speedy process.[124]

Another benefit to the parties, which some view as unfair, is that arbitral decisions are final, except under very limited circumstances.[125] Although there exists a Code of Ethics for arbitrators, the

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[121] *See generally* Gugliotta v. Evans & Co., Inc., 690 F. Supp. 144 (E.D.N.Y. 1988) (courts more willing to uphold arbitration clauses, since SEC has expansive power to ensure adequacy of procedures employed by exchanges and associations); Note, *supra* note 17, at 223 (investors have choice of arbitration organizations, some of which are unconnected to securities industry). *But see* Comment, *Who's Protecting the Investors? Shearson/American Express v. McMahon, 107 S. Ct. 2332 (1987) Compels Private Claims Under §10(b) of the Securities Exchange Act into Arbitration*, 19 ARIZ. ST. L.J. 793, 818 (1987) (*Wilko* should fall only if SEC devises arbitration rules responsive to policy concerns).

[122] *See* The Boston Globe, *supra* note 19.

[123] *See, e.g.* S. GOLDBERG, E. GREEN, F. SANDER, DISPUTE RESOLUTION 189-90 (1985); Golann, *supra* note 95, at 7-9 (arbitration process flexible and may be tailored to suit parties); Nelson, *supra* note 33, at 199 (arbitration alternative circumvents costs, delays of litigation); Note, supra note 33, at 952-53 (arbitration speedier, less expensive than litigation); *cf.* The Boston Globe, *supra* note 19 (industry trying to protect a procedure they control which keeps litigation costs low).

[124] See Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 259-60 & nn. 17-18 (1987) (Blackmun, J., dissenting).

[125] The feature of finality highlights the importance of the FAA, and the arbitra-

limited grounds for judicial review may impair the court's task in this complex area of law.[126]

Indeed the securities industry is so bullish on arbitration, that its General Counsel's advice is to "sit back and let the process work."[127] The industry has repeatedly pointed out that investors win more than half of arbitration cases.[128]

The principal objections to mandatory arbitration of securities disputes relate to the fairness of the PDAA, and to the arbitrators and procedures used. Critics claim that brokerage agreements are essentially contracts of adhesion.[129] Since arbitration is almost the exclusive method for securities dispute resolution, investors' choices are limited even further.[130] This necessitates even closer scrutiny of

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tion process in general, because without this feature parties could automatically appeal to a district court for a trial de novo. In such a scenario, the arbitration proceeding would be left with a mere supposition of correctness. *See* McLaughlin, *supra* note 33, at 20 (broad rights of appeal present in litigation absent from arbitration). Four grounds for vacating arbitration awards are available under the FAA. See 9 U.S.C.A. §10 (West 1981 & Supp. 1988). *See* Golann, *supra* note 95, at 8 (that arbitrators failed to follow legal precedent not grounds for appeal).

[126] *See* R. Coulson, *supra* note 10, at 118-23 (Canons are hortatory, suggesting arbitrators disclose conflicts of interest, avoid improprieties, decide cases in fair manner, respect confidences and relationships of trust). Judicial review is still limited to the four grounds listed in §10 of the FAA, and to the concept of "manifest disregard for the law." *See supra* note 31 and accompanying text (discussing review of arbitral decisions).

[127] N.Y. Times, *supra* note 5.

[128] *See* Forbes, *supra* note 18. *But see infra* notes 137-44 and accompanying text.

[129] This has been defined as a case where a "contracting party with superior bargaining strength presents a standardized form agreement to a party of lesser bargaining power and requires that party to accept or reject its terms without an opportunity for negotiation." Sanchez, *Should Claims Involving Public Customers Arising Under the Securities Exchange Act of 1934 Be Subject to Compulsory Arbitration?*, 10 HARV. J.L. & PUB. POL. 173, 185 (1987). Courts may enforce such contracts since they might add to enterprise efficiency and stability. Contracts of adhesion will not be enforced under two circumstances. *See* Di Fiore, *supra* note 7, at 269 (court will not enforce adhesion contract if not within weaker party's reasonable expectations or if terms unduly oppressive or unconscionable). *Compare* Woodyard v. Merrill Lynch, Pierce, Fenner, & Smith, Inc., 640 F. Supp. 760 (S.D. Tex. 1986) (court refused to enforce arbitration provision against unsuspecting customer) *with* Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 733 F.2d 59 (8th Cir. 1984) (arbitration clause enforceable despite its standardized form).

[130] *See* Di Fiore, *supra* note 7, at 270 (virtually all brokerage houses require customers to sign arbitration agreement prior to investing); Letter, *supra* note 7 and accompanying text (discussing typical customer agreement). James E. Buck of the New York Stock Exchange responded to SEC Chairman Ruder's letter, commenting on Chairman Ruder's congressional testimony. *See* Letter from James E. Buck to David S. Ruder (Oct. 14, 1988) [hereinafter Buck's letter] (SEC believes customers

the contracts to determine whether they are enforceable. The Court in *Mitsubishi Motors* cautioned judges to be "attuned to well-supported claims that the agreement . . . resulted from the sort of fraud or overwhelming economic power that would provide grounds . . ." for revocation.[131] Courts must scrutinize the fairness of the parties' agreement, especially when customers have no choice but to sign it in order to invest, and when brokers represent large institutional entities.

Inherent conflicts exist in the SRO arbitration especially. The system was never designed to handle the complexity or volume of cases it now decides.[132] The SROs recruit panelists from which investors are forced to choose.[133] Moreover, the securities industry ultimately finances SROs.[134] Critics contend that there is virtually no training of arbitrators.[135] Top-flight legal talent is increasingly present at arbitration proceedings, so that even the industry has become worried that on-the-job training of arbitrators is insufficient.[136]

Additional criticisms have been leveled at the arbitral decision-making and award process. Arbitrators are not bound by judicial precedent, so that predictability of outcomes is undercut.[137] Nor must arbitrators file written opinions, which drastically undermines the effectiveness of judicial review.[138] As a corollary to this point,

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should have sufficient notice of their arbitration clause, and SROs should prevent brokers from using economic power to limit customers' rights); *cf.* The Boston Globe, *supra* note 19 (securities industry counsel concedes that system's not perfect).

[131] 473 U.S. 614, 627 (1985). *See generally* Buck's Letter, *supra* note 130, at 8 (Chairman Ruder suggests that not all securities cases are appropriate for arbitration, such as those involving class actions, those that are difficult and complex, and those involving novel legal theories and challenges to industry practice).

[132] N.Y. Times, *supra* note 5.

[133] N.Y. Times, *supra* note 5. *See supra* notes 22-25 and accompanying text.

[134] N.Y. Times, *supra* note 16.

[135] N.Y. Times, *supra* note 5 (no formal training relating to arbitration of state or federal securities laws).

[136] N.Y. Times, *supra* note 5. Such changes, of course, militate against a speedy and inexpensive process. *See* N.Y. Times, *supra* note 16 (securities industry President currently urging SROs to develop larger pool of "knowledgeable arbitrators").

[137] *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 257-59 (1987) (Blackmun, J., dissenting) (as at time of *Wilko*, neither record of proceedings nor written opinions required).

[138] While arbitrators' awards are written, their opinions are not, so that courts are left with a very meager record upon which to base their review. *See* N.Y. Times, *supra* note 5 (industry opposes written opinions because it opens door to appeals). *See* Lipton, *supra* note 29, at 13-14. *But see* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 233-34 (1987) (although judicial scrutiny limited, review sufficient to ensure arbitrators comply with statutory requirements).

arbitral decisions offer no guidance for future disputes.[139] On the other hand, this feature serves to reduce formality and costs and to substantiate the role of the FAA. The author speculates that this feature leads to a lack of consistency and predictability in outcomes, and encourages questions into the system's fairness. Securities disputes are frequently complex matters, for which findings of fact and conclusions of law would appear to be indispensable.

Historically arbitrators' awards have been limited to compensatory damages, so that customers could recover only compensation, whereas in court they enjoyed the possibility of being awarded punitive damages as well.[140] This rule has begun to change, however, as more courts have upheld arbitrators' awards of punitive damages.[141] In one of the many changes in arbitration discussed below, the SEC recently issued a release empowering arbitrators to grant investors any relief they may otherwise have had in court.[142]

Supporters of arbitration clauses point to their success in the labor context as evidence of their efficacy. However, securities disputes are more transactional than relational in nature, so that there is less reason to promote the parties' relationship in the securities context than in the labor context. Moreover, the parties in the labor scenario bargained for their agreement, such bargained-for exchange is entirely absent in the securities arena.[143]

Finally, critics argue that the arbitration system is "loaded" in favor of the securities industry and that most arbitrators have "significant ties" to it.[144] Therefore, one would expect for the securities

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[139] *See* Letter from Securities Industry Conference on Arbitration to Richard G. Ketchum (Dec. 14, 1987) at 6-7 (SICA agrees with SEC recommendation for maintenance of case results, but then criticizes plan as lacking in utility and misleading in nature); N.Y. Times, *supra* note 5 (secretive process contrary to American notions of justice).

[140] *See* Golann, *supra* note 95, at 12-13; Robbins, *Securities Arbitration: Preparation and Presentation*, 42 Arb. J. 3, 13 (June 1987) (trend towards allowing punitive damages as more varied claims reach arbitration).

[141] *See* Raytheon Co. v. Automated Business Systems, Inc., 882 F.2d 6 (1st Cir. 1989) (upholding award of punitive damages, attorney fees and costs, even if not provided for in PDAA and not within a court's power under local law). *But see* Garrity v. Lyle Stuart, Inc., 386 N.Y.S. 2d 831, 353 N.E. 2d 793 (1976) (punitive damages remedy not available under New York law).

[142] *See* Golann, *supra* note 95, at 13 & n. 61.

[143] *See supra* notes 129-30 and accompanying text (discussing involuntariness of securities arbitration agreements). *But cf.* 17 C.F.R. § 180.3 (1989) (Commodities Future Trading Commission makes PDAAs optional).

[144] *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 260-61 (1987) (Blackmun, J., dissenting) (possible for arbitrators to have clients who have been exchange members or SROs); N.Y. Times, Mar. 29, 1987, at C8, col. 1 (securities arbi-

industry to prevail more often than not in arbitration. Recent studies have produced inconsistent results regarding how well customers fared in arbitration as compared with litigation. Since June, 1989 the SROs have been required to make public their customer awards, which show customers receiving awards in half the cases.[145] The dollar amount of the awards, however, shows customers recovered a mere 21% of their claimed losses.[146] Another recent study by an SRO confirms these results, showing that prevailing customers averaged 15 cents per dollar of claim.[147]

At the SEC's request, the NYSE commissioned Deloitte, Haskins & Sells to audit customer originated cases.[148] The results show that arbitration was a few months speedier, legal costs were lower, and payments to customers were four times higher for arbitrated claims.[149] The SRO study further showed that customers received a greater percentage of their original claim in arbitration and recovered on average $35,000, as compared with $25,000 in litigation.[150]

Finally, an independent AAA survey showed a 68% success rate for customers,[151] while an SRO survey by the NASD revealed awards to only 55% of its customers.[152] Although evidence exists to support these claims, recent studies tend to show that customers prevail more often than not. It appears that the securities industry is generally comfortable with the present system and does not welcome proposed changes to it.[153] Even the Securities Industry Association

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tration expert observed that brokerage houses like present system because "they own the stacked deck"). Arbitrators "affiliated with the securities industry" have been defined as "[p]ersons who have, directly or indirectly, within the last five years been employed by or acted as counselors, consultants, advisors or attorneys to any SRO or affiliate." Friedman, *supra* note 16, at 29. For a discussion of SICA's recommendations on categories of persons who should be excluded from serving as arbitrators, see Letter, *supra* note 139, at 2-3.

[145] *See* N.Y. Times, *supra* note 5 (pursuant to new rule, exchanges required to make public arbitrators' awards in individual cases).

[146] *See* N.Y. Times, *supra* note 5.

[147] *See* Forbes, *supra* note 18.

[148] *See* Letter, *supra* note 130, at 4-7 & Exh. A.

[149] *See* Letter, *supra* note 130.

[150] *See* Letter, *supra* note 130, at 6 & Exh. A.

[151] *See* Bedell, Harrison & Harvey, *supra* note 17, at 9 & n.57; SICA Rep't, *supra* note 27, at 6.

[152] *See* N.Y. Times, *supra* note 5.

[153] *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 261 (1987) (Blackmun, J., dissenting) (overwhelming support by securities industry for compelled arbitration suggests "some truth" to the belief that industry has advantage) (emphasis in original); *see also* Letter from Joseph R. Hardiman to David S. Ruder (Oct. 14, 1988) at 1-2 (NASD argued prohibition of arbitration clauses would lead to increased commission rates, or reduction in services, and suggested their insurance

President admits that there are many flaws in the current system.[154]

The SEC is the regulating authority charged by Congress with the task of reconciling conflicts inherent in the arbitration of securities disputes. Consumer groups have had virtually no role in this dispute resolution technique. The SEC's role in the regulation and enforcement of securities laws through arbitration has been questionable. Indeed, until *McMahon*, the SEC consistently considered it to be a fraudulent, manipulative, or deceptive act for brokers to bind customers to PDAAs.[155] (Possibly anticipating *McMahon*,the SEC filed a brief as *amicus curiae*, contending that its former position was based solely upon *Wilko* rather than upon an independent analysis). Since *McMahon*, the SEC has attempted to overcome its ambivalence toward arbitration by instituting many positive changes in arbitration procedures.[156] Former SEC Chairman David S. Ruder supports arbitration, but he also acknowledges that, despite Supreme Court pronouncements, not every securities dispute is appropriate for arbitration.

As recently as May, 1989, the SEC approved a number of rule changes in an effort to improve the arbitration process. These changes represent two years of work between the SEC and the securities industry (but not including investor representatives). The changes formalize the arbitration process.[157] For example, the arbitration clause in accounts opened after September, 1989 must now

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rates would be adversely impacted); Letter from John M. Liftin to Richard A. Grasso (Oct. 6, 1988) (Kidder Peabody alleged that customer initialling of arbitration clauses to signal awareness and agreement too costly and time consuming and would foster litigation); Letter from Joel E. Davidson to John J. Phelan, Jr. (Oct. 5, 1988) (Paine Webber generally "supports" SICA's proposed rules changes with exception of initialling requirement because it would be too burdensome and may dissuade the customer from reviewing rest of agreements); Letter from Jeffrey B. Lane to John T. Phelan, Jr. (Oct. 4, 1988) (Shearson Lehman Hutton also opposes initialling requirement because it places undue emphasis on arbitration clause and encourages needless litigation).

[154] *See* The Boston Globe, *supra* note 19.

[155] *See supra* notes 52 & 71 and accompanying text (discussing former SEC position).

[156] *See* Gugliotta v. Evans & Co., Inc., 690 F. Supp. 144 (E.D.N.Y. 1988) (principal reason *McMahon* Court upheld PDAAs was because SEC vested with expansive oversight power). *But cf.* Comment, *supra* note 121 (SEC supervision of arbitration on case by case basis arguably exceeds its authority under 15 U.S.C.A. §78(s)(d)(2) (West 1981 & Supp. 1988)). For an outline of the SEC's objectives, see Letter, *supra* note 7.

[157] *See* Duke, *SEC Rules on Investor-Broker Disputes*, Wall St. J., May 11, 1989, at C1, col. 3 (sweeping changes will "greatly improve" arbitration process). The rules are aimed at defusing controversy surrounding PDAAs. *Id.*

be highlighted and clearly explained.[158] Arbitration hearings may now include pre-trial conferences and preliminary hearings, and discovery is easier for customers in that brokers must comply within 30 days to requests for documents.[159] Arbitrators' decisions and awards, but not the identities of the parties, are now made public.[160]

Moreover, the securities industry has initiated a campaign for better arbitrator selection as well as training in an effort to counter charges that the arbitration system unfairly favors the industry.[161] In a related effort, the Securities Industry Association has called for a single arbitration agency to replace the many existing SROs.[162] This proposal is meant to reduce the backlog experienced at some SROs, and to avoid the SROs duplicated efforts.

Not all of the current rule changes bode well for investors, however. Recently, the American Stock Exchange removed a clause from its constitution allowing investors to take their cases to the independent AAA.[163] And now at NASD hearings, brokers have the opportunity to summarize their cases last.[164] In the traditional order of summary arguments, customers, since they have the burden of proof, enjoy the last word.

The arbitration system has instituted many substantive changes, and there are many more to go. It appears that Congress may impose changes if the industry does not. State attempts to regulate arbitration represent another way of changing the present system. The United States Supreme Court may rule on the validity of such state regulations.

CONCLUSION

With so many changes in arbitration, the Supreme Court's support for arbitration appears to have been somewhat overdone. Controls on conflict of interest and arbitrator training cannot be overemphasized as strategies to remedy defects in the arbitration process. Congress ought to consider an expansion of judicial review for arbitral decisions. Discovery should be the rule rather than the exception in arbitration proceedings. Finally, customers must be

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[158] This is required despite industry-wide opposition. *See supra* note 153 and accompanying text. *See generally* N.Y. Times, *supra* note 5.

[159] *See generally* Forbes, *supra* note 18.

[160] *See* N.Y. Times, *supra* note 5. *See supra* note 137.

[161] *See* N.Y. Times, *supra* note 5. *See supra* notes 124-28.

[162] *See* N.Y. Times, *supra* note 16.

[163] *See* N.Y. Times, *supra* note 5. *See supra* note 16.

[164] *See* N.Y. Times, *supra* note 5.

able to make an informed and meaningful choice on whether to agree to a PDAA. It may be that customers fare just as well, if not better, in arbitration. But public perception of the market fairness is crucial to confidence and stability in the capital markets. For Courts and Congress to allow private remedies under the Securities and Exchange Acts, and then to permit brokerage firms to unilaterally impose arbitration upon customers seems to undermine the system's fairness. Compelling arbitration due to a clause signed as a precondition to investing without negotiation unfairly curtails Congressionally created and judicially recognized rights.

The solution appears to lie in increased Congressional, State and SEC oversight if investors' rights are to be properly vindicated without the assistance of the courts. Arbitration is, however, a very attractive dispute resolution technique in cases where both sides knowingly agree to be bound by it and have an opportunity to participate in the formulation of arbitration procedures for their case. It seems that, if arbitration is to be the exclusive dispute resolution method, then Congress and the SEC should bear heavy responsibility to ensure that customers' rights are thoroughly and scrupulously protected.