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On the Continued Vitality of Securities Arbitration: Why Reform Efforts Must Not Preclude Predispute Arbitration Clauses

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I. INTRODUCTION

It is the rare case when a court will review an arbitration decision, let alone vacate an award. However, this is exactly what happened on April 22, 2008 in *Barclays Capital Inc. v. Shen*.[1] The issue before the New York trial court was whether the National Association of Securities Dealers ("NASD") arbitrators awarded the defendant punitive damages in manifest disregard of the law.[2] In vacating the award in part, the court held that both prongs of the "manifest disregard doctrine" had been satisfied because the petitioner demonstrated that: "(1) the arbitrator's [sic] knew of a governing legal principle, yet refused to apply it or ignored it altogether *and* (2) that the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case."[3] The petitioners in this case overcame the almost insurmountable burden that generally gives full deference to an arbitrator's decision and award.[4]

What this case highlights is that there are serious problems inherent within the securities arbitration industry. The system has been accused of being unfair, biased, and utterly opaque.[5] These accusations resonate even more loudly during a time when investors have many legitimate reasons to question the integrity of the United States marketplace and its self-regulated system of dispute resolution.[6] From a policy standpoint, these

1. Barclays Capital Inc. v. Shen, 857 N.Y.S.2d 873 (N.Y. Sup. Ct., 2008).

2. *Id.* Barclays alleged that the NASD arbitrators were aware of and disregarded the holding of *Rosenberg v. MetLife, Inc.*, which precludes any monetary damages (including punitive damages) for defamatory statements in U-5 filings concerning terminated employees. *Id.*; *see also* Rosenberg v. MetLife, Inc., 8 N.Y.3d 359 (2007).

3. *Barclays*, 857 N.Y.S.2d at 875 (citing Wallace v. Buttar, 378 F.3d 182 (2d Cir. 2004)). Of note here is the United States Supreme Court's recent decision in *Hall Street Associates v. Mattel, Inc.*, which directly addresses the "manifest disregard of the law" standard as a continuing means for vacating an arbitration decision. 552 U.S. 576 (2008). The majority opinion held that the Federal Arbitration Act provides the sole statutory grounds for vacatur. *Id.* at 578. The defendants in the case pointed out that the "manifest disregard" standard, widely used by courts in reviewing arbitration decisions, is not among the statutory grounds for vacatur. *Id.* at 584. While not explicitly upholding the continuing vitality of the "manifest disregard" standard, the Court suggested where it may fit into the existing statutory framework. It reasoned:

> Maybe the term "manifest disregard" was meant to name a new ground for review, but maybe it merely referred to the § 10 grounds collectively, rather than adding to them. Or, as some courts have thought, "manifest disregard" may have been shorthand for § 10(a)(3) or § 10(a)(4), the subsections authorizing vacatur when the arbitrators were "guilty of misconduct" or "exceeded their powers."

Id. at 585.

4. *Id.* at 583–87; *see also* J. Kirkland Grant, Securities Arbitration for Brokers, Attorneys, and Investors 51–66 (1994).

5. Jill I. Gross, *McMahon Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. Cin. L. Rev. 493, 497–98 (2008).

6. Press Release, FINRA, New National Survey Shows Widespread Anxiety Among American Investors (News Release) (Aug. 30, 2007), *available at* http://www.finra.org/Newsroom/NewsReleases/2007/P036658. Recent years have seen high-profile accounting frauds associated with the Enron and WorldCom scandals. More recently, investors have seen the sub-prime mortgage crisis and the ensuing credit crunch that led to the downfall of long-standing institutions Bear Stearns, Lehman Brothers, Merrill Lynch, and Washington Mutual and the government-backed bailout of AIG, Fannie Mae, and

accusations are juxtaposed against a regulatory system that was designed to protect investors and to promote market transparency and integrity.[7] Although the marketplace has changed over the decades, these remain important goals of the securities laws.[8]

Today, the operation and regulation of the U.S. markets are even more important to the general public because of the average investor's increased access to the markets via online brokerage firms such as E*TRADE and mutual funds.[9] Accordingly, investor protection has been thrust into the spotlight.[10] As a general matter, investors benefit from Securities and Exchange Commission ("SEC") mandated disclosures because such rules and regulations create transparency in the marketplace for debt and equity instruments and other investment vehicles.[11] However, when investments take a turn for the worse and small investors seek to bring actions against the industry professionals who allegedly caused them harm, the SEC has ironically taken a "hands-off" approach to the arbitration system run by securities-industry insiders.[12] Given the current economic state, investors justifiably feel threatened.[13] Nearly every investor who opens an account with a brokerage firm must sign a standard form agreement that compels the investor to submit to mandatory arbitration in lieu of a jury trial should a dispute arise.[14] The increasing popularity of mandatory arbitration following the Supreme Court's seminal decision in *Shearson/American Express, Inc. v.*

Freddie Mac. Nelson D. Schwartz, *But What of the Small Investor?*, N.Y. Times, Apr. 30, 2008, at BU2; David Goldman, *Your $3 Trillion Bailout*, CnnMoney.com, Nov. 5, 2008, http://money.cnn.com/2008/11/05/news/economy/three_trillion_dollar_bailout.

7. The Securities Act of 1933 and the Securities Exchange Act of 1934 were passed in large response to the 1929 collapse of the stock market. In large part, the crash was due to speculation on the part of investors who had relatively little information about the securities in which they were investing. Therefore, when Congress set out to reform the securities markets, disclosure to investors and market transparency became the underlying policy goals. Donna M. Nagy, Richard W. Painter & Margaret V. Sachs, Securities Litigation and Enforcement 2–3 (2d ed. 2008) [hereinafter Nagy].

8. SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, http://www.sec.gov/about/whatwedo.shtml (last visited Feb. 26, 2010) ("The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.").

9. *Id.* ("As more and more first-time investors turn to the markets to help secure their futures, pay for homes, and send children to college, our investor protection mission is more compelling than ever.").

10. *Id.*

11. *Id.*

12. Stephen J. Ware, *What Makes Securities Arbitration Different from Other Consumer and Employment Arbitration?*, 76 U. Cin. L. Rev. 447, 448–49 (2008) ("The Exchange Act also requires broker-dealers to register with, and submit to the rules of, a self regulatory organization (SRO) as a condition of doing business. The SEC has authority to regulate broker-dealers, but the bulk of the day-to-day regulation of broker-dealers is generally delegated to the SROs by the SEC."). In fact, the SROs place an affirmative, non-contractual duty on the broker-dealers to arbitrate; only investors have the choice of forum if they are indeed able to negotiate out of a standard predispute arbitration clause. *Id.* at 452.

13. *See* FINRA, *supra* note 6.

14. *No Ban on Brokerage Arbitration Pacts*, Chi. Trib., July 10, 1988 at BU11; *see also* Mark J. Astarita, Esq., *Securities Laws—Avoiding Customer Disputes*, http://www.seclaw.com/avdisp.htm (last visited Feb. 26, 2010).

McMahon[15] has given rise to a perceived pro-industry, anti-investor bias.[16] Although arbitration is more often than not an effective and fair means of dispute resolution, when injured investors are most in need of SEC-enforced protections, which encourage proper disclosure, they are instead met with an arbitration process that can appear to be the very antithesis of transparent.

In response to the growing concern of investors and various activist groups and organizations, Congress has taken note of the problems with current mandatory arbitration provisions.[17] Two main pieces of legislation have found their way onto the Congressional floor: the Fair Arbitration Act of 2007[18] ("Fair Arbitration Act") and the Arbitration Fairness Act of 2009[19] ("Arbitration Fairness Act" or "AFA"). While the former seeks to keep the current system intact by enacting major reform efforts from the inside, the latter goes so far as to render unenforceable all predispute arbitration agreements.[20] This note argues that arbitration is a viable and necessary component of the United States' securities system and, as such, the Arbitration Fairness Act goes too far. Instead, Congress must legislate reform efforts within the existing structure to afford meaningful due process to investors unlawfully harmed by industry insiders.

Part II of this note explores the rising popularity of arbitration within the American legal system and the current policy of mandatory arbitration in the securities industry. Part III examines the Arbitration Fairness Act through the lens of basic contract law and argues that the legislation goes too far in overhauling the system by barring commercial entities from enforcing mandatory arbitration provisions. Part IV explores more effective means of reforming securities arbitration and proposes a new approach.

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15. 482 U.S. 220 (1987).

16. *See* Nagy, *supra* note 7, at 982.

17. For example, at the Arbitration Fairness Act committee hearing in the House of Representatives, the Public Citizen's Congress Watch Division, a Coffee Beanery franchise owner, and several plaintiffs' lawyers testified as to the concerns of investors regarding mandatory arbitration. *Hearing on H.R. 3010, the "Arbitration Fairness Act of 2007" Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 110th Cong. (2007) [hereinafter *H.R. 3010 Hearing*] (statements of Laura MacCleery, Director, Public Citizen's Congress Watch Division; Deborah Williams, Owner, Coffee Beanery Franchise; Theodore G. Eppenstein, Esq., Partner, Eppenstein and Eppenstein). This note will rely on the committee testimony stemming from the 2007 bill since committee hearings have not yet taken place for the 2009 bill, as discussed *infra*.

18. Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007). The sponsor of this bill, Republican senator Jeff Sessions, also introduced a similar bill in 2002 called the Arbitration Fairness Act of 2002. Arbitration Fairness Act of 2002, S. 2026, 107th Cong. (2002). Because the subject of this note concerns the Arbitration Fairness Acts of 2007 and 2009, the Arbitration Fairness Act of 2002 will not be discussed, so as not to confuse the reader with the similarity of name.

19. Arbitration Fairness Act of 2009, S. 931, 111th Cong. (2009). The Arbitration Fairness Act was originally introduced in 2007 under similar language. This note will discuss the 2007 version and the 2009 version together for general purposes of discussing their proposed effect on the viability of predispute arbitration clauses. It will distinguish between the two Acts as is necessary to distinguish the additional proposals included within the 2009 version.

20. *See id.*; *see also supra* note 17.

This note concludes that effectuating reform from within the existing structure can better ensure meaningful due process to injured investors.

II. SECURITIES ARBITRATION IN THE UNITED STATES

A. Arbitration in the United States Judicial System

Alternative dispute resolution ("ADR") is not a novel process.[21] Civilizations as far back as the ancient Greeks and Romans sought to resolve disputes through trade groups or guilds rather than by turning to the courts for formalized proceedings.[22] This early means of dispute resolution was successful, in part, because the particularized groups themselves were governed by informal codes and systems of group or professional norms.[23] People within a specific group, as insiders, were familiar with the norms of their industry and shared "community values."[24] Thus, early arbitrators applied the specialized rules governing a particular trade group to the respective community and were not expected to follow any sort of per se legal precedent.[25] Furthermore, arbitration was intended to resolve disputes among industry insiders; it was not "a suitable model for a dispute resolution system for non-industry members to vindicate statutory rights."[26]

In the United States, arbitration traces its roots back to the colonial times when it was primarily used as a means of dispute resolution within commercial communities.[27] Like other early forms of arbitration, arbitrators were members of a particular industry and used industry-specific norms from their own commercial community to resolve disputes.[28] As such, arbitration existed outside of, and often times in tension with, the American legal system.[29]

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21. The New York State Unified Court System defines alternative dispute resolution as including "mediation, arbitration and other ways of resolving conflicts with the help of a specially trained neutral third party without the need for a formal trial or hearing." New York State Unified Court System, ADR, http://www.courts.state.ny.us/ip/adr/What_Is_ADR.shtml (last visited Feb. 26, 2010).

22. Katherine V.W. Stone, *Arbitration—National*, *in* 1 Encyclopedia of Law & Society: American and Global Perspectives 88–92 (David S. Clark ed., 2007), *available at* http://ssrn.com/abstract=781204.

23. *Id.*

24. Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration,* 84 N.C. L. Rev. 123, 125 (2005); *see also* Edward Brunet and Jennifer J. Johnson, *Substantive Fairness in Securities Arbitration*, 76 U. Cin. L. Rev. 459, 460 (2008).

25. *See* Johnson, *supra* note 24, at 125.

26. *Id.*

27. Stone, *supra* note 22, at 3.

28. *Id.*

29. *Id.* This legal tension was embodied in the early common law rule of revocability. During this time, courts did not give legal significance to arbitration agreements because it was said that "agreements to arbitrate were revocable by either party until the arbitral award was rendered." *Id.* at 3. This meant that if either party wished to bring a legal suit instead of submitting to arbitration, no court would compel the arbitration, despite any existing contract compelling the arbitration. *Id.* at 3–4.

However, the turn of the twentieth century saw a rise in commercial activity, and commercial lawyers saw the need for legal acceptance of arbitration as an essential means of speedy resolution of commercial disputes.[30] New York State was at the forefront of this campaign.[31] In 1920, the New York State Legislature passed the New York Arbitration Act, which made arbitration agreements "valid, irrevocable, and enforceable save on such grounds as exist at Law or in Equity for the revocation of any contract."[32] Following subsequent United States congressional hearings and debate, Congress adopted into law the United States Arbitration Act, a statute reflecting the language and underlying policy considerations of the New York statute.[33] From its conception, American commercial arbitration has reflected the business community's need to have a fast, industry-driven means of dispute resolution that operates alongside, and with due respect from, the judicial system.[34] Modern ADR models have continued to evolve and now exist as wide-scale mediation centers and arbitration associations that serve the particularized necessities of a fast-paced society.[35]

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30. *Id.* at 4.

31. *Id.*

32. *Id.* This Act is still in force, and is codified in Article 75 of the Civil Practice Law and Rules. N.Y. C.P.L.R. §§ 7501–7514 (McKinney 1998).

33. Stone, *supra* note 22, at 4. Congress debated and considered the Illinois approach, which rejected enforcement of predispute arbitration clauses but permitted enforcement of arbitration agreements that were made between parties following a dispute. *Id.*

34. *Id.* at 4–5.

35. "The American Arbitration Association was founded in 1926, following enactment of the Federal Arbitration Act, with the specific goal of helping to implement arbitration as an out-of-court solution to resolving disputes. This legal framework was passed by Congress and signed by President Calvin Coolidge." American Arbitration Association, AAA Mission and Principles, http://www.adr.org/aaa_mission (last visited Mar. 17, 2010). "The AAA's staff members and neutrals continue to live out the principles on which the Association was founded." *Id.* Current leading arbitration mediation institutions include: the American Arbitration Association, the National Arbitration Forum, and JAMS. *See, e.g.*, American Arbitration Association, http://www.adr.org (last visited Feb. 26, 2010); National Arbitration Forum, http://www.adrforum.com (last visited Feb. 26, 2010); JAMS Alternative Dispute Resolution, http://www.jamsadr.com (last visited Feb. 26, 2010). One argument against arbitration is that it is flawed because inexperienced investors and sophisticated businessmen are not members of the same community, as was the case in early arbitration models. However, Congress made the conscious policy decision to expand from this model when it adopted the United States Arbitration Act (now Federal Arbitration Act) and developed a model of arbitration that is given independent legal significance through legal oversight. *See* Stone, *supra* note 22, at 4. This model of legal oversight exists in various forms throughout the greater business community. For example, lawyers practicing before the SEC are bound by the rules of the respective national securities exchange, which is in turn subject to SEC oversight. Securities Exchange Act of 1934 § 6(b)(1), 15 U.S.C. § 78f (2006). Broker dealers must register with the SEC. Securities Exchange Act of 1934 § 15(a)(1), 15 U.S.C. § 78e (2006). Furthermore, individual registered representatives of a broker dealer are required to pass certification tests such as the General Securities Representative Exam ("Series 7") and the Uniform Securities Agent State Law Examination ("Series 63"). FINRA, Inc., FINRA Registration and Examination Requirements, http://www.finra.org/RegistrationQualifications/BrokerGuidanceResponsibility/Qualifications/p011051 (last visited Feb. 26, 2010).

B. Arbitration within the Securities Context

1. Regulatory Bodies

Arbitration of claims within the securities industry dates back to 1845 at the New York Stock Exchange ("NYSE").[36] Throughout the modern era, most disputes have been arbitrated by the National Association of Securities Dealers ("NASD") following "standard form-pad customer and employment agreements."[37] An industry-wide set of rules, however, was not a feature of the various self-regulatory organizations ("SRO") until the mid-1970s. The impetus came in 1975 when congressional amendments to the securities laws gave the SEC oversight of SRO securities arbitration.[38] In June 1976, the SEC solicited comments regarding the creation of a "uniform system of dispute grievance procedures for the adjudication of small claims."[39] Afterward, in April 1977, the Securities Industry Conference on Arbitration ("SICA") was established to develop such a system of rules.[40] The uniform code produced by SICA was largely adopted by industry SROs from 1979–1980.[41] A major change, however, hit the securities industry in July 2007 when the SEC consolidated SRO oversight of the exchanges to the Financial Industry Regulatory Authority ("FINRA"), a combined organization merging the former-NASD and the regulatory arm of the NYSE.[42] This merger was meant to increase investor confidence and to improve market stability by centralizing oversight into one board with a consolidated set of rules.[43] Today, most securities arbitration takes place through FINRA under a uniform, industry-wide, and SEC-regulated set of rules.[44]

2. Judicial Treatment of Securities Arbitration

Arbitration was given particular legal significance in 1925 when Congress passed the Federal Arbitration Act ("FAA").[45] The Act as a whole requires courts to enforce

36. Johnson, *supra* note 24, at 136.

37. Grant, *supra*, note 4, at 94.

38. *Id.* at 143.

39. Constantine N. Katsoris, *Roadmap to Securities ADR*, 11 Fordham Jour. of Corp. and Fin. L. 413, 420 (2006).

40. *Id.*

41. *Id.* at 422.

42. Press Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority – FINRA (News Release) (July 30, 2007), *available at* http://www.finra.org/Newsroom/NewsReleases/2007/P036329.

43. *Id.*

44. FINRA – Overview, http://www.finra.org/ArbitrationMediation/AboutFINRADR/Overview/index.htm (last visited Feb. 26, 2010) ("Today, FINRA is known as the largest and most effective dispute resolution forum in the securities industry—handling virtually all such arbitrations and mediations in the United States."). Additionally, FINRA rules are subject to SEC oversight and approval. *Id.*

45. Federal Arbitration Act, 9 U.S.C. § 2 (2006); *see also* Johnson, *supra* note 24, at 127.

arbitration agreements just as they enforce other contractual provisions.[46] In particular, section 2 of the FAA provides that predispute arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[47] Initially, the Supreme Court was skeptical of predispute arbitration clauses as applied to the "investor-protective provisions" of the Securities Act of 1933.[48] The first case where the Court was asked to interpret congressional intent regarding securities laws and arbitration came in 1953 with *Wilko v. Swan*.[49] There, the Court expressed doubt regarding the existing arbitration procedures within the securities industry and held that notwithstanding the FAA, the Securities Act reflected a congressional intent favoring judicial enforcement of the statutory investor protections.[50] However, subsequent decisions incrementally narrowed the *Wilko* exception to the FAA, eventually overruling it.[51] Thus, the Court's early interpretations of congressional intent behind securities laws with respect to arbitration clauses were quite protective of the judiciary; however, following *Wilko* and its progeny, the Court departed from this protectionist trend and found that arbitration was suitable, if not preferable, for other federally created investor causes of action.[52]

In the seminal case of *Shearson/American Express, Inc. v. McMahon*, the Supreme Court upheld a predispute arbitration agreement in an action arising under the Securities Exchange Act.[53] In effect, this decision changed the judicial course to one that embraced a "new pro-arbitration philosophy."[54] The *McMahon* majority held that claims arising under section 10(b) of the Securities Exchange Act were arbitrable

46. 9 U.S.C. § 2.

47. *Id*. This language is adopted from the language enacted by the New York State Legislature in the New York Arbitration Act. *Supra* notes 32–33. *See also* Scherk v. Alberto-Culver Co., 417 U.S. 506, 510–11 (1974) (quoting H.R. Rep. No. 96, at 1–2 (1924)) ("The Act was intended to 'revers[e] centuries of judicial hostility to arbitration agreements,' to allow parties to avoid 'the costliness and delays of litigation,' and to place arbitration agreements 'upon the same footing as other contracts.'").

48. Grant, *supra* note 4, at 113.

49. 346 U.S. 427 (1953).

50. *Id*. at 438 (holding a predispute agreement to arbitrate unenforceable, notwithstanding contrary authority in the FAA, since the agreement was found to have violated pubic policy); *see also* Johnson, *supra* note 24, at 127–28.

51. Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 481 (1989) (overruling *Wilko*); *see also Scherk*, 417 U.S. at 519–20 (holding an arbitration clause enforceable in the context of an international agreement notwithstanding the fact that the claim was brought as a violation of section 10(b) of the Securities Exchange Act); Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) (holding that an antitrust dispute brought under the Sherman Act was arbitrable under the Federal Arbitration Act).

52. Grant, *supra* note 4, at 117.

53. *McMahon*, 482 U.S. at 238.

54. Johnson, *supra* note 24, at 128; *see also McMahon*, 482 U.S. at 238 (concluding that Congress did not intend section 29(a) of the Exchange Act to bar enforcement of all predispute arbitration agreements and thus holding McMahons' agreements to arbitrate enforceable).

under predispute arbitration agreements.[55] The Court further refined judicial acceptance of arbitration in *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*[56] The Court examined the public policy considerations underlying the *Wilko* decision, finding that the cardinal fear of the *Wilko* Court had been that "[e]ven though the provisions of the Securities Act apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings."[57] Justice Kennedy's majority opinion for the *Rodriguez* Court held that this suspicion—that arbitration weakens the protections of substantive securities laws to putative plaintiffs—was "out of step" with contemporary favor for arbitration as a method of dispute resolution.[58] Given the modern proliferation of organized arbitration forums and the significant oversight and rules governing arbitration procedure, today's Court no longer shares the *Wilko* Court's suspicions.[59] Indeed, the percentage of broker-dealers that have added predispute arbitration clauses to cash account agreements has risen from a pre-*McMahon* level of 39% to virtually all broker-dealers today.[60]

3. Rules and Regulations

Arbitration is touted by its proponents as a quick and inexpensive alternative to litigation.[61] Although the process shares certain features with traditional litigation,[62] it is presided over not by judges but by arbitrators.[63] Under the FINRA consolidated

55. *McMahon*, 482 U.S. at 237–38.

56. *Rodriguez*, 490 U.S. at 477.

57. *Id.* at 481; *see also Wilko*, 346 U.S. at 435.

58. *Rodriguez*, 490 U.S. at 481.

59. As far back as *McMahon*, the Supreme Court noted that when *Wilko* was handed down, the SEC did not have the same authority over the SROs as it did at the time of *McMahon*. *McMahon*, 482 U.S. at 233–34. Today, the SEC has considerable authority over FINRA rules governing arbitration procedures. *See generally* Thomas Lee Hazen, Principles of Securities Regulation, 324–30 (2d ed. 2006). In retaining supervisory authority, the SEC ensures adequate procedure in the arbitration process. *McMahon*, 482 U.S. at 233–34; *see also* Grant, *supra* note 4, at 122 ("Finding *Wilko* concerned primarily with the procedural protection of litigation, the Court concluded, again in light of the SEC's recently expanded authority 'to oversee and regulate those arbitration procedures,' the *Wilko* rationale no longer existed.").

60. Gross, *supra* note 5, at 494, n.8 (citing Order Approving Proposed Rule Changes by the NYSE, NASD, and AMEX Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses, 54 Fed. Reg. 21, 144, 21, 153 n.51 (May 10, 1989)); *see also* Grant, *supra* note 4, at XXVI.

61. FINRA, Arbitration Procedures: What is Arbitration?, http://www.finra.org/ArbitrationMediation/Parties/Overview/ArbitrationProcedures/P009532 (last visited Feb 26, 2010).

62. Some have argued that the arbitration process has gradually become *so much* like litigation that arbitration now resembles a slightly modified version of a litigation proceeding itself. For a more detailed discussion of this proposition and the dangers associated therein, see Grant, *supra* note 4, at 315 ("[T]he danger is that the SRO procedures would become too similar to litigation. To make arbitration more formal would be to have it more similar to the institution it seeks to replace—the court. The result will be another legal institution.").

63. FINRA, Arbitration Procedures: Who are the Arbitrators?, http://www.finra.org/ArbitrationMediation/Parties/Overview/ArbitrationProcedures/P009534 (last visited Feb. 26, 2010). FINRA describes arbitrators as "impartial persons who are knowledgeable in securities industry disputes." *Id.*

rules, parties participate in the arbitrator selection process by ranking candidates on, or striking them from, a list automatically generated by the Neutral List Selection System.[64] FINRA staff then uses input from both parties to select neutral arbitrators.[65] Similar to the litigation process, arbitration involves an adversarial hearing. [66] The parties to an arbitration proceeding present their cases to the arbitrator through testimony and documentary evidence.[67] However, unlike a traditional court proceeding, arbitration does not follow strict rules of evidence.[68] Following the arbitration hearing, the arbitrators deliberate, decide the outcome of the case, and then issue an arbitration "award" to the parties involved.[69] Importantly, arbitration awards, unlike court decisions, generally do not contain a detailed explanation of the arbitrators' rationale and findings and are never memorialized as a published, written opinion.[70] In large part, the non-requirement for published rationales is due to the roots of arbitration growing out of equitable forums and not courts of law.[71] A practical effect of this non-requirement is that arbitration awards are not available, and moreover cannot be used, as precedent.[72]

In 2009, a total of 7137 cases were filed through FINRA dispute resolution and 4571 of those cases were closed through arbitration.[73] Industry-prepared statistics state that "[i]n 2009, approximately 70% of customer claimant cases resulted, through settlement or awards, in monetary or non-monetary recovery for the investor."[74] The average turnaround time for cases decided by a full hearing was 16.6 months.[75]

64. FINRA, Arbitration Procedures: Appointment of the Arbitrators, http://www.finra.org/ArbitrationMediation/Parties/Overview/ArbitrationProcedures/P009538 (last visited Feb. 26, 2010).

65. *Id.*

66. FINRA, Arbitration Procedures: How Are the Hearings Conducted?, http://www.finra.org/ArbitrationMediation/Parties/Overview/ArbitrationProcedures/P009542 (last visited Feb. 26, 2010).

67. *Id.*

68. FINRA, Code of Arbitration Procedure for Indus. Disputes § 13604 (2010); FINRA, Code of Arbitration Procedure for Customer Disputes § 12604 (2010).

69. FINRA, Arbitration Case Flow Definitions, http://www.finra.org/ArbitrationMediation/Neutrals/ArbitrationProcess/ArbitrationCaseFlow/ArbitrationCaseFlowDefinitions/index.htm#9 (last visited Feb. 26, 2010).

70. *Id.*

71. Barbara Black & Jill Gross, *The Explained Award of Damocles: Protection or Peril in Securities Arbitration*, 34 Sec. Reg. L.J. 2 (2006). "Arbitration is considered a forum of equity, as arbitrators may consider 'common sense notions of fairness' and other equitable factors when resolving disputes before them. This focus on equity has been a benefit of securities arbitration for investors, because the law is not investor-friendly in many jurisdictions." *Id.*

72. *Id.*

73. FINRA Dispute Resolution Statistics, http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm (last visited Feb. 26, 2010).

74. *Id.* It should be noted that the amount of recovery as compared to the damages actually claimed by the injured investors is not provided.

75. *Id.* FINRA notes in its statistics that "[t]he *timing* of the arbitration process is heavily influence by Code of Arbitration Procedures time limits, the parties, and the panel." *Id.* In simple cases where the

III. THE ARBITRATION FAIRNESS ACT OF 2009

The 2007 version of the Arbitration Fairness Act was introduced in Congress on July 12, 2007 by Senator Russ Feingold (D-Wisc.) and Representative Hank Johnson (D-Ga.).[76] Following its introduction in the House of Representatives, the House Committee on the Judiciary, Subcommittee on Commercial and Administrative Law held a hearing on the proposed Act on October 25, 2007.[77] Shortly thereafter, the Senate Committee on the Judiciary, Subcommittee on the Constitution held its hearing on December 12, 2007.[78] After moving no further in the legislation process than the 2007 Subcommittee hearings, the Arbitration Fairness Act was redrafted and reintroduced in 2009—on February 12th in the House and on April 29th in the Senate.

As proposed, the Arbitration Fairness Act of 2009 seeks, in part, to amend the FAA to exclude arbitration agreements in contracts involving "an employment, consumer, or franchise dispute," or "a dispute arising under any statute intended to protect civil rights."[79] The bill itself provides:

> (b) No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of—
>
> (1) an employment, consumer, or franchise dispute; or
>
> (2) a dispute arising under any statute intended to protect civil rights.[80]

The Senate version of the legislation is substantially the same as the House version; however, it also includes "services relating to securities and other investments" to its definition of the term "consumer dispute."[81] The bill thus leaves no doubt that its drafters intend to sweep securities regulation within the ambit of the proposed reforms.

As the legislation currently stands, the bill does not completely bar arbitration agreements; most notably, it does not bar disputes between investors and securities brokerage firms. What the bill does, however, is require that parties of unequal

arbitrators need only review the relevant party documents, the turnaround time was 6.6 months. Combined, the average turnaround time for all cases in 2009 was 12.4 months. *Id.*

76. Arbitration Fairness Act of 2007, S. 1782, 110th Cong. (2007).

77. *H.R. 3010 Hearing*, *supra* note 17.

78. *The Arbitration Fairness Act of 2007: Hearing on S. 1782 Before the Subcomm. on the Constitution of the S. Comm. on the Judiciary*, 110th Cong. (2007) [hereinafter *S. 1782 Hearing*]. This note will rely on the testimony presented during the 2007 hearings since hearings have not yet been held on the 2009 version of the proposed Act.

79. Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. (2009).

80. *Id.* The 2007 version of the AFA contained the same provision, but in subsection (b)(2) inserted "or to regulate contracts or transactions between parties of unequal bargaining power" following "civil rights." Arbitration Fairness Act of 2007, S. 1782, 110th Cong. (2007).

81. Arbitration Fairness Act of 2009, S. 931, 111th Cong. (2009).

bargaining power agree to submit to arbitration only after a dispute arises.[82] According to Senator Feingold, the Arbitration Fairness Act seeks to "[reflect] the FAA's original intent by requiring that agreements to arbitrate employment, consumer, franchise, or civil rights disputes be made after the dispute has arisen."[83] The bill's proponents argue that it will give small investors a "true choice" in deciding whether to arbitrate or to go forward with traditional civil litigation.[84]

The 2009 proposal is quite a departure from the approach the drafters took when submitting the 2007 version of the bill. The current bill proposes an additional provision that purports to give jurisdiction to the federal courts to determine whether an agreement to arbitrate is valid and enforceable.[85] Presently, this issue is decided by the arbitrator under the doctrine of "competence-competence."[86] Effectively, the addition of this provision would allow any party to dispute jurisdiction of the arbitrators, for example, by alleging fraudulent inducement of the original contract.[87] In practical terms, it would give a losing party an unhindered right to appeal to the courts, an effect that would "potentially jeopardiz[e] some of the efficiencies of arbitration."[88]

In sum, there are several distinctive bill provisions that have the potential to inflict severe harm on dispute resolution within the securities industry. First, the bill seeks to prohibit parties with unequal bargaining power within an employment, consumer, or franchise relationship from contractually agreeing to presubmit to binding, mandatory arbitration.[89] Second, the bill goes even further by "retroactively invalidating" existing contracts that contain binding arbitration clauses.[90] Finally, the bill seeks to vest exclusive jurisdiction with the courts, rather than the arbitrator, to determine the "validity or enforceability of an agreement to arbitrate."[91] In examining the issues with the above-stated provisions of the AFA, a threshold consideration is that arbitration exists as a "creature of contract."[92] A given party's intent to cede civil

82. Russ Feingold, U.S. Senator (D-Wisc.), Introduction of Consumer Justice Legislation: Arbitration Fairness Act of 2009 (Apr. 29, 2009), *available at* http://feingold.senate.gov/record.cfm?id=312222&.

83. *Id. But see supra* text accompanying note 33 (discussing Congress's rejection of the Illinois approach in favor of the "New York approach," an approach which permitted enforcement of predispute arbitration clauses).

84. Feingold, *supra* note 82.

85. Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. (2009); *see also* Arbitration Fairness Act of 2009, S. 931, 111th Cong. (2009).

86. *See Congress Considers "Arbitration Fairness Act of 2009,"* Stay Current (Paul Hastings, New York, N.Y.), March 2009, *available at* http://www.paulhastings.com/assets/publications/1255.pdf [hereinafter *Paul Hastings Alert*] ("[The doctrine] provides that parties are entitled to vest arbitrators with the power to determine their own jurisdiction.").

87. *See id.*

88. *Id.* The efficiencies jeopardized include: finality of an arbitrator's decision and the threat of unrestricted judicial appeal.

89. *See id.*; *see also* Op-ed, *No Lawyers, Please*, Wall St. J., Apr. 5, 2008 at A8.

90. *See No Lawyers, Please*, *supra* note 89.

91. *Paul Hastings Alert*, *supra* note 86, at 2.

92. Grant, *supra* note 4, at 11.

jurisdiction in favor of private arbitration can be made evident only by contractual agreement.[93] In other words, "[arbitration's] jurisdiction arises from and is based on voluntary agreement of the parties, or their contract."[94] As such, traditional principles and philosophies underlying basic contract law are of the utmost importance in considering any legal aspect of arbitration. Thus, at the most fundamental level, the issue is that the cited provisions of the Arbitration Fairness Act are diametrically opposed to the basic principles underlying the nature of a contractual agreement, namely freedom of contract and certainty of contract.

A. Freedom of Contract

It is a basic tenet of contract law that parties have the freedom of contract.[95] However, in modern society, such freedom has been substantially restricted. With the rise of privatization, freedom of contract has been reduced as part of a necessary compromise. Private citizens lose full freedom to contract as they wish; however, they gain the benefits associated with standardization of contract throughout society as a whole.[96] That is, society and its industries are regulated through such standardization as Congress and other regulatory bodies legislate in an effort to mandate the standard terms that may govern the dealings between various people and industries.[97] As more and more dealings and relationships become standardized into uniform procedures and contracts, regulators have a greater ability to shape the terms, thereby giving the coordinating ability to level the playing field for all parties involved.[98] Applying these concepts to the field of securities arbitration, standardization of broker-dealer contacts, including mandatory arbitration clause provisions, both permits a balance between the needs of brokerage firms and private investors and maximizes the greater societal gains.[99]

Investors have argued that not only does mandatory arbitration deprive them of the freedom of contract, but also that this "freedom" is illusory to the extent that so-called arbitration "agreements" are unconscionable contracts of adhesion, and

93. *See id.*

94. *Id.* at 13.

95. 1 E. Allan Farnsworth, Farnsworth on Contracts § 1.7 (Aspen Publishers 3d ed. 2004). For an optimistic perspective on how freedom of contract has allowed for the progression of society, see *id.* (citing H. Maine, Ancient Law 170 (1861)) ("[W]e may say that the movement of the progressive societies has hitherto been a movement from Status to Contract.").

96. *See id.*

97. *See id.*

98. To this end, it has been said that government best serves the interests of its citizens when the system "acts with a reasonable degree of uniformity." 1 Arthur Linton Corbin, Corbin on Contracts § 1.1, at 2 (Joseph M. Perillo ed., Yale University 1993).

99. *See generally* Grant, *supra* note 4, at 100–01 (discussing the brokerage industry as an oligopolistic industry where regulation comes both from the outside (federal statutes; SEC regulations) and from the inside (self-imposed SRO regulations)).

therefore unenforceable.[100] This is essentially the same argument underlying the provision of the Arbitration Fairness Act that would invalidate a predispute arbitration agreement regulating a contract that was made between parties of unequal bargaining power.[101] The assertion is correct to the extent that no one could argue that the average investor and industry-regulated broker-dealer negotiate at "arm's length." However, courts repeatedly have held that the consumer-industry relationships typifying those found within the securities arbitration context are not so unduly oppressive as to render a predispute arbitration clause void.[102]

Upholding mandatory binding arbitration makes sense from both a practical perspective and a public policy standpoint. The business realities of a fast-paced and market-driven economy require the use of a standard-form contract.[103] Admittedly, this generally means that small investors with little bargaining power are forced to give up *some* freedom in making the economic decision to invest in the markets.[104] However, after the major Supreme Court cases of *McMahon* and *Rodriguez* and the clear federal policy favoring arbitration, no investor could claim that he or she was not on notice that predispute arbitration clauses are the industry norm.[105] Knowing this, investors are free to choose to submit to the arbitration clause, thereby enjoying the benefits associated with capitalism and a free marketplace. Investors are equally free, however, to pursue the alternate, yet equally free choice to invest by other means—that is to say, no one forces the hand of the investor into the stock market or

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100. *See id.* at 29; Restatement (Second) of Contracts § 208 (1981) ("If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result.").

101. Arbitration Fairness Act of 2007, S. 1782, 110th Cong § 4(4) (2007).

102. Grant, *supra* note 4, at 30; *see also McMahon*, 482 U.S. at 226 ("'[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals' should inhibit enforcement of the [Arbitration] Act 'in controversies based on statutes.'" (citing *Mitsubishi Motors Corp.*, 473 U.S. at 626–27; *Wilko*, 346 U.S. at 432; *Rodriguez*, 490 U.S. at 481 (reasoning that section 14 does not prohibit "agreements to arbitrate future disputes relating to the purchase of securities.")).

103. *See* Grant, *supra* note 4, at 99.

> The brokerage firms have created standard form contracts for several purposes. The standard contract will reduce administrative and transaction costs. This may result in lower prices for the consumer. Standardization also promotes efficiency within the large organization and promotes efficient use of managerial and legal resources, as well as acting as a check on wayward behavior.

Id. Furthermore, as discussed *supra*, standardization of broker-dealer contracts has allowed the securities industry to be regulated. This regulation arguably allows for *more* investor protection than if the industry were left unregulated. *See supra* text accompanying notes 96–98.

104. Although federal policy favors arbitration, courts have been an ally to investors where principles of state law would otherwise protect the party with less bargaining power from undue oppression from the stronger party. *See, e.g.*, Ticknor v. Choice Hotels Int'l, Inc., 265 F.3d 931 (9th Cir. 2001). That is, there are clear judicial limits that prohibit the party with greater bargaining power from being unduly oppressive in its dealings with its weaker counterparties.

105. Grant, *supra* note 4, at 30.

other financial investments.[106] Finally, legislative policy choices and subsequent judicial interpretations have made clear that the advantages of a thriving stock market outweigh the small investor's loss of freedom in choosing to submit to a brokerage contract containing an arbitration clause.[107]

Even acknowledging that industry professionals have the upper hand in drafting the brokerage contract agreements, there is empirical evidence to suggest that the investing public favors arbitration.[108] In a fast-paced world (none more so than Wall Street), going through the formal litigation process is often not a viable option for investors for both temporal and economic reasons.[109] In fact, a recent poll released on behalf of the U.S. Chamber of Commerce affirms that Americans prefer "cheaper and faster methods of settling arguments."[110] An overwhelming 82% of those surveyed chose arbitration as the way they would prefer to settle a business dispute as compared to the 15% who chose litigation.[111] Among the reasons cited were: (i) saving time by arbitrating rather than litigating, and (ii) avoiding the heightened expenses associated with litigating in a court of law.[112] By completely barring mandatory arbitration as a viable option, the Arbitration Fairness Act takes away an industry-wide standard and a public-preferred means of dispute resolution.[113] In its

106. Courts have generally supported predispute arbitration clauses under the principles of freedom of contract. *Id.* at 11.

107. *See id.* at 30. ("[T]he strong public policy favoring arbitration and economies of standardized contracts requires a heavy burden (similar to summary judgment) of the one seeking to avoid it by establishing unconscionability."); *see also* Edward J. Murphy, Richard E. Speidel & Ian Ayres, Studies in Contract Law 4 (6th ed. 2003) ("One cannot gainsay the importance of freedom of contract to a market economy and the relative superiority of such a system to unproductive command economies which are, seemingly, in decline throughout the world today.").

108. *No Lawyers, Please*, *supra* note 89.

109. *See The Arbitration Fairness Act of 2007: Hearing on H.R. 3010 Before the Subcomm. On Commercial and Administrative Law and the H. Judiciary Comm.*, 110th Cong. 7–8 (2007) [hereinafter Rutledge Testimony] (testimony of Peter B. Rutledge, Associate Professor of Law, Columbus School of Law, Catholic University of America). Professor Rutledge argues that an additional reason eliminating litigation as a viable option is that lawyers are unwilling to take cases to court unless "the amount in controversy is sufficiently high and the merits sufficiently strong." *Id.* at 7–8 (citing David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research,* 57 Stan. L. Rev. 1557, 1574 (2005)). Empirical evidence within the employment arbitration context showed that over 95% of claimants were turned away from representation. *Id.* (citing Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. Rev. 105, 107 (2003)).

110. *No Lawyers, Please*, *supra* note 89.

111. *Id.*

112. *Id.*

113. It has been suggested that if the public prefers arbitration, injured investors would still agree to it in the absence of mandatory clauses. However, what this argument fails to consider is the emotional, human element that naturally arises when one's investments have turned sour, especially if they turned sour unlawfully at the hands of a securities broker. Reacting on raw emotion, the investor's reaction would mirror the stereotypical person slamming the door while screaming, "I'll see you in court!" Thus while intentional or unintentional, by requiring investors and brokerage firms to agree to arbitrate after a dispute, the Arbitration Fairness Act would most likely lead investors to flood the courts with complaints.

wake, the Arbitration Fairness Act would leave behind the potential for a flood of litigation, because absent complete agreement between the parties, the only remaining forum would be the courts.[114]

B. Certainty of Contract

A second fundamental tenet of contract law called into question by the Arbitration Fairness Act is that of legal certainty and predictability. People enter into contracts as a means of protecting the expectations they intend to realize when entering into a promise with another party.[115] "[T]o promote and facilitate reliance on agreements," the law protects the expectation interests inherent within a contractual agreement.[116] The great legal scholar Roscoe Pound proposed that the "whole economic order" rests on the presupposition that promises will be kept and that "the whole social order rests upon stability and predictability of conduct, of which keeping promises is a large item."[117]

Over time, modern contract law has evolved by attempting to standardize the common law rules of contract into workable forms such as those model rules set forth in the Restatements and the Uniform Commercial Code.[118] Various industries have also standardized the rules that govern inter-party relationships. By developing a system of written rules that governs the relationship between various parties, individuals entering into a contract have a clear understanding of what to expect with respect to honoring and enforcing their agreed upon contractual provisions.[119]

Federal case law since *McMahon* has made clear that there is a judicial preference for arbitration of securities disputes.[120] Likewise, the rules governing the relationship between an investor and a brokerage firm are exceedingly clear with respect to predispute arbitration agreements. At the SRO level, FINRA rules spell out the governing principles for arbitration procedures with great specificity.[121] Yet even if an

114. The potential effect on the civil court dockets would be staggering. Through December 2009, 7137 cases were filed during the year at FINRA, a number on the rise. FINRA, Dispute Resolution Statistics, http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm (last visited Feb. 26, 2010).

115. Corbin, *supra* note 98, § 1.1.

116. *Id.* (citing Lon L. Fuller & William R. Perdue, *The Reliance Interest in Contract Damages*: *1*, 46 Yale L.J. 52, 59–62 (1936)).

117. Murphy et al., *supra* note 107, at 3 (quoting 3 Pound, Jurisprudence 162–63 (1959)).

118. Farnsworth, *supra* note 95. "But the shape of modern contract law is due in good part to the scholars whose treatises and other writings brought order out of the growing mass of cases." *Id.*

119. *See id.*

120. Grant, *supra* note 4, at 30; *see also Rodriguez*, 490 U.S. at 477.

121. FINRA's Code of Arbitration Procedure and Code of Mediation Procedure were recently revised following the consolidation of the NASD and the regulatory arm of the NYSE. The Code of Arbitration Procedure has been divided into the Customer Code and the Industry Code. The rules are accessible through FINRA's website. FINRA – Arbitration & Mediation Rules, http://www.finra.org/ArbitrationMediation/Rules/index.htm (last visited Feb. 26, 2010).

investor were not familiar with the case law or with the more technical FINRA rules, SRO-imposed regulations take the extra step to ensure that investors have been made aware of their agreement to arbitrate when they sign their brokerage firm customer agreement.[122]

Within the otherwise boilerplate contract language, the brokerage firm must take great care to highlight the predispute arbitration clause.[123] Generally, this means that the clause is set out in a substantially larger font than the rest of the document and in boldface type.[124] Additionally, just above an investor's signature line, there must be a statement reminding the investor that the agreement contains a predispute arbitration clause.[125] Finally, any customer signing an agreement containing such a clause must be given a copy of the agreement and must acknowledge receipt of the agreement on a separate document.[126] Given this comprehensive disclosure, parties know the rules that protect their expectation interests.

Despite the existence of clear rules governing the system, the Arbitration Fairness Act seeks to render unenforceable all pre-existing binding arbitration clauses.[127] While there is no reliable estimate of the number of brokerage accounts that currently exist in the United States, even a decade ago, U.S. online brokerage accounts alone numbered eighteen million.[128] Because nearly all customer agreements contain a

122. The SICA-proposed rules governing predispute arbitration agreements became section 31 of its Uniform Code of Arbitration, which was both approved by the SEC and adopted by the various SROs in the securities industry. GRANT, *supra* note 4, at 75. While FINRA continues through its transition period in developing a consolidated rule book, the pertinent regulation is NASD Manual, Rule 3110(f). FINRA Manual Online, NASD Rules, http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3734 (last visited Feb. 26, 2010).

123. *Id.* ("Any predispute arbitration clause shall be highlighted and shall be immediately preceded by the following language [provisions of arbitration agreement] in outline form.").

124. *See, e.g.*, GRANT, *supra* note 4, at 81–82.

125. NASD Rule 3110(f)(2)(A). FINRA Manual Online, NASD Rules, http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3734 (last visited Feb. 26, 2010) ("In any agreement containing a predispute arbitration agreement, there shall be a highlighted statement immediately preceding any signature line or other place for indicating agreement that states that the agreement contains a predispute arbitration clause. The statement shall also indicate at what page and paragraph the arbitration clause is located.").

126. NASD Rule 3110(f)(2)(B). FINRA Manual Online, NASD Rules, http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3734 (last visited Feb. 26, 2010) ("Within thirty days of signing, a copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.").

127. *S. 1782 Hearing*, *supra* note 78. According to Senator Russ Feingold, "What this bill does is ensure that citizens once again have a true choice between arbitration and the traditional civil court system by making unenforceable any predispute agreement that requires arbitration of a consumer, employment, or franchise dispute." Russ Feingold, U.S. Senator (D-Wisc.), Opening Statement: Senate Judiciary Subcommittee on the Constitution Hearing on "The Arbitration Fairness Act of 2007" (Dec. 12, 2007), *available at* http://feingold.senate.gov/statements/07/12/20071212.htm.

128. *E-Trade Craze Hits Europe: Number of Brokerage Accounts Doubles in 6 Months*, INT'L HERALD TRIB., Aug. 12, 2000, *available at* 2000 WL 3309303.

predispute arbitration clause, the Arbitration Fairness Act would affect hundreds of millions of investors.[129]

In addition, the Arbitration Fairness Act would greatly affect the legal system. Under the Act, unless both parties agree to submit a dispute to arbitration after it arises,[130] courts will be forced to consider the claims from investors against their broker-dealers that would have formerly been handled through arbitration.[131] If the majority of injured investors proceeded in litigating their claim rather than arbitrating, the impact on the courts would be dramatic. In 2008 alone, 4982 cases were filed for arbitration at FINRA.[132] However, with the recent proliferation of investor claims surrounding the sub-prime mortgage/auction-rate security crisis, 7137 cases were filed in 2009 and came close to the 8945 cases that were filed at the height of the dot-com boom.[133] To add these cases to civil court dockets would not only disrupt the contractual expectations of investors and brokers, but would also overwhelm the unsuspecting civil court systems with securities claims from injured investors.[134]

Finally, disrupting the system risks sending the investing public a message that the system is broken beyond repair—that in judicially favoring arbitration of investors' securities claims since *McMahon*, the government has failed to protect investors with a fair system of dispute resolution. As argued by the American Arbitration Association, the AFA's mandated "[m]odification would unnecessarily send a message of ambiguity and policy hostility to arbitration to the international [and national] community. Companion legislation can accomplish the goals of Congress, without disruption to a venerable and successful process."[135]

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129. *No Ban*, *supra* note 14.

130. The gravamen of the AFA is that it would disallow predispute agreements to arbitrate between parties of unequal bargaining power. It would, however, allow the parties to agree to submit to arbitration *after* a dispute had already arisen. *See* H.R. 3010, 110th Cong. (2007).

131. Of course, this assumes that injured investors would be able to find adequate legal representation. That is, these injured investors are more likely to be individuals, and members of the plaintiffs' bar are likely to require a contingency fee. Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007); *see also* 148 Cong. Rec. S9720–23 (daily ed. Oct. 1, 2002) (statement of Sen. Sessions); Rutledge Testimony, *supra* note 109 (citing Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. Rev. 105, 107 (2003)). In practical terms, this means that if the plaintiff's expected damages do not reach a certain threshold, lawyers will be forced to turn down even those who have viable claims. Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007). According to a recent survey of members of the plaintiffs' bar, "a prospective plaintiff need[s] to have a minimum of $60,000 in provable damages . . . before an attorney would take the case." *Id.*

132. FINRA, Dispute Resolution Statistics, http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm (last visited Feb. 26, 2010); *see also supra* text accompanying note 114.

133. FINRA, Dispute Resolution Statistics, http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm (last visited Feb. 26, 2010); *see also supra* text accompanying note 114.

134. *See supra* Part III.A.

135. *H.R. 3010 Hearing*, *supra* note 17 (testimony of Richard Naimark, Senior Vice President, Am. Arb., Ass'n).

IV. REFORM: RESTORING INVESTOR CONFIDENCE

A. Recognized Problems within the Current System

Since the Supreme Court upheld mandatory arbitration clauses in *McMahon*, investors have become increasingly wary of the industry-sponsored arbitration process that they claim is tilted in favor of the securities industry.[136] Senator Feingold has attacked the current system of mandatory arbitration as depriving Americans of their day in court.[137] Rather than act to deprive injured investors, he has argued that arbitration be used only if it is desired by both the investor and the broker-dealer at the time that the dispute arises.[138] His rationale is that because it is not per se accountable to a higher authority, the arbitration system favors big business and is unfair to the average investor.[139] His solution is not to better regulate the existing system, thereby making it accountable;[140] but rather, it is to destroy the existing system entirely.[141]

As discussed, his proposed bill, the Arbitration Fairness Act, is inexorably flawed as being antithetical to fundamental underpinnings of contract law.[142] Where Senator Feingold is correct, however, is in recognizing that a lack of investor confidence in the current securities dispute resolution system is harmful both to the American market and to the investors that the market serves.[143] A common complaint of investors is the lack of transparency in arbitration, because arbitrators are not required to provide an opinion or rationale in issuing an award.[144] In response, the former-NASD proposed, but ultimately did not adopt, a rule change in July 2005 that would have required arbitrators to provide written explanations of awards upon a customer's request.[145] Upon release of the proposal, NASD Chair and CEO Robert R. Glauber explained, "[w]e have found that investors want to know more about how a panel reaches its decision . . . [b]y giving investors the option of requiring a written explanation of an arbitration panel's decision, we will increase investor confidence in the fairness of the NASD arbitration process."[146]

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136. Black & Gross, *supra* note 71.

137. *S. 1782 Hearing*, *supra* note 78 (statement of Sen. Feingold).

138. *See id.*

139. *See id.*

140. *See id.*

141. *See id.*

142. *See* discussion *supra* Part III.

143. *See* SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, http://www.sec.gov/about/whatwedo.shtml (last visited Feb. 26, 2010).

144. Marilyn Blumberg Cane & Ilya Torchinsky, *Explaining "Explained Decisions": NASD's Proposal for Written Explanations in Arbitration Awards*, 16 Univ. Miami Bus. L. Rev. 23, 26 (2007) ("At present, the NASD Code of Arbitration Rule 10330(e) requires only limited factual information, including a summary of the issues and the relief requested and awarded. Although the arbitrators may include the rationale underlying their decision in the award, they are not required to do so.").

145. Black & Gross, *supra* note 71.

146. *Id.* (citing News Release, NASD, New Arbitration Rule Requires Award Explanations upon Investor Request (Jan. 27, 2005), http://www.finra.org/Newsroom/NewsReleases/2005/P013145).

Opponents of the rule change argued that lengthy opinions would unduly increase the cost and the length of the process without any tangible benefit, citing FINRA's position prohibiting the use of a written rationale as binding precedent.[147] It was also argued that a written rationale requirement would have the damaging side-effect of making arbitration so much like litigation that the courts would either swallow up the "pseudo-litigation" under their own jurisdiction and/or arbitration would no longer be a "cheap and speedy alternative to litigation."[148]

Investors have also argued that arbitrators should be educated on the securities laws.[149] That is to say, even though arbitration is an equitable forum, resolving securities disputes simply cannot be equitable if arbitrators are free to disregard legal standards.[150] People enter into investment contracts knowing that the securities laws operate to protect investors—this includes legal precedent pursuant to the securities statutes, rules, and regulations.[151] Allowing arbitrations to operate primarily upon equitable principles has the paradoxical potential of leading to inequitable results.[152] Investors maintain that consistency and legal certainty is key, and both can only

147. Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2, Exchange Act Release No. 34-52009, 70 Fed. Reg. 41,065 (July 15, 2005).

148. Grant, *supra* note 4, at 315. *But c.f.* Press Release, Center for Int'l Envtl. L., UN Body Supports Transparency in New Arbitration Rules (July 3, 2008), *available at* http://www.ciel.org/Tae/UNCITRAL_Transparency_3Jul08.html. The United Nations Commission on International Trade Law ("UNCITRAL") recently mandated that the rules governing UNCITRAL be made more transparent in arbitrations brought by investors against States. *Id.* This is a clear example of reforming the *existing* arbitration system to ensure fairness rather than destructing the system. Despite these concerns, FINRA has continued to respond to investors' perceived problems with the arbitration system, and on October 27, 2008, it resubmitted a revised proposal for comments. Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure to Require Arbitrators to Provide an Explained Decision upon the Joint Request of the Parties, Exchange Act Release No. 34-58862 (Oct. 27, 2008), *available at* http://www.sec.gov/rules/sro/finra/2008/34-58862.pdf.

149. Thomas E. Carbonneau, *The Revolution in Law through Arbitration*, 56 Clev. St. L. Rev. 233, 268 (2008). Note that the NASD instructs arbitrators, "As arbitrators, you are not strictly bound by case precedent or statutory law. However, it's important that you follow the underlying policies of the law." NASD, Arbitrator Training Panel Member Course Preparation Guide 210 (1996) (on file with author). Although arbitrators are not required to be experts on securities laws, they are expected to understand the underlying policies. This implies recognition of the laws which carry out the underlying policies.

150. In arguing for a proposed rule change requiring a written explanation for an arbitration decision, one commentator argued that "[a]rbitrators are hiding gross incompetence and bias towards the securities firms when omitting any written explanation." Cane & Torchinsky, *supra* note 143, at 38 (citing Letter from Richard Skora to Jonathan G. Katz, Secretary, SEC (Aug. 3, 2005), *available at* http://www.sec.gov/rules/sro/nasd/nasd2005032/rskora4644.pdf).

151. For example, in one Massachusetts case, notwithstanding the fact that Massachusetts law does not provide for punitive damages to securities investors, a U.S. District Court judge upheld an arbitrator's award of $1.5 million in punitive damages. He reasoned that "arbitrators are given a 'blank slate unless educated in the law by the parties.'" Noah Schaffer, *U.S. District Court Upholds Panel's 1.5M Punitive Award*, Mass. Law. Wkly., Aug. 20, 2006. Citigroup, the defendant in the case and in the arbitration, argued that "the arbitration panel, which included one lawyer, should have been familiar with the rule of 'widespread familiarity' and known that Massachusetts law—for more than 100 years—has prohibited punitive damages unless expressly authorized by statute.'" *Id.*

152. *See id.*

happen if the insiders administering equitable justice are familiar with the parties' expectations and the pre-existing rules and laws governing their expectations.[153] Noting just a small sampling of the problems that the Arbitration Fairness Act sets out to fix, the remainder of this note will explore other more effective ways of achieving reform—reform that preserves the existing, generally workable system.

B. Existing Reform Efforts

1. State Level Reform Efforts

Significant reform efforts have already been made at the state level. There, the first wave of arbitration reform statutes sought to invalidate arbitration provisions in private contracts.[154] In the lawsuits arising from these "first generation FAA preemption cases," the Supreme Court held it unconstitutional under the FAA and the federal preemption doctrine for a state to ban arbitration entirely.[155] Following judicial rejection of this legislative approach, states began to enact statutes that sought to reform arbitration procedures rather than to ban the process; however, the Supreme Court has yet to rule substantively on this type of reform statute.[156]

As the most comprehensive attempt at procedural reform, the California State Legislature proposed ethics standards for arbitrators and codified these standards into the California Rules of Court.[157] Arbitrators in California are now required to "disclose all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed . . . arbitrator would be able to be impartial . . . ."[158] In contrast, "[t]he SRO rules allow a party to request additional information about an arbitrator's background from the Director of Arbitration, but there is no requirement that the requested additional information be provided."[159] California's heightened disclosure requirements and additional disqualification standards were intended to promote greater public confidence in arbitration as a fair alternative to a judicial proceeding by allowing access to all information that may cause a potential arbitrator to have an otherwise undisclosed conflict of interest.[160]

153. *See id.*

154. Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 Ind. L.J. 393, 393 (2004).

155. *Id.* at 393–94; Southland Corp. v. Keating, 465 U.S. 1 (1984) (holding that the FAA preempted such state statutes).

156. Drahozal, *supra* note 154, at 394; *see also* Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444 (2003) (granting review on the issue of FAA preemption involving a class, not an individual, without reaching the "second generation" preemption issue).

157. Cal. Civ. Proc. Code § 1281.85(a) (West 2008); Mayo v. Dean Witter Reynolds, Inc., 258 F. Supp. 2d 1097, 1100–01 (2003); Drahozal, *supra* note 153 at 394–95.

158. Cal. Civ. Proc. Code § 1281.9 (West 2008); *Mayo*, 258 F. Supp. 2d at 1100.

159. *Mayo*, 258 F. Supp. 2d at 1106.

160. *See Mayo*, 258 F. Supp. 2d at 1116; *see also* Gretchen Morgenson, *Dear S.E.C., Reconsider Arbitration*, N.Y. Times, May 6, 2007, § 3, at 1, *available at* http://select.nytimes.com/2007/05/06/business/yourmoney/06gret.html?_r=1&oref=slogin ("Arbitrators' selection raises fairness questions, too. Lawyers for both sides in a case choose panelists from a list of names and past awards. Panelists who want to be

While these "second generation" reforms have not been invalidated under state law, in *Mayo v. Dean Witter Reynolds, Inc.*, a California federal district court held that under a private contract specifying that arbitration take place under NYSE rules, the California heightened disclosure standards were preempted by both NYSE rules and the FAA.[161] The court made clear that any changes to the procedural aspects of securities arbitration must be made by the SEC, the administrative agency given congressional authority to oversee securities arbitration.[162] However, it is not clear that the SEC would find such disclosure requirements in the best interest of the investing public. In fact, the *Mayo* court contemplated that it would probably *not* so find.[163] Unfortunately, without the consent of the SEC, FINRA cannot take this reform approach—an approach that, if taken, would likely eliminate conflicts of interest—conflicts that contribute to the perceived pro-industry bias by investors.

2. SRO-based Reforms

Another existing avenue of reform is through the SROs themselves, particularly FINRA and the former-NASD. These SROs have consistently responded to investors' complaints in adopting reforms "to improve the quality and fairness of the [arbitration] process."[164] As discussed earlier in this note, the former-NASD sought major reform in 2005 when it proposed and the SEC solicited comments on a new rule that would have required arbitrators to provide a factual, non-legal written rationale for his or her decision upon a *customer's* request.[165] During the review period following the SEC's publication of the proposed rule change, the SEC received almost 200 comments.[166] While the former-NASD, and thereafter FINRA, was reviewing the comments and formulating its response, SICA published an arbitration survey on "Perceptions of Fairness" and found that 55% of respondents would be "more satisfied if they had an explanation in the award."[167]

hired again may shy away from making big awards to investors, fearing that firms will strike them from future panels.").

161. *Mayo*, 258 F. Supp. 2d at 1108.

162. *Id.* at 1112.

163. *Id.* at 1110 n.16 ("Indeed, the SEC's decision not to exercise its power under the Exchange Act to amend any SRO rules to accommodate the California standards and its approval of NYSE Arbitration Rule 600(g) indicate that any rule changes proposed by SROs to accommodate the California standards likely would be met with disapproval by the SEC.").

164. *See* Black & Gross, *supra* note 71.

165. *See supra* Part IV.B.1.; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto, to Provide Written Explanations in Arbitration Awards Upon the Request of Customers, or of Associated Persons in Industry Controversies, Exchange Act Release No. 52009, 70 Fed. Reg. 41,065 (July 15, 2005), *available at* http://www.sec.gov/rules/sro/nasd/34-52009.pdf.

166. Order Approving Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure to Require Arbitrators to Provide an Explained Decision upon the Joint Request of Parties, Exchange Act Release No. 34-59358, 74 Fed. Reg. 6928-01 (Feb. 4, 2009), *available at* http://www.sec.gov/rules/sro/finra/2009/34-59358.pdf.

167. *Id.*

As a result of both the comments and subsequent developments, FINRA withdrew the 2005 proposal and resubmitted a new proposed rule for comments in October 2008.[168] The 2008 rule proposed to require the chair of the arbitration panel to provide an explained decision upon *joint* request of the parties at least twenty days before the first scheduled hearing date.[169] The explanation would be limited to a factual rationale and would not include legal authorities or a calculation of the damages.[170]

On February 4, 2009, the SEC issued an order adopting the 2008 proposed rule change. As it currently stands, FINRA rules permit parties to submit a joint request for an explained decision no later than twenty days prior to the first scheduled hearing.[171] The parties may limit their request to address only certain claims. If so requested, the Chairperson will assume responsibility to write only a fact-based explanation of the decision, for which he will be compensated.[172] It should be noted that arbitrators would still retain the *choice* to write an explained decision on either their own motion or on the motion of one party only.[173] As a matter of policy, the SEC stated that with respect to the rule adopted, it "believes that the even-handed approach of providing parties a means of jointly requesting a decision represents a reasonable compromise between the status quo, whereby the Code offers parties no formal means of requesting an explained decision, and the original proposal, whereby claimants alone would have the right to request an explained decision."[174]

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168. *Id.*

169. *Id.* at 6929.

170. *Id.*

171. This corresponds to the time period in which parties exchange documents and identify witnesses. *Id.*

172. The SEC suggested in its release that since the Chairperson must undergo specific training before being qualified to serve as the Chair, the additional experience would be beneficial toward producing higher-quality explained decisions. *Id.* Moreover, limiting the decision to only the facts would "ensur[e] the continued finality of a FINRA award." *Id.* In addition, a rationale limited to the facts will be easily distinguishable from a judicial opinion—in such a way that there will be no confusion that the rationale is not precedent and is not an automatic means for judicial appeal.

173. *Id.* at 6930. It has been argued by some that the current proposal does not address sufficiently the interests of the small investor; that is, there is a heightened risk that big-business and/or industry insiders would block requests. This, in fact, reflects the intent behind FINRA's original proposal. However, after considering the 200 comment letters received, the SEC determined that a customer-only request was too one-sided. *Id.* at 6929. Moreover, such a one-sided rule would have potentially led to an increase in the number of motions to vacate filed on the civil dockets. As a compromise, FINRA stated that "any risks that may be associated with explained decisions should be borne by the parties only after they have agreed jointly to request an explained decision." *Id.* at 6930. Because these are still valid concerns, however, the SEC had requested that FINRA gather statistics for a period of one year in order to determine whether parties are more often than not unable to agree to request an explained decision. *Id.*

174. *Id.* The requirement that both parties must agree to make a formal request for a written decision is a necessary limitation. Without it, the losing party may be always inclined to demand a rationale as a matter of right. Adopting such an absolute requirement would put a two-fold stress on arbitration: it would first eliminate the speediness of the process and make the process more costly, and secondly, it would lead arbitration down the legal path, rather than following in the direction of equity. GRANT, *supra* note 4, at 315. ("[T]he danger is that the SRO procedures would become too similar to litigation.

3. Other Congressional Action

As a final means of existing reform efforts, congressional legislation offered another approach in the form of Senate Bill 1135, the Fair Arbitration Act of 2007 ("the Fair Arbitration Act").[175] Unlike the Arbitration Fairness Act, this bill would work within the existing arbitration system by amending the FAA to "grant several specific 'due process' rights to all parties to an arbitration proceeding."[176] Most significantly, the bill would require heightened requirements for arbitrator qualification and additionally mandates inclusion of a written explanation for the arbitrator's basis for the decision.[177] Specifically, the bill would require, inter alia, that an arbitrator be "a member in good standing of the bar in the highest court of the State in which the hearing is to be held" and would require the arbitrator "[to] provide each party with a written explanation of the factual and legal basis for the decision."[178]

C. Effective Change: A Proposed Congressional Approach

In examining the previously discussed existing reform efforts, proposed substantive state reforms to arbitration procedures have proved dubious at best and unconstitutional at worst.[179] SRO-initiated rule changes could be meaningful; however, they occur as piecemeal, rule-by-rule amendments, and may take years to effectuate any substantial change.[180] Additionally, congressional legislation that, while otherwise moderate, shifts the focus of arbitration from equity to law, has proven undesirable and unsuccessful.[181] Therefore, Congress should take into account the policy behind state and SRO reform efforts, such as the California amendments and the FINRA proposed rule amendments, and should focus on preserving due process rights, as in the Fair Arbitration Act, in enacting amendments to the FAA. In making changes, federal law reform will use preemption from the top down, and thus force the SEC and FINRA to provide investors with better protection in the case they are harmed by unlawful industry action.[182] Proponents of reform should

To make arbitration more formal would be to have it more similar to the institution it seeks to replace—the court. The result will be another legal institution.").

175. Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007).

176. 148 Cong. Rec. S9721 (daily ed. Oct. 1, 2002) (statement of Sen. Sessions).

177. Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007).

178. *Id.* Unlike the Arbitration Fairness Act, which has over 100 co-sponsors and has gone through the hearing stage, the Fair Arbitration Act was referred to the Senate Committee on the Judiciary on April 17, 2007 and has not proceeded further in the legislative process. *Id.*

179. *See* discussion *supra* Part IV.A.

180. *See* discussion *supra* Part IV.B.2. For example, the NASD made its original rule proposal regarding written rationales in early 2005 and re-proposed a revision in late 2008. This is a period of over three years without any meaningful change. *Id.*

181. *See* discussion *supra* Part IV.B.3.

182. The preemption doctrine finds its roots in Article VI, section 2 of the U.S. Constitution and refers to the supremacy of federal law over inconsistent state law. *See, e.g.*, Crosby v. Nat'l Foreign Trade Council,

bear in mind the twin aims championed by investors and supported by securities law policy—those of enhanced transparency and disclosure throughout the arbitration dispute resolution process.[183]

In sum, Congress should revisit the Fair Arbitration Act's more moderate approach to reform, that is, an approach that maintains the time-tested arbitration forum, modifying the rules and regulations to afford more meaningful due process. Instead of amending the FAA to mandate *legal* requirements for arbitrator neutrality and written decisions, such as those proposed in the Fair Arbitration Act, it should adopt the California approach as federal law, thus mandating nationwide heightened disclosures for arbitrators. As discussed, public confidence in the markets is near its all-time low.[184] In an attempt to eliminate any real or alleged industry bias by arbitrators and in turn promote public confidence, the California state legislature called for more stringent disclosures with respect to potential conflicts of interest.[185] Within the existing system, FINRA maintains a massive database of available arbitrators; with such vast personnel resources, there is no practical reason for limiting disclosures.[186] Rather, disclosure benefits everyone: investors would be more confident that the system is not stacked against them, and the arbitration system would benefit by allowing a theoretically equitable forum to operate equitably.

In addition to leveling the playing field by requiring heightened arbitrator disclosures of potential conflicts of interest, Congress should mandate more comprehensive standards for who can be an arbitrator.[187] *McMahon* acknowledged that arbitration was a competent forum in which to vindicate statutory rights.[188] Even though arbitration is an *equitable* forum, arbitrators should at least be cognizant of both the relevant law and how it operates to govern the legal relationships between investors and broker-dealers in order for arbitration to be a competent forum in which to vindicate statutory rights.

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530 U.S. 363 (2000). Federal preemption is necessary to effectuate reform because, as discussed *supra* Part IV.B.1, state reform efforts have been struck down under this same preemption doctrine.

183. *See* Nagy, *supra* note 7, at 3.

184. On Monday, September 29, 2008, the Dow Jones Industrial Average fell 777.68 points after Congress failed to pass its first attempt at a bailout of Wall Street. At 7%, the Dow dropped even more than it did on September 11, 2001. Heather Landy and Renae Merle, *A Record Fall on Wall Street: Stocks Dive as Bailout Bill Fails to Pass*, Wash. Post, Sept. 29, 2008, at D01.

185. *See* Katsoris *supra* note 39, at 437.

186. FINRA, FINRA Dispute Resolution Fact Sheet, http://www.finra.org/ArbitrationMediation/AboutFINRADR/Overview/FactSheet/index.htm (last visited Feb. 26, 2010) ("FINRA DR maintains a diverse roster of approximately 6,000 arbitrators and 1,000 mediators who are carefully selected from a broad cross-section of professions and backgrounds. Arbitrators are not FINRA employees.").

187. The current requirements to become a FINRA arbitrator are: at least five years of business or professional experience and completion of at least two years of college-level credits. Arbitrators must also successfully complete FINRA's basic arbitrator training. FINRA, Frequently Asked Questions About Becoming a FINRA Arbitrator, http://www.finra.org/ArbitrationMediation/Neutrals/BecomeAnArbitrator/FAQ/index.htm (last visited Feb. 26, 2010).

188. 482 U.S. at 238.

Many professions require continuing education as a condition to maintaining a professional license.[189] Under congressional reform legislation, the SEC and FINRA should follow suit and be required to implement an education program requiring a "continuing education" series of lectures and seminars to ensure that arbitrators are up to speed on the relevant securities laws.[190] Even though it has been established that arbitrators are not required to per se apply the law, understanding the existing law is essential to reaching an equitable outcome in any arbitration proceeding.[191] Furthermore, Congress may consider extending some of the current FINRA requirements for an arbitrator chair to all arbitrators. These requirements are: (i) that a chair be a public arbitrator,[192] (ii) complete FINRA arbitration training, and (iii) have a law degree or have completed a certain minimum level of experience on an arbitration panel.[193] While Congress need not go so far as to require all arbitrators to be lawyers, the continued education training should be required of lawyers and non-lawyers alike to ensure that all potential arbitrators have an up-to-date grasp on the applicable securities laws. Combined with ongoing education initiatives, investors participating in arbitration at FINRA can be assured that the arbitrators will use their background knowledge of the securities laws to reach equitable outcomes.

Finally, Congress should vehemently reject the AFA's additional proposal to repeal the doctrine of "competence-competence." As noted, the proposed effect of the Arbitration Fairness Act would be to vest exclusive jurisdiction with the federal courts to determine arbitrability.[194] Because this would take the jurisdiction decision away from the arbitrators, parties would have a nearly unhindered right to gain access to the courts simply by stating in their complaint that the arbitrator lacked jurisdiction.[195] The real threat is that arbitration would no longer be an "alternative" form of dispute resolution. That is, parties would have no reason to choose arbitration in a world where each and every award was subject to virtually automatic judicial

189. Key examples include education, medicine, and law. Using New York State as an example, see New York State Education Department, Office of the Professionals, NYS Dentistry, Continuing Education Q&A, http://www.op.nysed.gov/prof/dent/dentceques.htm (last visited Feb. 26, 2010); New York State Bar Association, Mandatory CLE, New York Requirements, http://www.nysba.org/AM/Template.cfm?Section=CLE&CONTENTID=2653&TEMPLATE=/CM/ContentDisplay.cfm (last visited Feb. 26, 2010); New York State Education Department, Professional Development for Professional Certificate Holders, http://www.highered.nysed.gov/tcert/certificate/maintaincrt-prof.html (last visited Feb. 26, 2010).

190. Under the current system, arbitrators are only required to complete comprehensive training and pass a written examination. Although specialized continuing education courses are made available online, they not required. FINRA Dispute Resolution Fact Sheet, *supra* note 185.

191. *See The Investor's Advocate*, *supra* note 142.

192. A public arbitrator is defined by FINRA in the negative as an arbitrator who is not a non-public arbitrator. FINRA rule 12100(u). In short, a public arbitrator is not associated with a broker-dealer, corporate-affiliated attorney, or employee of a bank or other financial institution. *See id.*

193. FINRA, Code of Arbitration Procedure, Rules 12400 and 13400.

194. *See Paul Hastings Alert*, *supra* note 86, at 4.

195. *See id.* at 1–2.

review.[196] Provided that Congress takes seriously the reforms that are necessary, investors should feel confident in a time-tested process that has served the public well for over eighty years.

V. CONCLUSION

After the WorldCom and Enron accounting scandals in 2000, the Sarbanes-Oxley Act[197] provided for a new oversight board, the Public Companies Accounting Oversight Board ("PCAOB"), to ensure that accounting firms would be held to high standards.[198] In large part, the creation of the PCAOB was meant to increase investor confidence in the securities markets by ensuring the accuracy of information provided in company financial statements.[199] Although FINRA was not consolidated or created in response to an industry-wide scandal like the PCAOB was, its establishment was meant, in part, to reestablish investor confidence.[200] With the recent severe downturn in the economy, Congress should seize on FINRA's mandate to make securities arbitration meaningful to investors.[201] There is no need to eliminate binding arbitration; however, the process should be made more transparent. Doing so would bring securities arbitration reform full circle; like the 1933 Act, it would aim to restore investor confidence and market integrity through informational disclosure.[202]

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196. *See id.* at 2.

197. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., 28 U.S.C., & 29 U.S.C.).

198. Public Companies Accounting Oversight Board, About the PCAOB, http://www.pcaobus.org/About_the_PCAOB/index.aspx (last visited Feb. 26, 2010).

199. *Id.*

200. News Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority – FINRA (July 30, 2007), http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P036329 (last visited Feb. 26, 2010). FINRA's Chief Executive Officer stated:

> With investor protection and market integrity as our overarching objectives, FINRA will be an investor-focused and more streamlined regulator that is better suited to the complexity and competitiveness of today's global capital markets. By eliminating overlapping regulation and establishing a uniform set of rules placing oversight responsibility in a single organization, we will enhance investor protection while increasing the competitiveness of our financial markets.

Id.

201. *See id.*

202. *See* Nagy, *supra* note 7 and accompanying text.