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SECURITIES ARBITRATION AFTER *McMAHON**

Constantine N. Katsoris**

I. Introduction

It has been a little over a year since the Supreme Court, in *Shearson/American Express, Inc. v. McMahon*,¹ decided that federal securities claims under the Securities Exchange Act of 1934 (1934 Act or Exchange Act)² are arbitrable.³ Since *McMahon*, there has been a flurry of activity in, and focus upon, the general area of arbitration of public securities disputes. This activity has generated particular interest in such subjects as: arbitration forums; pre-trial procedures and discovery; remedies and relief; composition of panels; training, background and evaluation of arbitrators; and the rendering of written opinions. In discussing many of these areas, this Article will track the history of securities arbitration before *McMahon*, analyze the *McMahon* decision, and explore possible solutions and alternatives which may help forge the pattern of securities arbitration in the future.

* Based upon comments delivered by Constantine N. Katsoris as a Panelist at the program "Securities Arbitration 1988," sponsored by the New York Institute of Finance on January 15, 1988, and an appearance before the Subcommittee (Markey Committee) on Telecommunications and Finance of the House Committee on Energy and Commerce on March 31, 1988.

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1. 107 S. Ct. 2332 (1987).

2. Pub. L. No. 291, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a-78kk (1982)).

3. *McMahon*, 107 S. Ct. at 2334.

II. Securities Arbitration Before *McMahon*

A. Establishment of the Securities Industry Conference on Arbitration (SICA)

Prior to 1976, most Securities Regulatory Organizations (SROs) had differing rules for the administration of securities arbitration disputes. In June 1976, the Securities and Exchange Commission (SEC or Commission) solicited comments from interested persons on the feasibility of developing a "uniform system of dispute grievance procedures for the adjudication of small claims."⁴ After conducting a public forum at which written and oral comments were received, the SEC's Office of Consumer Affairs issued a report recommending the adoption of procedures for handling investor disputes and the creation of a new entity to administer the system.⁵

Before implementing the proposal for a new arbitration forum, the Commission invited further public comment.⁶ In response, several SROs proposed that a securities industry task force be established to consider the development of "a uniform arbitration code and the means for establishing a more efficient, economic and appropriate mechanism for resolving investor disputes involving small sums of money."⁷ Accordingly, a Securities Industry Conference on Arbitration (SICA), consisting of representatives of various SROs,⁸ the Securities Industry Association (SIA)⁹ and the public,¹⁰ was established

4. Sec. Exch. Act Release No. 12528 (June 9, 1976), *reprinted in* 9 SEC Docket 833-35 (Mar.-July 1976).

5. Sec. Exch. Act Release No. 12974 (Nov. 15, 1976), *reprinted in* 10 SEC Docket 955-56 (July-Dec. 1976).

6. *See id.*

7. *Id.* FIFTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION 2 (Apr. 1986) (available at *Fordham Urban Law Journal* office) [hereinafter FIFTH REPORT].

8. The following SROs were represented: the American, Boston, Cincinnati, Midwest, New York (NYSE), Pacific and Philadelphia Stock Exchanges, the Chicago Board Options Exchange, the Municipal Securities Rulemaking Board and the National Association of Securities Dealers, Inc. (NASD). *Id.* at 3.

9. *Id.* The SIA is a trade association for the securities industry.

10. Peter R. Cella, Jr., Esq., Mortimer Goodman, Esq., and the author have served as Public Members of SICA since its creation in 1977. *Id.* In 1983, Justin Klein, Esq., was added as the fourth Public Member of SICA. *Id.* The public representatives were selected because of their broad experience, independence and demonstrated interest in arbitration. *Id.* Peter Cella is principally a claimant's attorney with wide litigation and corporate experience and was one of the people who testified before the SEC regarding independent arbitration proceedings. Mortimer Goodman is also an attorney with extensive experience in all aspects of the securities industry.

in April 1977.¹¹

B. SICA's Role

Once SICA was created, the SEC initially requested that it address, among other things, improved methods for the resolution of investors' small claims.¹² After holding numerous meetings throughout the country, SICA developed a simplified arbitration procedure for resolving customer claims of \$2,500 or less,¹³ and issued an informational booklet describing small claims procedures (Small Claims Booklet).¹⁴ Realizing, however, that the development of a small claims procedure was only a first step,¹⁵ SICA then developed a comprehensive Uniform Code of Arbitration (Uniform Code of Arbitration or Code)¹⁶ for the securities industry. The Code established a uniform system of arbitration procedures for all claims by investors.¹⁷ In addition, SICA prepared an explanatory booklet for prospective claimants (Procedures Booklet or Arbitration Procedures)¹⁸ explaining procedures under the

Justin Klein, who was subsequently added in 1983, was the Director of the Office of Consumer Affairs when SICA was formed. The author was a public member of the NASD's National Arbitration Committee (1975-1981) when SICA was initially created. See also Statement of Constantine N. Katsoris before Markey Committee (Mar. 31, 1988) (available at *Fordham Urban Law Journal* office).

11. FIFTH REPORT, *supra* note 7, at 1-2.

12. *Implementation of An Investor Dispute System*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,136, at 87,905 (Apr. 26, 1977) (Sec. Exch. Act Release No. 13470) [hereinafter *Investor Dispute System*].

13. FIFTH REPORT, *supra* note 7, at 2. SICA subsequently raised the jurisdictional limit of small claims to \$5,000, and then again to the present \$10,000. See *SEC Approves NASD Proposal to Raise Ceiling for Simplified Arbitrations*, Sec. Reg. & L. Rep. (BNA) No. 20, at 560 (Apr. 15, 1988). Some SROs, however, have not yet increased the small claims limit to \$10,000.

14. See SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, HOW TO PROCEED WITH THE ARBITRATION OF A SMALL CLAIM (undated) (available at *Fordham Urban Law Journal* office).

15. REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION TO THE SECURITIES AND EXCHANGE COMMISSION 7-8 (Nov. 15, 1977) (available at *Fordham Urban Law Journal* office).

16. See Uniform Code of Arbitration (as amended), reprinted in FOURTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION TO THE SECURITIES AND EXCHANGE COMMISSION Exhibit C (Nov. 1984) (available at *Fordham Urban Law Journal* office) [hereinafter Uniform Code of Arbitration]. The small claims procedure was incorporated into § 2 of the Code. See Uniform Code of Arbitration, *supra*, § 2.

17. FIFTH REPORT, *supra* note 7, at 2.

18. See THIRD REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION TO THE SECURITIES AND EXCHANGE COMMISSION 5 (Jan. 31, 1980) (available at *Fordham Urban Law Journal* office); SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, ARBITRATION PROCEDURES (1980) (available at *Fordham Urban Law Journal* office) [hereinafter PROCEDURES BOOKLET].

Code. To a great extent, the Code incorporated and harmonized the rules of the various SROs and codified various procedures which the SROs had followed but which were not included in their existing rules. The Code was adopted by the participating SROs during 1979 and 1980.¹⁹ Since then, various revisions have been made to both the Code and the Procedures Booklet,²⁰ and SICA has continued to "meet periodically to monitor the performance of the Code in action."²¹ To date, well over ten thousand cases—including small claims—have been filed with the participating SROs since the approval of the Code.²²

C. Events Leading to *McMahon*

1. *Wilko v. Swan*

Most arbitration between an investor and his broker is brought pursuant to an arbitration agreement executed at the time a customer opens an account with his broker.²³ Under the United States Arbitration Act (Federal Arbitration Act or Arbitration Act),²⁴ agreements to arbitrate future disputes are, in general, specifically enforceable.²⁵

19. FIFTH REPORT, *supra* note 7, at 4. Once SICA adopts a new rule, each SRO must then generally go back to their organization in order to get a rule change which is then usually submitted to the SEC for approval. Accordingly, there is often a time lag between SICA approval and SRO action.

20. For examples of such amendments, see FIFTH REPORT, *supra* note 7, at 4-5.

21. FIFTH REPORT, *supra* note 7, at 4.

22. See FIFTH REPORT, *supra* note 7, at Exhibit A—Statistical Report; Franklin, *Rewriting the Roles, Securities Arbitration: Claims Up; Procedures Proposed*, N.Y.L.J., Jan. 28, 1988, at 5, col. 3.

23. SROs by rule require that their membership consent to arbitrate disputes with their customers. By belonging to the SRO, its members agree to be bound by the SRO's rules. Consequently, customers of an SRO may compel a member of an SRO to arbitrate; however, absent a written contract, the member cannot compel the customer to arbitrate. See P. HOBLIN, *SECURITIES ARBITRATION: PROCEDURES, STRATEGIES, CASES 2-3 to 2-4* (1988).

24. 9 U.S.C. §§ 1-14 (1982).

25. Section 2 of the Arbitration Act provides: "A written provision in . . . a contract evidencing a *transaction involving commerce* to settle by arbitration, a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.* § 2 (emphasis added). Because the Federal Arbitration Act applies to claims arising from transactions involving interstate commerce, *id.*, and because securities dealings usually involve such transactions, state securities claims, as well as those arising under the federal securities laws, are usually arbitrable.

In *Wilko v. Swan*,²⁶ however, the Supreme Court was faced with the issue of whether a broker could bind a customer to arbitration under such an agreement if the customer's claim arose under the provisions of the Securities Act of 1933 (1933 Act or Securities Act).²⁷ After recognizing that the essential purpose of the Arbitration Act was to avoid the delay and expense of litigation,²⁸ whenever possible, the Court observed that the purpose of the 1933 Act—with its three special provisions—was to provide a judicial forum for the resolution of securities disputes.²⁹

Faced with these two conflicting policies, the Court concluded that although the enforcement of pre-dispute arbitration agreements might be economically advantageous,³⁰ Congress' desire to protect investors would be more effectively served by holding invalid any pre-dispute arbitration agreements relating to issues arising under the 1933 Act.³¹ In effect, the *Wilko* Court concluded that the three *special* provisions of the Securities Act—the non-waiver provision of section 14,³² in conjunction with the special rights provision of section 12³³ and the special process and forum provisions of section 22³⁴—implicitly repealed the Arbitration Act with regard to securities claims arising under the 1933 Act.³⁵

2. Problems Under the 1934 Act

Most federal securities claims brought against brokers by the public, however, are brought under the 1934 Act. The reason for this is

26. 346 U.S. 427 (1953).

27. 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (1982)).

28. *Wilko*, 346 U.S. at 431.

29. *Id.* The Court noted that the Securities Act was designed to protect investors from fraud by requiring full disclosure on the part of the dealer. *Id.* In order to effectuate this policy, Congress included three special provisions in the 1933 Act. For example, § 12 specifically gave investors a *special* right to recover for misrepresentation which differs substantially from the common-law action in that this special right imposes upon the seller the burden of proving lack of scienter. *Id.*; 48 Stat. 84 (codified as amended at 15 U.S.C. § 771 (1982)). Moreover, under § 14 of the Act, 48 Stat. 84 (codified at 15 U.S.C. § 77n (1982)), an investor could not waive this *special* right. Finally, § 22 of the Act specifically affords the plaintiff national service of process and a broad choice of forum by making the right enforceable by the investor in any court of competent jurisdiction—federal or state. 48 Stat. 86 (codified as amended at 15 U.S.C. § 77v(a) (1982)).

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

31. *Id.* at 432.

32. 48 Stat. 84 (codified at 15 U.S.C. § 77n (1982)).

33. 15 U.S.C. § 771 (1982).

34. 15 U.S.C. § 77v(a) (1982).

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

that, unlike the 1933 Act, which is concerned with the initial distribution of securities,³⁶ the 1934 Act deals principally with post-distribution trading.³⁷ Despite this difference, many federal courts before *McMahon* presumed that the *Wilko* prohibition extended to the 1934 Act, and thus refused to order arbitration—under pre-dispute arbitration agreements—of customers' claims arising under the Exchange Act.³⁸

The confusion regarding the *Wilko* extension to claims under the 1934 Act was further exacerbated when a public customer joined a non-arbitrable *Wilko* claim with an arbitrable non-federal securities claim. Some courts bifurcated the two and ordered that the *Wilko* claim be litigated and the other claim be arbitrated.³⁹ Other courts, however, found the two claims to be so intertwined that it was impractical or impossible to separate them and, therefore, ordered that both be litigated together.⁴⁰

The intertwining/bifurcation issue was finally settled by the Supreme Court in *Dean Witter Reynolds, Inc. v. Byrd*,⁴¹ which involved both 1934 Act claims and arbitrable non-federal securities claims. *Byrd* raised two issues: (1) whether *Wilko* extends to 1934 Act claims; and (2) whether the federal and non-federal claims should be bifurcated or, if intertwined, tried together.⁴² Although the Court declined to

36. See Katsoris, *Accountants' Third Party Liability—How Far Do We Go?*, 36 FORDHAM L. REV. 191, 208-09 (1967) [hereinafter Katsoris I]. The Act requires full and fair disclosure of the character of the securities sold to the public and provides for civil liability. See, e.g., 15 U.S.C. §§ 77k, 77l, 77o (1982).

37. See Katsoris I, *supra* note 36, at 209. Liability under the Exchange Act is generally founded on § 18, 15 U.S.C. § 78r (1982), the implied provisions of § 10(b), 15 U.S.C. § 78j(b) (1982), and the Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240 (1985). Most 1934 Act investor claims against brokers, however, involve § 10(b) of the Act. See Bell & Fitzgerald, *Mixed Arbitrable/Nonarbitrable Disputes*, 16 REV. SEC. REG. 849, 851-52 (1983).

38. See *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979) (arbitration agreement overridden by anti-waiver provision of federal securities laws); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978) (same); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 835 (7th Cir. 1977) (same); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 & n.12 (3d Cir.) (same), *cert. denied*, 429 U.S. 1010 (1976); *Newman v. Shearson, Hammill & Co.*, 383 F. Supp. 265, 268 (W.D. Tex. 1974) (same).

39. See *Macchiavelli v. Shearson, Hammill & Co.*, 384 F. Supp. 21, 31 (E.D. Cal. 1974) (arbitrable contract claim severed from a Rule 10b-5 claim).

40. See *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 335 (5th Cir. 1981); *Sibley v. Tandy Corp.*, 543 F.2d 540, 544 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

41. 470 U.S. 213 (1985).

42. *Id.* at 214, 215 n.1.

specifically resolve the issue of whether *Wilko* applies to 1934 Act claims,⁴³ it did hold that when an arbitrable claim is joined with a non-arbitrable *Wilko* claim, though intertwined, the claims need not be tried together involuntarily. Thus, *Byrd* rejected the concept of "intertwining" and supported the principle of automatic bifurcation,⁴⁴ when a non-arbitrable *Wilko* claim is joined with an arbitrable claim. In other words, the two claims may be tried separately and simultaneously. Whatever the merits of automatic bifurcation, it unleashes and sets in motion two separate forums on a collision course. At the very least, it greatly complicates the task of arbitrators, who often are not lawyers.⁴⁵

III. *Shearson/American Express, Inc. v. McMahon*

The issue of whether the *Wilko* exemption applied to 1934 Act claims was answered by the Supreme Court in *Shearson/American Express, Inc. v. McMahon*.⁴⁶ In a 5 to 4 decision, the Court reversed the United States Court of Appeals for the Second Circuit and ruled that contractual agreements to arbitrate claims asserted under section 10(b) of the 1934 Act are enforceable and not exempted by *Wilko*.⁴⁷

Before *McMahon*, the SEC had adhered to the then generally accepted position that 1934 Act claims could not be forced into arbitration;⁴⁸ and, understandably, the SEC insisted that the public be so notified.⁴⁹ The SEC changed its position, however, in *McMahon*

43. *Id.* at 215 n.1. The Court declined because Dean Witter Reynolds, Inc., did not seek to compel arbitration of the federal securities claims at the district court level. *Id.*

44. See Pitt, 'Byrd', *First Step to Heighten Role of Arbitration*, Legal Times, Mar. 11, 1985, at 15, col. 1.

45. See generally Katsoris, *The Arbitration of a Public Securities Dispute*, 53 *FORDHAM L. REV.* 279, 301-04 (1984) [hereinafter Katsoris II].

46. 107 S. Ct. 2332 (1987).

47. 107 S. Ct. at 2341-42. It is noteworthy that *McMahon* did not overrule *Wilko* as to 1933 Act claims. Indeed, the *Wilko* application to 1933 Act claims was recently upheld in *McCowan v. Dean Witter Reynolds, Inc.*, 87 Civ. 2336 (S.D.N.Y. Dec. 21, 1987). See also *Chang v. Lin*, 824 F.2d 219 (2d Cir. 1987); but see *Rodriguez de Quijas v. Shearson/Lehman Brothers Inc.*, No. 87-2888 (5th Cir. May 31, 1988); *Karouras v. Visual Products Systems, Inc.*, 680 F. Supp. 205 (W.D. Pa. 1988); *Staidman v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 673 F. Supp. 1009 (C.D. Cal. 1987). Regardless of whether the Supreme Court ultimately overrules *Wilko*, the fact remains the special provisions sought to be protected by the 1933 Act differ from the 1934 Act. See Katsoris II, *supra* note 45, at 297-301.

48. See Katsoris II, *supra* note 45, at 296-97.

49. See Sec. Exch. Act Release No. 19813 (May 26, 1983), reprinted in 27 SEC Docket 1260 (Feb.-June 1983).

and, stressing its "oversight" role over SROs, asserted that 1934 Act claims should be arbitrable. In resolving the issue, the Supreme Court noted:

This mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time. This is especially so in light of the intervening changes in the regulatory structure of the securities laws. Even if *Wilko's* assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedure subject to the SEC's oversight authority.⁵⁰

The *McMahon* Court, in a 9 to 0 decision, also ruled that contractual agreements to arbitrate claims asserted under the Racketeer Influenced and Corrupt Organizations Act (RICO)⁵¹ are similarly enforceable.⁵²

IV. Events After *McMahon*

The practical effect of *McMahon* is that securities arbitrations will multiply, because it effectively sealed the escape valve of a separate 10(b) 1934 Act hearing in federal court.⁵³ With arbitration now

50. 107 S. Ct. at 2341.

51. 18 U.S.C. §§ 1962-64 (1982).

52. 107 S. Ct. at 2343-44. Yet, the SEC does not have the power to administer the law under RICO. Interestingly, this unanimous opinion on RICO was joined by Justice Blackmun, who filed a dissent (joined by Justices Brennan and Marshall) to the Court's opinion on § 10(b), suggesting that procedures at the various SROs might be inadequate to resolve federal securities disputes or biased towards the securities industry. In spite of this "the dissenting Justices on the § 10(b) issue joined the majority in agreeing that RICO disputes are arbitrable notwithstanding the fact that RICO claims predicated on federal securities law violations will now be resolved at the very forums which they have attacked." Krebsbach & Friedman, *Securities Arbitration 1988*, at 3 (Jan. 15, 1988) (unpublished manuscript) (available at *Fordham Urban Law Journal* office). Moreover, because RICO claims often may involve the same pattern of conduct, complicated issues of joinder and consolidation could surface. See generally Abrams, *Civil Rico's Cause of Action: The Landscape After Sedima*, 12 *TULANE MARITIME L.J.* 19, 41-51 (1988). Section 13(c) of the Uniform Code of Arbitration places such authority to join and consolidate claims initially on the Director of Arbitration and finally upon the discretion of the arbitration panel. See *FIFTH REPORT*, *supra* note 7, at 34. Unfortunately, this issue of joinder and consolidation raises a difficult dilemma of whether the possibility of substantial prejudice arising from such consolidation or joinder outweighs the "time and expense involved in separate actions or the possibility of conflicting awards." Stipanowich, *Arbitration and the Multiparty Dispute: The Search for Workable Solutions*, 72 *IOWA L. REV.* 473, 489-90 (1987).

53. See *Arbitration Caseloads Expected to Rise in Wake of Market Crash*, *Alternative Dispute Rep. (BNA) No. 1*, at 278-79 (Nov. 12, 1987); Salwer, *Investors Swap Securities-Arbitration System*, *Wall St. J.*, Mar. 15, 1988, at 37, col. 3.

realistically the principal forum for the settlement of securities disputes, a reexamination of its strengths and its weaknesses is warranted. The issues are numerous and the debate is healthy.

Shortly after the *McMahon* decision, the SEC dispatched to SICA a list of recommendations for changes in SRO arbitration, and requested SICA's comments.⁵⁴ SICA responded in a letter which represented a consensus view of its members.⁵⁵ Several members of SICA also sent separate responses, in addition to the official SICA response.⁵⁶ Many of these issues had already been previously discussed at SICA; and, SICA's response was generally in agreement with the SEC's proposals.⁵⁷ There is still some honest disagreement on certain points, and constructive ongoing discussions between SICA and the SEC are continuing. This Article will not comment specifically on such ongoing discussions. Instead, in an attempt to make the arbitration process fairer, yet preserve it as a viable and attractive alternative remedy to court litigation, this Article will focus on and attempt to analyze some of the more common suggestions and criticisms regarding present securities arbitration procedures.⁵⁸

After the *McMahon* case, some have suggested that Congress overturn that ruling and decree that pre-dispute arbitration agreements

54. See Letter from SEC to SICA (Sept. 10, 1987) [hereinafter SEC Letter], reprinted in J. SCHROPP, *SECURITIES ARBITRATION, NEW APPROACHES TO SECURITIES COUNSELLING & LITIGATION AFTER MCMAHON* 141-53 (1988) [hereinafter SCHROPP]. The SEC's proposals principally revolved around such issues as: selection, qualification, background training and evaluation of arbitrators; challenges for cause; method of transcribing and preserving the record of arbitration hearings; written outline and explanation of the basis for an award; pre-hearing discovery, depositions and exchange of documents; expanding the use of educational pamphlets; increased pressure on SRO arbitration systems brought about by the anticipated increased case load; adherence to Rule 19b-4; notification of abuses to disciplinary authorities; and large cases. *Id.*

55. See SICA Letter to Richard G. Ketchum (Dec. 14, 1987) [hereinafter SICA Letter], reprinted in SCHROPP, *supra* note 54, at 154-69. It is noteworthy, however, that the composition of SICA is: ten SROs, the SIA and four public members. Obviously, the *public members* are in the *minority*, which means they cannot effect change unilaterally or as fast as they wish. Nevertheless—even before the intense scrutiny of arbitration brought on by *McMahon*—a productive and generally cooperative spirit has prevailed at SICA which has led to greater uniformity and steady progress and improvement over the years.

56. See, e.g., Letter from Public Members of SICA to Richard G. Ketchum (Oct. 9, 1987) [hereinafter Public Members' Letter], reprinted in SCHROPP, *supra* note 54, at 170-72.

57. See SICA Letter, *supra* note 55, at 155.

58. The opinions expressed herein are the author's and do not necessarily represent those of SICA.

are not binding as to 1934 Act claims.⁵⁹ In fact, Congress has begun examining arbitration in the aftermath of *McMahon*.⁶⁰ Whatever the outcome of such inquiry, it is respectfully suggested that Congress should not overrule *McMahon* because of court congestion and the Supreme Court's decision in *Dean Witter Reynolds, Inc. v. Byrd*.⁶¹

The *Byrd* Court held that when an arbitrable claim is joined with a non-arbitrable federal securities claim, it would not order the claims to be involuntarily tried together, even though they were intertwined.⁶² In other words the two claims—even though factually related—could be tried separately and simultaneously.⁶³ Troublesome logistical and practical issues could result from having two discovery proceedings and hearings occurring at the same time at different locations before different triers of fact. Moreover, complicated issues of collateral estoppel and res judicata are sure to surface—raising a difficult question as to the preclusive effect, if any, that a decision at one forum would have upon the other forum, and vice versa.⁶⁴ Our congested trial dockets should not be subjected to such unnecessary duplication and confusing trauma.

V. To What Extent Do We Change Securities Arbitration?

What is attractive about arbitration is that it is generally speedy, economical and fair. Obviously, improvements can always be made; but, we should retain the basic characteristics of arbitration.

The dangers in the post-*McMahon* era are efforts to recast arbitration as a clone to court litigation. If that occurs, then why do

59. See, e.g., *McMahon Decision Should Be Overturned To Protect Investors, House Panel Told*, Sec. Reg. & L. Rep. (BNA) No. 20, at 492 (Mar. 31, 1988) [hereinafter *Protect Investors*].

60. Nash, *The House of Representatives, Life in a Giant Shadow Tests Lawmakers' Skills*, N.Y. Times, Apr. 20, 1988, at A20, col. 1 [hereinafter Nash].

61. 470 U.S. 213 (1985).

62. *Id.* at 217. See *supra* notes 39-45 and accompanying text.

63. See, e.g., *Chang v. Lin*, 824 F.2d 219 (2d Cir. 1987).

64. See Katsoris, *The Securities Arbitrators' Nightmare*, 14 FORDHAM URB. L.J. 3, 9-11 (1986) [hereinafter Katsoris III]. Indeed, the author recently sat as an arbitrator in a case where the bifurcated federal claim had already been dismissed in federal court; and, thereafter the claimant sought to proceed with the arbitrable claim. In ruling on whether such federal disposition of the federal securities claim precludes the later arbitration, it required—at the very least—a careful reading and analysis of the federal securities proceedings. Such needless layers of delay and confusion should be avoided at all cost. Thus, assuming *arguendo* that Congress overturns *McMahon*, Congress should then also overturn the automatic bifurcation provisions of *Byrd* and allow intertwined claims to be tried together. See *supra* notes 39-45 and accompanying text. That, at least, would avoid duplicative litigation.

we need a separate duplicative system that parallels our court system? Why not just expand our court system? Simply put, the lengthy litigation, excessive costs and delay prevalent in our court system is hardly the answer either for the securities industry or the public it serves. Recently, in California, the Los Angeles County Bar Association filed suit in federal court to appoint more state court judges because it takes about five years for a civil case to come to trial.⁶⁵ This is simply unacceptable.⁶⁶ Indeed, justice delayed, or made prohibitively costly, often results in justice denied.

Although speed and economy are important, they should not be achieved at the expense of fairness. All three can co-exist, however, with fairness the paramount consideration. Thus, in opting for arbitration, we must provide the necessary safeguards to ensure a fair and complete hearing without—in the process—destroying the fabric of arbitration. Because such safeguards often slow the proceedings down, the benefits of each new procedure must be weighed against the resultant escalation in time and cost. This Article will now consider some of the current suggestions of change.

A. Pre-Hearing Procedures

Generally, pre-trial discovery procedures such as bills of particulars, interrogatories, depositions and notices to produce documents are intended to eliminate “trial by ambush . . . by bringing to light the pertinent [issues] before trial.”⁶⁷ Unfortunately, such discovery can be unnecessarily expensive and burdensome.⁶⁸ Indeed, it can “become a stalling tactic, a nuisance, an effort to grind down the other side.”⁶⁹

It is largely for these reasons that in most jurisdictions pre-trial discovery is much more limited in arbitration than in an action at

65. See Marcotte, *L.A. County Bar Sues California*, A.B.A. J., Feb. 1, 1988, at 28; see also *Lawsuits Triple in Federal Courts*, N.Y. Times, July 16, 1987, at B6, col. 6.

66. Current estimates indicate that claims at the New York Stock Exchange take about 9 months. See Morris, *Was He Hibernating With Puxatawney Phil?*, Nat'l L.J., Apr. 11, 1988, at 12, col. 2.

67. Goldstein, *Issue of Pretrial Discovery*, N.Y. Times, Jan. 5, 1979, at D4, col. 1 [hereinafter Goldstein].

68. COMMITTEE ON ARBITRATION, ASS'N OF THE BAR OF THE CITY OF N.Y., *THE USE OF DISCOVERY IN ARBITRATION* 231-32 (1978) [hereinafter *THE USE OF DISCOVERY IN ARBITRATION*].

69. Goldstein, *supra* note 67, at D4, col. 1. See also Oberer, *Trial By Ambush Or Avalanche? The Discovery Debacle*, 1987 Mo. J. OF DISPUTE RESOLUTION 1, 5; Hazard, *Depositions: Modern-Day Inquisitions*, Nat'l L.J., Mar. 14, 1988, at 13, col. 1.

law.⁷⁰ It is principally for this reason that arbitration is cheaper and speedier than court litigation; and, it is precisely this desire to contain costs and avoid delay that is usually the major reason why parties elect and agree to arbitrate disputes.⁷¹

In securities arbitration, the parties are expected to exchange documents informally "as will serve to expedite the arbitration."⁷² There is, however, no established mechanism to ensure that parties cooperate in document production. Accordingly, some parties do not produce documents until the day of the hearing. The practical problem under the Uniform Code is that the party seeking the documents "does not know whether on the day of the hearing, he is going to argue over discovery matters only or whether the arbitrators will proceed to resolve the case on the merits."⁷³

Arbitrators, under their broad powers, already have the authority to resolve discovery disputes in advance of the hearing. Indeed, some SROs forward discovery disputes to arbitrators, prior to hearings on the merits,⁷⁴ including giving the panel chairman the authority to be sworn and to resolve discovery disputes in advance of the hearing. Some arbitrators, however, particularly those who are not attorneys, are reluctant to exercise such powers without specific authorization in the Uniform Code.

In any event, it would appear that the time has arrived to codify the informal practice of some SROs to get the arbitrators involved in discovery disputes before the first hearing.⁷⁵ Even if this involves some additional cost and time, it would appear to be more than counterbalanced by the equitable consideration of preventing undue surprise and possible prejudice to either party once the hearing on the merits begins. In fact, the resolution of such disputes before the first hearing might often save time and expense at the hearing.

What would prevent such procedures from becoming abusive as often happens in court litigation? The answer is, an experienced

70. See Katsoris II, *supra* note 45, at 287 n.52 (citations omitted).

71. See THE USE OF DISCOVERY IN ARBITRATION, *supra* note 68, at 232.

72. See Uniform Code of Arbitration, *supra* note 16, § 20(b). "Prior to the first hearing session, the parties shall cooperate in the voluntary exchange of such documents and information as will serve to expedite the arbitration. If the parties agree, they may also submit additional documents to the Director of Arbitration for forwarding to the arbitrators." FIFTH REPORT, *supra* note 7, at 35.

73. SEC Letter, *supra* note 54, at 149.

74. This author has, as an arbitrator, been involved in such pre-hearing discovery disputes and feels these procedures work quite well.

75. See SEC Letter, *supra* note 54, at 149-50. It is noteworthy, however, that the public members of SICA had proposed such pre-hearing rules long before the *McMahon* decision. See Public Members' Letter, *supra* note 56, at 170.

knowledgeable arbitrator who will not let matters get out of hand. Accordingly, SICA is in the process of amending the Uniform Code of Arbitration by basically providing that if a demand for documents is not honored within a certain period of time or is objected to within that same period of time, the requesting party can have an arbitrator appointed who will then oversee and enforce the discovery process before the first hearing.⁷⁶ Moreover, SICA is also in the process of amending its Uniform Code of Arbitration to provide for pre-hearing discovery conferences.⁷⁷

The Code does not specifically refer to depositions. SICA is presently considering adopting such a rule in limited circumstances.⁷⁸ This rule will be based upon the existing authority of parties to take depositions under statutory and case law in limited circumstances.⁷⁹ In this regard, it should be noted that an SRO rule mandating certain forms of depositions could only reach unavailable witnesses who are members or persons associated with members.⁸⁰ Of course, enforceability by a court of a deposition is coextensive with the law applicable to that court without regard to an SRO rule.⁸¹

B. Pre-Dispute Arbitration Agreement

1. Voluntariness

Another persistent complaint is that the public investor is often forced by the broker to execute a pre-dispute arbitration agreement at the time of opening a securities account.⁸² Although some courts

76. See *SROs May Propose Rule To Facilitate Pre-Hearing Discovery in Arbitrations*, Sec. Reg. & L. Rep. (BNA) No. 20, at 411 (Mar. 18, 1988). Actually, SICA had already adopted such a rule in March 1988; the rule is in the process of some adjustment, because of some SRO objections. See *Arbitration Group To Urge SRO Review of Disclosures in Customer Agreements*, Sec. Reg. & L. Rep. (BNA) No. 20, at 559 (Apr. 15, 1988). An amended discovery rule was finally adopted by SICA at its meeting of May 24, 1987. See *SROs Nearing Agreement on Using Summary Arbitration Award*, Sec. Reg. & L. Rep. (BNA) No. 20, at 795 (May 27, 1988). The rule provides that once a party has requested a document the other side has 30 days in which to produce the document or file an objection, with any disputes being ultimately resolved by a single arbitrator, or the entire panel, as the case may be. *Id.*

77. *Id.*

78. See SICA Letter, *supra* note 55, at 160.

79. See *id.*

80. See *id.*

81. See *id.*

82. See *Katsoris II*, *supra* note 45, at 292 n.86.

have recognized the issue of adhesion,⁸³ it would appear that most courts do not consider it to be a problem in the case of securities arbitration clauses.⁸⁴ Regardless of current trends, however, the issue should be examined as part of the public's overall perception as to the fairness of the arbitration process.⁸⁵

Investors should not be forced to agree to a pre-dispute arbitration agreement as a condition to access to the securities markets. It should be entered into freely, and only after the full effect and meaning of such a clause is disclosed.⁸⁶ Besides, such informed consent would

83. See *Graham v. Scissor-Tail Inc.*, 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981); *Hope v. Superior Court of Santa Clara County*, 122 Cal. App. 3d 147, 175 Cal. Rptr. 851 (1981). Adhesion arises when a standardized contract, usually drafted by a party of superior bargaining power, is presented to a party whose choice is limited to accepting or rejecting the contract without the opportunity to negotiate its terms. Such agreements are usually used when a party enters into similar transactions with many individuals, and the agreements resemble ultimatums or laws rather than mutually negotiated contracts. See Katsoris II, *supra* note 45, at 306. As to the enforceability of such contracts generally, see *id.* at 306-09.

84. See, e.g., *Cohen v. Wedbush, Noble, Cooke Inc.*, No. 87-6174 (9th Cir. Mar. 2, 1988); *Parr v. Superior Court of San Mateo County*, 139 Cal. App. 3d 440, 446-47, 188 Cal. Rptr. 801, 805 (1983). It would also appear that in *McMahon*, the Supreme Court did not consider that the contract to arbitrate was one of adhesion. See *Shearson/American Express, Inc. v. McMahon*, 107 Sup. Ct. 2232, 2336 (1987).

85. SICA has never specifically addressed the issue of pre-dispute arbitration agreements in depth because many of the SRO members believed that such agreements were private contractual issues between the customer and the broker. Nevertheless, this author has repeatedly expressed concern about the voluntariness of the arbitration agreement *before McMahon*. See Katsoris II, *supra* note 45, at 306-09; Katsoris III, *supra* note 64, at 11-14. See also T. Ricks, *SEC May Seek Ban on Clauses for Arbitration*, Wall St. J., June 2, 1988, at 26, col. 5.

86. See Katsoris II, *supra* note 45, at 296 n.124. Indeed, a pre-dispute arbitration agreement under the Commodity Exchange Act, 7 U.S.C. §§ 7-26 (1982), is enforceable if:

- a. executing the agreement is not essential to access to the market;
 - b. customer . . . separately signs the arbitration clause or agreement;
- and,
- c. customer is given a warning, in bold face type, that he is surrendering certain rights to assert his claim in court.

17 C.F.R. § 180.3(b)(1), (2), (6) (1988). In fact, such agreement may not require the customer to waive the right to seek reparations under § 14 of the Commodity Exchange Act and Part 12 of the regulations; and, such customer has 45 days to seek such reparations after being notified that arbitration will be demanded under the agreement. 17 C.F.R. § 180.3(b)(3) (1988). Considering the fact that the industry is generally *automatically* bound to arbitrate, see *supra* note 23 and accompanying text, a pre-dispute securities arbitration agreement—if freely and knowledgeably consented to—should thereafter be binding without an additional escape clause such as the 45 day option applicable to commodities futures trading. *Id.* To hold otherwise would make a mockery of the law of contracts.

eliminate the troublesome issue, that often arises, of whether a customer understood or even read the arbitration clause.

Some in the industry have countered that such clauses are necessary because of the great cost differential between court litigation and arbitration; and, if a customer refuses to so sign, he should be required to pay for the additional cost differential through increased commissions (a two-tiered rate structure).⁸⁷

The two-tiered rate structure, however, raises an interesting question. It presumes that an unwilling customer can find access to the market through a broker who would accept his account. Assuming such access is assured, there may be some justification for the imposition of a reasonable surcharge to cover the additional court litigation costs. If such access is not available to the public customer, however, then some remedial action would appear to be in order.⁸⁸

2. *Standard Agreement*

Quite apart from the voluntariness of executing a pre-dispute arbitration clause is the issue of the contents of such clauses.

Arbitration clauses should be entered into freely and their meaning expressed in plain open language. Recent incidents, however, point to the necessity of requiring some sort of basic safeguards or standardization.

For example, SICA has a six-year rule for the bringing of actions in arbitration.⁸⁹ A broker recently inserted a one-year statute of limitations clause in an arbitration clause.⁹⁰ Such a unilateral disregard

87. See *Protect Investors*, *supra* note 59, at 492-93.

88. Although that may not now be the case, particularly with respect to cash accounts, it is possible that through conscious parallelism in action such access may be denied someday. In that event, Congress should insist upon access without a pre-dispute arbitration clause, without prohibiting a reasonable surcharge for handling an account without the arbitration clause. Permitting the imposition of such a surcharge does not seem unreasonable in view of the fact that brokers' commissions and margin interest rates are already negotiable. On the other hand, if this litigation surcharge becomes excessive, Congress should entertain the imposition of a reasonable cap based upon cost differentials. It remains to be seen, however, whether competitive forces in the market would permit the imposition of such a two-tiered rate structure.

89. See Uniform Code of Arbitration, *supra* note 16, § 4.

90. See *Roney & Co. v. Goren*, 88 Civ. 72105DT (E.D. Mich. 1988). Moreover, it is worthy of note that the Third Circuit—in borrowing from the provisions of the 1934 Act—recently held that the proper limitations period for claims arising under § 10(b) or Rule 10b-5 is one year after the plaintiff discovers the facts constituting the violation, and in no event, more than three years after such violation. See *In re Data Access Systems Securities Litigation*, Nos. 87-5205/5385 (3d Cir. Mar. 8, 1988).

for the Uniform Code of Arbitration at the expense of an unsuspecting customer who "willingly" signed the agreement runs counter to the perception that the arbitration process is fair. Moreover, arbitration clauses often will use language that the law of a particular state will apply, such as New York. Although the clause seems innocent enough, it obscures the fact that New York law does not permit punitive damages in arbitration.⁹¹ In short, the arbitration clause should not become a trap for the unwary.⁹²

C. The Arbitration Panels

1. Classification of Arbitrators

The rules of arbitration and the forums that administer them must be fair and impartial to both sides; however, both are only as good as the arbitrators that serve. Moreover, it is axiomatic that those arbitrators must *be*, and *appear to be*, honest, competent and free of any conflict of interest.

The SICA Procedures Booklet provides that arbitrators are to be impartial persons who are knowledgeable in the areas in controversy.⁹³ Each sponsoring organization maintains a roster of individuals who are not employees of the sponsoring organization but whose professional qualifications and experience qualify them for service as arbitrators.⁹⁴ As a safeguard to public customers, the Uniform Code of Arbitration clearly provides that unless the public customer requests otherwise, the matter will be arbitrated by a panel "at least a majority of whom shall not be from the securities industry" (public arbi-

91. See *Garrity v. Lyle Stuart*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976). Whether the holding in *Garrity* remains valid today may be questioned in light of the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1982), and the Supreme Court's strong support for arbitration. See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985). See also *Bonar v. Dean Witter Reynolds, Inc.*, No. 87-3270 (11th Cir. Jan. 22, 1988). In any event, arbitration and court litigation should basically differ on procedural matters only, but not necessarily on the scope of relief granted. See Stipanowich, *Punitive Damages in Arbitration: Garrity v. Lyle Stuart, Inc. Reconsidered*, 65 B.U.L. REV. 953 (1986).

92. See PROCEDURES BOOKLET, *supra* note 18, at 3. Some sort of mutually agreeable standard arbitration clause should be achievable through the efforts of the SEC or the SROs. See also *supra* note 49 and accompanying text.

93. See PROCEDURES BOOKLET, *supra* note 18, at 3.

94. *Id.*

trators).⁹⁵ No further guidance, however, is given by the Code as to who qualifies to be a public arbitrator. Furthermore, only a slight clarification was provided by the original version of the Procedures Booklet, which described public arbitrators as "individuals who are neither associated with, nor employed by a broker-dealer or securities industry organization."⁹⁶

The Code and Procedures Booklet left several questions unanswered. For example, does the fact that someone was once associated with the securities industry disqualify him as a public arbitrator? Similar questions arose concerning the person who owns publicly traded stock of a brokerage house or who services clients in the securities industry, such as an attorney or a public accountant. Finally, would SICA disqualify an employee of a corporation that is not in the securities business but that is either a parent or subsidiary of a brokerage house? After much debate, SICA revised the Procedures Booklet by adding the following classification section:

Guidelines for the Classification of Persons as Public Arbitrators:

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.

Additional information concerning a particular arbitrator may be obtained by a party or the party's attorney upon request directed to the Director of Arbitration prior to the commencement of the hearing or a submission to the arbitrator without a hearing.⁹⁷

SICA purposely left the section governing classification of public arbitrators flexible so that the vast experience of many needed and qualified persons would not be lost. Nevertheless, the SEC has sug-

95. Uniform Code of Arbitration, *supra* note 16, § 8(a)(1), (2). It has recently been suggested that arbitration panels should consist *only* of public members. See *SIA, NASAA Split Over Fairness of Securities Arbitration Procedures*, Sec. Reg. & L. Rep. (BNA) No. 20, at 870 (June 10, 1988). Gluck, *Seeking 'Fairness' in Brokers' Disputes*, N.Y. Daily News, June 26, 1988, (Business), at 10, col. 1. Not only would this suggestion purge such panels of invaluable insight into the workings of the securities industry, but it would undoubtedly be perceived by that industry as stacking the deck against it. Indeed, if the industry loses faith in the feasibility of arbitration and succeeds in avoiding its use, it is suggested that the public will generally not be well served. See *supra* notes 65-66 and accompanying text.

96. PROCEDURES BOOKLET, *supra* note 18, at 3. The search for a "Diogenes" type of trier is hardly limited to arbitration. See Petzinger, *Celebrities of Texaco's Saga*, Wall St. J., Mar. 24, 1988, at 6, col. 1; *Wachtler Supports A Nonpartisan Vote To Re-elect Judges*, N.Y. Times, Mar. 6, 1988, at 56, col. 1.

97. See FIFTH REPORT, *supra* note 7, at 17.

gested a tighter definition of public arbitrator, with a view towards eliminating from that classification those with close affiliations with the securities industry. This dialogue with SICA is presently continuing. The New York Stock Exchange has already tightened its guidelines unilaterally;⁹⁸ and, it is suggested that they be adopted by all the SROs.

2. *Information on Arbitrators*

Moreover, section 11 of the Code requires arbitrators to disclose circumstances which might preclude them from rendering an objective and impartial determination. In addition, the Procedures Booklet provides that "[a]dditional information concerning a particular arbitrator may be obtained by a party or the party's attorney upon request directed to the Director of Arbitration prior to the commencement of the hearing or a submission to the arbitrator without

98. The latest New York Stock Exchange guidelines for arbitration provide:

In order to insure continued investor confidence in the arbitration process, the New York Stock Exchange has adopted the following policies with regard to the classification of securities industry and public arbitrators and to the exercise of challenges for cause:

1. Individuals with close securities industry ties such as attorneys, accountants or other professionals who routinely represent industry firms or individuals, will either be reclassified as industry arbitrators or not be used.
2. Individuals who have spent a substantial part of their business careers in the securities industry shall always be classified as industry arbitrators.
3. Individuals who have spent a relatively minor portion of their career in the securities industry shall not be classified as public arbitrators until at least five (5) years have elapsed from the date of their last industry affiliation. All such past affiliations shall be disclosed and challenges for cause based upon such past affiliations shall be sustained.
4. Close family relationships with broker/dealers shall be disclosed and challenges for cause based on such relationships shall be honored.
5. Attorneys, accountants and other professionals whose firms have close securities industry ties will still be classified as public arbitrators provided the attorney or other professional does not routinely represent industry firms or individuals. Challenges for cause based on such industry ties will be honored.
6. All arbitrators shall read and become familiar with the Code of Ethics for Arbitrators developed by the American Bar Association and the American Arbitration Association.
7. Any close question on arbitrator classification or on challenges for cause shall be decided in favor of public customers.
8. Spouses of securities industry personnel may not serve as arbitrators.

See SCHROPP, *supra* note 54, at 108; see also *Exchanges, SEC Staff Still Split Over Definition of 'Public' Arbitrator*, Sec. Reg. & L. Rep. (BNA) No. 20, at 100 (Jan. 22, 1988).

a hearing."⁹⁹ Nevertheless, the SEC has recommended that SICA be more specific as to the scope of such disclosure.¹⁰⁰ Accordingly, SICA is considering amending the Code to require detailed biographical information from each arbitrator, most of which will be available automatically to the parties when the arbitrators are appointed.¹⁰¹ This approach will help detect potential conflicts-of-interest initially, and aid in the participants' exercise of their preemptory challenges and those for cause.¹⁰²

3. *Training of Arbitrators*

Before the *McMahon* decision, the typical securities arbitration claim involved churning, unauthorized trading or unsuitability. After *McMahon*, arbitrators will more likely also be expected to handle 10(b) claims¹⁰³ and treble damage claims under RICO,¹⁰⁴ and rule on issues of discovery, document exchange,¹⁰⁵ and motions to preclude arbitration because of res judicata or collateral estoppel.¹⁰⁶ It is imperative, therefore, that arbitrators receive more extensive training. SICA feels, however, that educational training for arbitrators through seminars and periodic newsletters is generally better handled through the various SROs, and SICA encourages them to do so.¹⁰⁷ Nevertheless, SICA has undertaken to develop an arbitrators' manual to instruct arbitrators concerning their duties and responsibilities.¹⁰⁸

4. *Evaluation of Arbitrators*

There have been suggestions that arbitrators be evaluated on their performance.¹⁰⁹ Such evaluations have been done informally by SRO arbitration staffs for years. No one can question the usefulness of an evaluation process in retaining competent arbitrators, or in purging incompetent ones. On the other hand, it should be done in a dignified and professional manner by the arbitration staffs or the other ar-

99. PROCEDURES BOOKLET, *supra* note 18, at 3.

100. See SCHROPP, *supra* note 54, at 145.

101. See *id.* at 158.

102. See *id.* at 159.

103. See *supra* note 47 and accompanying text.

104. See *supra* notes 51-52 and accompanying text.

105. See *supra* notes 67-78 and accompanying text.

106. See *supra* notes 62-64 and accompanying text.

107. See SCHROPP, *supra* note 54, at 157.

108. See *id.*

109. See *id.* at 145.

bitrators. It should not turn into a popularity contest by parties, either jubilant or disgruntled by an award.¹¹⁰

In a similar vein, it has been suggested that a public voting record be kept on each arbitrator, *i.e.*, the type of case, the issues involved, the ruling and the dollar amount of the award. Presumably, the purpose of this is to assist the public in exercising challenges because laymen, or their counsel, are not as familiar with the habits of arbitrators as are the "in-house" staff of the industry who appear regularly before the arbitrators. Although this suggestion has some merit, it also has its drawbacks, for it can lead to a misleading impression, depending on the relative merits of each claim.¹¹¹ Moreover, the results may often be obscured by the process of consensus that often takes place in awards. Furthermore, to consciously identify an arbitrator as *pro*-public or *pro*-industry does a disservice to the ideal that all arbitrators, public or private, are neutral and decide only on the oral and written evidence. Finally, it is a disquieting thought that arbitrators—mindful that they have ruled one way or the other because of correct and valid reasons—would even consider, consciously or unconsciously, their prior rulings in deciding on the next close case in order to protect their "record resume."

In the final analysis the only true test of an arbitrator's mettle is to check the "record" of each proceeding he or she sat on, and not merely the final score. Admittedly, such a process is much more time consuming, but it is fairer and gives a truer reading.

5. Consideration for the Arbitrator

With the anticipated increase in numbers and complexities of arbitrations¹¹²—at a time when the classification of public arbitrators is narrowing¹¹³—the need for recruiting additional competent arbitrators is compelling.¹¹⁴ Similarly, attention should be given to retaining good arbitrators.¹¹⁵

110. *See id.* at 171.

111. If one arbitrator saw *ten* consecutive cases where there was clearly no valid claim, and another saw *ten* consecutive cases where there clearly was a claim, what would one expect their respective "paper" records to be? Would any respectable jurist want to be rated in this manner? *See, e.g., In Memoriam: Judge Edward Weinfeld Uniquely Served Both the Law and His Law School*, New York University School of Law Alumni Newsletter 1 (Spring 1988).

112. *See supra* note 53 and accompanying text.

113. *See supra* notes 93-98 and accompanying text.

114. *See* D. Lipton, Discovery Proceedings and the Selection and Training of Arbitrators: A Study of Securities Industry Practices 17-21 (undated) (unpublished manuscript) (available at *Fordham Urban Law Journal* office) [hereinafter Lipton Study].

115. *See id.*

Thus, in weighing many of the suggestions mentioned above regarding arbitration, the benefits should not only be weighed against any resultant additional cost and delay, but consideration should be given as to whether it discourages intelligent, honest and knowledgeable arbitrators from serving. In this regard, wasting their valuable time as a result of repeated adjournments is a frequent complaint; and, in this regard everyone bears some responsibility.

When a panel is appointed, arbitrators block out hearing dates on their calendars to the exclusion of other events. Accordingly, it is not fair to them to cancel these dates later for little or no reason. Because of this, judges dealing with attorneys appearing before them—but who have prior commitments elsewhere in securities arbitration hearings—must honor such prior arbitration commitments with the same degree of respect and concern as they would in dealing with attorneys with prior commitments before other judicial tribunals. In other words, arbitration hearings cannot be treated as second-class citizens to court proceedings. It is not fair to the parties, and it is not fair to the arbitrators.

Similarly, attorneys should not think of arbitration as a place where they can come and get an adjournment of hearings for little or no reason. It is difficult enough to stock the system with competent arbitrators without their having to lose two or three dates because of meaningless adjournments. You could not do it in court, and you should not be allowed to do it in arbitration. The issue of repeated adjournments is of great concern to SICA.¹¹⁶

Furthermore, the Uniform Code of Arbitration provides that unless requested by the arbitrators or a party or parties to a dispute, no record of the arbitration procedure need be kept.¹¹⁷ Certain SROs, however, have already provided for the preservation of a record of the proceeding.¹¹⁸ SICA has already proposed an amendment to the Code that would require that a record be kept in all proceedings.¹¹⁹ In any event, such a record should also be transcribed for the benefit of the arbitrators in a multi-session or complex arbitration which spans an extended period of time.¹²⁰

116. The Uniform Code of Arbitration, *supra* note 16, requires that "a party requesting an adjournment after arbitrators have been appointed, if said adjournment is granted, shall pay a fee equal to the deposit of costs but not more than \$100." *Id.* § 18(b). Perhaps the time has come to increase this fine, at least after the first adjournment.

117. See Uniform Code of Arbitration, *supra* note 16, § 25.

118. See SCHROPP, *supra* note 54, at 159.

119. See *id.*

120. See *id.* at 171 ("[i]t is unrealistic to expect that the details and minutiae

D. Written Opinions

Still another topic recently discussed at SICA is whether to require arbitrators to render mandatory written opinions with findings of fact and conclusions of law.¹²¹ There are obvious advantages to such a suggestion, in that: (1) it gives insight into the reasons for the award; and (2) it may also help the claimants' bar in familiarizing itself with the views of the various arbitrators in exercising peremptory challenges.¹²² Upon closer analysis, however, such benefits may be outweighed by the negative implications of requiring such opinions.

First of all, such opinions would not necessarily be binding on, or of any precedential value to, other arbitration panels. They would often be written by laymen¹²³ inexperienced in expressing themselves in legal terms. The opinions would have to deal with claims that are often vague, loosely put together, and not always clearly set forth. Requiring such opinions might discourage many fine arbitrators, who are usually busy, successful people who basically serve at nominal cost, from serving.

Requiring written opinions would certainly slow down the rendering of awards; for, awards are often the basis of consensus. For example, suppose there are three arbitrators, A, B & C, and they found

of testimony will be retained over any protracted period. Notes taken in multi-session hearings are generally insufficient for that purpose. Moreover, consideration should be given to also providing such copies to the parties at a nominal cost").

121. *See id.* at 148.

122. It is submitted that much of this information could alternatively be obtained through the use of Award Reporting Services. For example, *The New York Jury Verdict Reporter* publishes pertinent data about jury verdicts in the New York courts. Indeed, in "a number of large cit[ies], claimants' attorneys have already developed dossier information about arbitrators who sit with regularity." Lipton Study, *supra* note 114, at 16-17. *See also SROs Nearing Agreement on Using Summary Arbitration Award*, Sec. Reg. & L. Rep. (BNA) No. 20, at 795 (May 27, 1982); J. Cahill, *Investors Seek Court of Last Resort*, N.Y. Daily News, June 5, 1988, (Business), at 13, col. 1; N.Y. Times, June 5, 1988, § 3 (Business), at 12, col. 3. SICA, at the instance of the SEC, is considering a mandatory one-page award statement prepared by the arbitrators which would disclose: (1) the name of the arbitration case; (2) a one-paragraph summary of the dispute; (3) damages or other relief requested; (4) damages or other relief awarded; (5) a summary of the issues involved and resolved; and, (6) the names of the arbitrators. *Id.* Since such award statement is to be prepared by the arbitrators, and in a complex case could well exceed the one-page format, this procedure could result in *de facto* written opinions. Such opinions have their advantages, but must be measured in terms of the overall effect on and cost of arbitration. *See infra* notes 123-25 and accompanying text.

123. Although it would appear that the majority of public arbitrators in the SRO pools are attorneys, the overwhelming number of industry arbitrators are not. *See Lipton Study, supra* note 114, at 17.

damages of \$10,000, \$20,000 and \$30,000, respectively. Suppose they ultimately agree on a \$20,000 award. When they write the opinion, however, A bases his award on unsuitability, B on churning and C on unauthorized trading. Can A, B and C issue an award for \$20,000, even though they cannot agree on the reasons? Moreover, would they?

Nor would written opinions necessarily enhance the cause of fairness. Indeed, in some instances mandatory opinions might even result in fewer awards in favor of claimants on general equity grounds.¹²⁴ It would also put additional pressure on the already strained staffs of the administering forum, while drafts of written opinions would be circulated and recirculated among the various arbitrators for corrections, redrafts and finalization.

Furthermore, arbitrators would have to be compensated for the additional time required to render such opinions. Indeed, it is respectfully submitted that instead of being used as the window into the rationale of arbitrators, a written opinion will be used as a platform and blueprint for many more appeals, because it identifies targets, meaningful or otherwise, for the losing party to attack. Appeals are both costly and time consuming.¹²⁵

Thus, looking at the totality of it, requiring written opinions of fact and law by arbitration panels—many of whom are not lawyers—would add delay and cost to arbitration without greatly enhancing or improving its operations. On the other hand, awards should clearly state the result, *e.g.*, if it includes relief for punitive damages or a RICO claim, it should state this separately.

E. Independence of Forum

Even if we could all agree that we could forge rules of arbitration that are fair, and even if we could oversee and ensure that their implementation was fair, we are still faced with the nagging complaint that we may be “compelling an investor to arbitrate securities claims . . . in a forum controlled by the securities industry.”¹²⁶ In other

124. Often, even though no specific violation occurred, arbitrators will render an award in favor of the claimant on general equity considerations. It is respectfully suggested that if such awards had to be reduced to writing, many of those so called equity awards would evaporate.

125. Appeals were considered by SICA and rejected as too costly and time consuming. *See Katsoris II, supra* note 45, at 290-91.

126. *Shearson/American Express v. McMahon*, 107 S. Ct. 2332, 2355 (1987) (Blackmun, J., dissenting). The uniform opposition of investors to compel arbitration and the overwhelming support of the securities industry for the process suggests

words, how can you convince the public that they are not facing a "stacked deck"?¹²⁷

In over fifteen years of sitting as a public arbitrator, it has been this author's experience that the securities arbitration procedures have, to date, resulted in an overall good faith effort to provide fair resolution of public securities disputes. Nevertheless, the image of a "stacked deck" will never be totally eliminated merely by improving the rules or the arbitrators. "[J]ustice should not only be done, but should manifestly and undoubtedly be seen to be done."¹²⁸ The only permanent solution to any lingering allegation is to remove securities arbitrations from the SROs themselves to a totally independent forum,¹²⁹ jointly governed by members of the public¹³⁰ and the securities industry.¹³¹ Such a concept was considered by SICA *before McMahon*.¹³² Indeed, the public members of SICA continue to express the opinion that such a separate forum should be established.¹³³ Moreover, it is submitted that such separate forum remain under the oversight authority of the SEC.¹³⁴

A separate independent forum means just that—independent from actual, inferential, subtle, practical or any other kind of imaginable

that there must be some truth to the investors' belief that the securities industry has an advantage in a forum under its own control. See Glaberson, *When The Investor Has A Gripe*, N.Y. Times, Mar. 29, 1987, § 3 (Business), at 8, col. 1 ("[t]he houses basically like the present system because they own the stacked deck") [hereinafter Glaberson].

127. Glaberson, *supra* note 126, at 8, col. 1.

128. Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 64 Cal. App. 3d 899, 903, 135 Cal. Rptr. 26, 28 (1976) (quoting King v. Sussex Justices, (1924) 1 K.B. 256, 259).

129. An analogous concept has proved workable in the accounting field. In fact, since 1977, some of the trustees of the Financial Accounting Foundation (FAF) have been selected by electors outside the accounting profession. See FINANCIAL ACCOUNTING STANDARDS BOARD, STATUS REPORT No. 68, at 2 (June 21, 1978). The FAF appoints, oversees and finances the Financial Accounting Standards Board (FASB), which is responsible for formulating the rules by which companies account and report their financial condition. *Id.* at 1-2; see HORNGREN, INTRODUCTION TO FINANCIAL ACCOUNTING 57-58 (2d ed. 1984).

130. The litmus test for such public member should be as stringent as that for a public arbitrator. See *supra* note 98 and accompanying text.

131. These public and industry representatives should have total responsibility for the appointment of arbitrators and the governance of the arbitration forums. Indeed, the SEC has expressed its concern regarding possible public apprehension over the impartiality of officials associated with SROs. See *Investor Dispute System*, *supra* note 12, ¶ 81,136, at 87,906.

132. See SCHROPP, *supra* note 54, at 172.

133. See *id.*

134. Such oversight authority by the SEC over the new forum might require congressional approval.

pressure. The forum should be independent of the industry, independent of the plaintiffs' bar, and, to some extent, independent of the SEC, other than in its general oversight role.¹³⁵ Its staff must also be independent from such influences. It must be a system that encourages career staff retention rather than staff turnover. Furthermore, arbitrators must also be free from such influences or pressures; otherwise, getting the necessary complement of competent independent arbitrators to serve with regularity will be extremely difficult, if not impossible to achieve.

It is doubtful whether an independent forum would increase the overall cost of arbitration. In fact, in the long run, it might even be more cost efficient than the aggregate costs of all of the various SROs. In any event, even a rise in cost could easily be funded by a small mandatory surcharge imposed upon each securities transaction. Moreover, the cost is negligible in view of the alternatives—namely mistrust of arbitration, endless debate and the ultimate flooding of the courts with securities disputes.¹³⁶

Ideally, such a new forum should provide for widely dispersed, permanent hearing locations.¹³⁷ Arbitrator pools should be merged.¹³⁸ Experienced staff personnel at the SROs could help restaff the in-

135. An independent forum will also help insulate an SRO from any potential conflicts of interests that might arise from the fact that the SRO supplies the arbitration forum. For example, does the arbitration department of an SRO have any "duty" to reveal to the enforcement and disciplinary branch of the same SRO any potential improprieties it discovers during the arbitration? Moreover, to what extent is an SRO vulnerable to SEC inquiry concerning the details of a particular arbitration proceeding specifically, or arbitration proceedings generally? In other words, the arbitration process cannot be turned into an extension of those charged with investigatory, enforcement or disciplinary responsibilities. This does not mean, of course, that the parties themselves could not refer improprieties to such other bodies. Indeed, SICA intends to add to its Procedures Booklet a statement that investors involved in disputes with a broker-dealer may draw regulatory attention to their allegations. See SCHROPP, *supra* note 54, at 163. Moreover, SICA intends to include in the newly proposed Arbitrators Manual a statement advising the arbitrators that they "may" refer a matter to the disciplinary authorities of an SRO if they find that the conduct of a broker-dealer is "particularly egregious." *Id.* (emphasis added).

136. See Katsoris II, *supra* note 45, at 312. Nor should the fact be ignored that the industry saves significant operating expenses by handling customer disputes through arbitration rather than court litigation.

137. While both the NYSE and NASD conduct arbitration hearings virtually around the country, their administration activities are more centrally located in New York. The NASD also has offices in Chicago and San Francisco. See Lipton Study, *supra* note 114, at 5.

138. Most SROs presently keep their own lists of arbitrators. See PROCEDURES BOOKLET, *supra* note 18, at 3.

dependent forum. The important thing is that the forum be governed by an independent management. It is only such structurally independent governance that should forever still any inferences of a "stacked deck."¹³⁹

Whether as a practical matter a separate independent forum will ever fly, only time will tell; but, it should be examined thoroughly. In the meantime, there should be some consolidation among the SRO arbitration forums. The SROs should immediately address this issue of perception by placing a meaningful number of public members on their arbitration committees that "oversee" their arbitration forums. Moreover, their budgets should be enlarged to meet the expanding needs of arbitration due to the anticipated increase in the numbers and complexity of cases as a result of the *McMahon* decision. The system will be tested in the years ahead, and it must be prepared to cope with it, if arbitration, as we know it, is to survive; and, survive it must in order to offer securities litigants a viable alternative to courtroom congestion and delay.

VI. Conclusion

After the events of October 19, 1987,¹⁴⁰ many individual investors—so essential to the health of our securities markets¹⁴¹—have lost faith in the markets.¹⁴² Rebuilding that faith will take time and much effort. Essential to the rebuilding of such confidence is the assurance that if a customer has a justifiable grievance against his broker, the controversy will be resolved fairly, yet swiftly, cheaply and with finality.¹⁴³ The only mechanism that can provide that relief is ar-

139. See *supra* notes 126-27 and accompanying text.

140. See Shell, *Arbitration After the Crash*, Nat'l L.J., Mar. 21, 1988, at 13, col. 1.

141. See Katsoris, *In Defense of Capital Gains*, 42 FORDHAM L. REV. 1 (1973).

142. "Forty percent of small investors have left the market since Oct. 19 . . . [a]nd it is becoming clear that the individual investors will not return to the market if they do not perceive that they are treated fairly." Nash, *supra* note 60, at A20, col. 1; Wallace, *The Death of Investor Confidence*, N.Y. Times, May 15, 1988, § 3 (Business), at 1, col. 3; Gottschalk, *Gloom Pervades Investment Conferences As Talk Turns to Crashes and Tulip Bulbs*, Wall St. J., Apr. 22, 1988, at 35, col. 4.

143. See Statement of Constantine N. Katsoris before the Securities & Exchange Commission (Dec. 8, 1977) ("[t]o insure . . . public investment we must retain the public's confidence—confidence in the markets themselves and confidence that should a dispute arise, it will be fairly resolved. This confidence, however, can only be earned by maintaining a de facto as well as a de jure image of fairness. In other words, the procedural rules must be fair and the administration of the forum must be objective and independent; [moreover] such administration should include public representation") (available at *Fordham Urban Law Journal* office).

bitration. Certainly dumping thousands of cases back to the courts is not the answer.¹⁴⁴

The *McMahon* decision gives arbitration the opportunity to make necessary adjustments that will insure that it will be *freely* chosen as the principal means of settling securities disputes. The opportunity, however, must not be wasted by populist, expedient or short term approaches which would strip arbitration of its chief attributes—speed and economy. Arbitration can be fair and still not made a clone of court litigation and procedures.

The *McMahon* momentum must be used to forge a forum that is equally fair to both claimants and respondents. If we fail, neither side will be the winner. The industry will be plagued by excessive litigation costs that, directly or indirectly, will be borne by the public; and, the public will often be denied justice by the costs and delays of court litigation.

To achieve this goal of an arbitration procedure that is practical and fair for all, many of the procedural and mechanical changes suggested above will have to be considered—with some being adopted and some rejected. In this regard, reasonable people can differ. SICA, with all its shortcomings,¹⁴⁵ has been a constructive voice in this dialogue and should continue to independently discuss, amend and monitor the Uniform Code of Arbitration.

Finally, a separate and independent forum should be established to handle securities disputes under the general regulatory authority of the SEC. It is only by establishing such independence that the whispers of “*favoritism*” will be stilled, once and for all.

144. See *supra* note 53 and accompanying text.

145. See *supra* note 55 and accompanying text.

