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Just Saying No: Avoiding Predispute Agreements to Arbitrate in Securities Cases

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COMMENT

JUST SAYING NO: AVOIDING PREDISPUTE AGREEMENTS TO ARBITRATE IN SECURITIES CASES

I. INTRODUCTION

When a would-be investor attempts to gain access to the securities markets, she will usually be required to sign an agreement to arbitrate any disputes arising out of the brokerage contract.1 These predispute agreements to arbitrate are in an of themselves contracts.2 If such contracts are valid, an investor will be forced to forego litigation in favor of arbitration.3 On May 15, 1989, in the case of Rodriguez de Quijas v. Shearson/American Express, Inc.,4 the United States Supreme Court held that predispute agreements to arbitrate claims under the Securities Act of 19335 (hereinafter referred to as the "1933 Act") are valid and enforceable.6 When coupled with the Court’s earlier decision in Shearson/American Express, Inc. v. McMahon,7 which held that predispute agreements to arbitrate under the Securities Exchange Act of 19348 (hereinafter referred to as the "1934 Act") were valid and enforceable,9 it appears that all predispute agreements to arbitrate under the securities laws are presumptively valid and must be enforced according to their terms. Consequently, the number of securities cases that go to arbitration will likely increase. Brokerage houses favor arbitration.10 The above decisions make arbitration more generally available. Thus, one can expect brokerage houses to implement and enforce predispute agreements to arbitrate.

Each year the number of security cases that are submitted to arbitration increases.11 After the McMahon decision, the number of securities claims arbitrated increased as the Court upheld predispute agreements to arbitrate under the 1934 Act.12 In response to the Supreme Court’s decision in de Quijas,

3. See infra notes 4 and 7.
9. McMahon, 482 U.S. at 236.
upholding predispute agreements to arbitrate under the 1933 Act, brokerage houses are likely to repeat the McMahon pattern and move to arbitrate securities disputes arising under the 1933 Act at an increased rate.13

This Comment will explore the current state of securities arbitration and will examine the advisability of arbitration in a securities context. In addition, this Comment will consider avenues of relief open to the securities plaintiff who is seeking to avoid arbitration.

II. THE FEDERAL POLICY OF ARBITRATION AND ARBITRABILITY

A. Arbitration

Alternative dispute resolution (hereinafter referred to as "ADR") has grown rapidly in popularity as both lawyers and litigants seek alternatives to litigation.14 The judicial system currently incorporates ADR through the use of out of court settlements. This use of out-of-court settlements disposes of 90% of all cases without adjudication.15 Unfortunately, 85% of attorneys express dissatisfaction with this informal process.16 The most commonly cited reasons for dissatisfaction include delay in reaching settlement, expense and stress.17

In contrast to litigation and the use of out-of-court settlements, ADR generally, and arbitration specifically, is quick and cost effective.18 Arbitration usually takes from four to six months and costs about one third as much as litigation from start to finish.19 Consequently, arbitration is an appealing method of resolving disputes, in that it reduces the time, expense and stress associated with litigation.20 In addition, as arbitration removes cases from the court system, court dockets become less crowded.

Historically, Congress has favored arbitration as a method of alternative dispute resolution.21 Giving expression to its preference in 1925, Congress enacted the Federal Arbitration Act (hereinafter referred to as the "FAA").22

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13. Id.
15. Id. at 670 n.8.
16. Id. at 670.
17. Id.
18. See supra note 11, at 282-283.
B. The Federal Arbitration Act

The FAA was enacted in 1925 in response to pressure by the business community for an alternative to litigation. The Act was intended to reduce historic judicial hostility toward arbitration. Congress felt that the FAA would help reduce the costs associated with litigation and would help clear congested court dockets. The broad language of the FAA thus embodies a strong federal policy in favor of arbitration (hereinafter referred to as the "mandate of the FAA").

The FAA carries out its mandate by making all agreements to arbitrate, "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." By its terms, the FAA applies only to transactions in interstate commerce. However, interstate commerce has been defined so broadly that almost all securities transactions will fall within the definition. The FAA creates a presumption of arbitrability, one that must be overcome by a party seeking to avoid arbitration.

The presumption of arbitrability is particularly important where the presumption is not rebutted and the arbitrator renders a decision. This is so, because the grounds for judicial review of the arbitrator's decision are extremely limited. Under the FAA there are only four grounds for overturning an arbitrator's decision:

1. There was an undisclosed relationship between an arbitrator and a party or his counsel affecting the arbitrator's impartiality or appearance of impartiality;
2. The arbitrator was corrupt;
3. The arbitrator failed to schedule or conduct the hearing in a fair and judicious manner;
4. The arbitrator granted relief which he was not authorized to grant under the arbitration contract.

Unless one of these four grounds is shown to exist, the arbitrator's decision will stand. Therefore, failure to rebut the presumption renders one subject to an arbitration proceeding from which the right to appeal is limited to a narrow

28. Id.
29. 9 U.S.C. § 1. See also Fletcher, supra note 19, at 402 (1982).
32. See supra note 11, at 290-91. See also 9 U.S.C. § 10 (1982).
spectrum. Absent misconduct on the part of the arbitrator, her decision will be final. This should not be a cause for concern if the arbitration process, including the initial agreement to arbitrate, is fundamentally fair to all parties.33

C. The Mandate of the FAA

The language of the FAA is broad and its mandate, as interpreted by the courts, is no less expansive.34 In a line of cases running from 1967 to 1987 the United States Supreme Court has given an expansive interpretation to the FAA.

(1) In the first of these cases, Prima Paint v. Flood & Conklin Mfg. Co.,35 the Supreme Court upheld the constitutionality of the FAA.36 The FAA was challenged on the ground that Congress may not "fashion federal substantive rules to govern questions arising in simple diversity" under the doctrine of Erie R. Co. v. Tompkins.37 The Court reshaped the inquiry to be, "[W]hether Congress may prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate."38 The Court answers the question in the affirmative, noting federal authority over interstate commerce and admiralty.39 Holding clear federal authority to create a substantive law of arbitrability, the Court found the Act to contain a presumption of arbitrability.

(2) In Moses Cone Memorial Hosp. v. Mercury Constr. Corp.,40 the Supreme Court broadly construed the FAA, finding a presumption in favor of arbitration.41 The Court states:

The FAA establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an alleged allegation of waiver, delay or a like defense to arbitrability.42

The presumption established in Moses operates to place a party seeking to avoid arbitration in the position of rebutting an unusually strong presumption, with no explicit guidance as to how this should be done. The Court's next decision

33. See infra note 111 and accompanying text.
34. See supra notes 27-30 and accompanying text.
36. Id. at 404-5.
37. Id. at 405 (citing 304 U.S. 64 (1939)).
40. Moses, 460 U.S. at 1.
41. Id. at 24-25.
42. Id.
interpreting the FAA provides no answers to the Moses problem, but further expands the reach of the Act.

(3) In the case of Southland Corp. v. Keating, the Supreme Court expands the reach of the FAA into state courts. The California Supreme Court held that anti-waiver provisions of that state’s Franchise Investment Law prohibited arbitration. The United States Supreme Court found the California law to be in conflict with the FAA. The Court held that the FAA overrides state law, where such state law conflicts with the FAA. In so doing, the Court expands upon its holding in Prima Paint, that the FAA created substantive federal law, by relying on the Supremacy Clause of the United States Constitution to extend the mandate of the FAA.

(4) In 1985, the Court answered the question left open in Moses as to how one rebuts the presumption of arbitrability. The Court in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc. established the principle that "unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue," courts must strictly enforce arbitration agreements. The analysis under Mitsubishi involves a determination of whether the agreement to arbitrate was broad enough to encompass consideration of the statutory claims and then whether Congressional intent exists to preclude arbitration. If either criterion is met, the presumption established in Moses is overcome and arbitration can be avoided.

(5) In the same term that Mitsubishi was decided, the Court decided Dean Witter Reynolds, Inc., v. Byrd. Byrd reiterates many of the Court’s prior statements involving the broad mandate of the FAA in promoting arbitration, but in a context that significantly advances that mandate. The Court reiterates its holding in Moses that where there is doubt concerning the validity of an arbitration agreement.
agreement, that doubt should be resolved in favor of arbitration.\textsuperscript{54} The Court also \{presaged\}?? the \textit{Mitsubishi} test, noting that the FAA represents a Congressional policy that favors arbitration and that such policy cannot be overridden "absent a countervailing policy in another federal statute."\textsuperscript{55}

The \textit{Byrd} Court expands the scope of the FAA by abolishing the intertwining doctrine. The intertwining doctrine holds that where non-arbitrable federal claims are intertwined with arbitrable state claims, a court in its discretion can choose to litigate all the claims in federal court, despite any agreement to arbitrate.\textsuperscript{56} The court in abolishing the intertwining doctrine specifically notes that considerations of judicial economy cannot override the mandate of the FAA. Inefficient "piecemeal" proceedings are required.\textsuperscript{57} Those claims subject to valid agreements to arbitrate must go to arbitration, even when to do so would be inefficient.

This line of cases establishes the sweeping breadth of the FAA. It is in light of this mandate that predispute agreements to arbitrate securities disputes must be considered. The party seeking to avoid a predispute agreement to arbitrate in their brokerage contract will have to overcome a presumption of arbitrability, embodied in substantive federal law, by showing an explicit intent on the part of Congress to exempt the transaction. The enforceability of predispute agreements to arbitrate securities disputes has tracked the expansion of the FAA.

\section*{III. Securities Arbitration}

In a line of cases running from 1953 to 1989 the United States Supreme Court has ruled on the enforceability of predispute agreements to arbitrate securities disputes.\textsuperscript{58} These rulings have reflected the expansion of the FAA's mandate favoring arbitration.

\subsection*{A. The Wilko Case and its Erosion}

(1) The first significant case in the area of securities arbitration is the Supreme Court's decision in \textit{Wilko v. Swan}.\textsuperscript{59} The case arose out of a predispute agreement to arbitrate a security claim under section 12(c)\textsuperscript{60} of the 1933 Act.\textsuperscript{61} The Court held that predispute agreements to arbitrate under the 1933 Act are unenforceable.\textsuperscript{62} The Court reasons that three factors combined to create a special right under section 12(c) of the 1933 Act, thus exempting such claims from

\begin{thebibliography}{62}
\bibitem{54} Id. at 221.
\bibitem{55} Id.
\bibitem{56} Id. at 216-217.
\bibitem{57} Id. at 217-221.
\bibitem{58} See supra note 10, at 99.
\bibitem{59} 346 U.S. 427 (1953).
\bibitem{61} \textit{Wilko}, 346 U.S. at 427.
\bibitem{62} Id. at 435-436.
\end{thebibliography}
the FAA. First, under section 12(c) of the 1933 Act scienter need not be proven.63
Second, plaintiffs are given a choice between federal and state forums.64

Finally, section 1465 of the 1933 Act prohibits any waiver of compliance with
the Act.66 In addition, the Wilko Court was motivated in part by the perceived
inability of arbitration procedures to protect the investor.67

Due to the substantial similarity between section 14 of the 1933 Act and
section 29(a) of the 1934 Act,68 lower courts in the wake of Wilko applied the
Wilko Doctrine to 1934 Act claims as well.69 The net effect of the decision in
Wilko was to make all securities claims non-arbitrable. Under the Wilko Doctrine
all predispute agreements to arbitrate would be unenforceable.

(2) The Supreme Court began to cut back on the Wilko Doctrine in 1974. In
Scherk v. Alberto-Culver Co.,70 the Court was faced with a predispute agreement
to arbitrate a securities dispute under section 10b-571 of the 1934 Act.72 While
the decision in Wilko and its progeny should have disposed of the case, it did not,
as the Court found a crucial distinction between Wilko and Scherk. Scherk involved
an international securities transaction which the Court found to be fact determina-
tive.73 The Court, citing considerations of comity and certainty,74 held that
predispute agreements to arbitrate securities disputes were valid and enforceable
in an international transaction.75 Scherk marks the beginning of Wilko’s erosion.

(3) The next case in the Court’s retreat from Wilko is Dean Witter Reynolds
v. Byrd.76 As noted earlier, Byrd confronted the problem of arbitrable state
claims joined with nonarbitrable federal securities claims under the 1934 Act.77
For the first time the FAA and the Securities Acts of 1933 and 1934, as
interpreted by Wilko met head on, and the FAA won. The Court in abolishing the

65. Id. at § 77n.
67. Id. at 433-435.
69. See supra note 20, at 209 (citing cases). See also note 11, at 297 (citing cases where the Wilko
doctrine was applied to sections 5 and 17 of the 1933 Act).
72. Scherk, 417 U.S. at 508-509.
73. Id. at 517-518.
74. Id. at 518-519.
75. Id. at 519-520.
76. Supra note 52 and accompanying text.
77. Scherk, 417 U.S. at 214.
intertwining doctrine read the FAA to mandate the arbitration of arbitrable claims, even when joined with nonarbitrable federal claims.\textsuperscript{78}

(4) The first of the Supreme Court’s landmark securities cases was \textit{Shearson/American Express, Inc., v. McMahon}.\textsuperscript{79} Under the 1933 Act, causes of action are expressly granted,\textsuperscript{80} while under the 1934 Act they are implied.\textsuperscript{81} As noted above, lower courts had applied \textit{Wilko} to causes of action under the 1934 Act, holding such predispute agreements to arbitrate are unenforceable.\textsuperscript{82} In \textit{McMahon}, the Court distinguishes between the treatment of express claims under the 1933 Act and the implied claims arising under the 1934 Act. The Court addresses the question of the validity of predispute agreements to arbitrate implied causes of action under the 1934 Act, finding such claims arbitrable.\textsuperscript{83}

The \textit{McMahon} decision overturned the \textit{Wilko} progeny which applied the \textit{Wilko} Doctrine to 1934 Act cases. After \textit{McMahon}, predispute agreements to arbitrate under the 1934 Act are enforceable.\textsuperscript{84} The decision also laid the groundwork for the eventual complete overruling of \textit{Wilko}. The \textit{McMahon} Court notes that the inability of arbitration to protect the investor was central to the decision in \textit{Wilko}. The Court further notes that arbitration has progressed since the time of \textit{Wilko} in 1953. The Court found current arbitration procedures adequate to protect the investor.\textsuperscript{85} While holding 1934 Act claims arbitrable, the Court declined to overrule \textit{Wilko}, as the arbitrability of 1933 Act claims was not before the Court.

(5) In \textit{Rodriguez De Quijas v. Shearson/American Express, Inc.},\textsuperscript{86} the Court addressed the question of the arbitrability of claims under section 12(2) the 1933 Act.\textsuperscript{87} In this second landmark case, the Court overturned \textit{Wilko}.\textsuperscript{88} The Court held that predispute agreements to arbitrate under the 1933 Act were enforceable.\textsuperscript{89} The Court notes the line of cases establishing the mandate of the FAA and applies the \textit{Mitsubishi} test to the 1933 Act,\textsuperscript{90} finding the \textit{Wilko} Doctrine wanting. The Court further notes the plaintiff’s failure to demonstrate why arbitration was an inappropriate forum for the resolution of 1933 Act claims or to demonstrate how the predispute agreement to arbitrate in question was

\begin{itemize}
\item \textsuperscript{78} Id. at 221.
\item \textsuperscript{79} 482 U.S. 220 (1987).
\item \textsuperscript{80} 15 U.S.C. § 78j(b) (1982); 17 C.F.R. § 240.10b-5 (1986).
\item \textsuperscript{81} 15 U.S.C. §§ 77(a)-77(aa) (1982).
\item \textsuperscript{82} Supra note 66 and accompanying text.
\item \textsuperscript{83} McMahon, 482 U.S. at 236.
\item \textsuperscript{84} Id.
\item \textsuperscript{85} Id. at 230-232.
\item \textsuperscript{86} 109 S. Ct. 1917 (1989).
\item \textsuperscript{87} Id. at 1919. Section 12(2) provides civil liability for anyone who offers or sells a security in violation of the Section 5 timing rules.
\item \textsuperscript{88} De Quijas, 109 S. Ct. at 1919.
\item \textsuperscript{89} Id.
\item \textsuperscript{90} Id. at 1920-1921.
\end{itemize}
adhesive. It would seem that after McMahon and De Quijas all predispute agreements to arbitrate securities claims, whether under the 1933 or 1934 Act, are enforceable.

B. The Post De Quijas Cases

Immediately after the United States Supreme Court’s decision in De Quijas, lower courts interpreted the holding as both compelling enforcement of predispute agreements to arbitrate in securities cases and as expanding the mandate of the FAA. Two cases are illustrative.

(1) Brown v. Dean Witter Reynolds, Inc.92

The plaintiff in Brown asserted claims under the 1933 and 1934 Acts. He attempted to avoid arbitration on several grounds. He argued that the Supreme Court’s decisions in McMahon and De Quijas should not be applied retroactively to a brokerage contract entered into before the decisions were handed down; that there was a waiver of the predispute agreement to arbitrate; and that a lack of meaningful discovery prevented him from challenging the arbitration agreement.93 The Eleventh Circuit denied each of the plaintiff’s arguments and held the predispute agreement to arbitrate enforceable.94

It is interesting to note that the Brown court gives retroactive effect to the decisions in McMahon and De Quijas. More interesting, however, is that a lack of discovery is no bar to enforcement. By excluding meaningful discovery in an arbitration context the court has placed a thumb on the scales of justice. If, as the court notes, "The party opposing arbitration bears the initial responsibility of informing the court of its opposition [to the predispute agreement to arbitrate],"95 and yet cannot conduct discovery, how is the burden of rebutting the presumption of validity of the predispute agreement to arbitrate to be met? The answer appears to be, not easily. Court sanctioned lack of discovery prevents the party opposing arbitration from gaining the information the same court demands to rebut the presumption of arbitrability. Fundamental fairness would seem to suggest that the party opposing arbitration be given the opportunity to discover the information necessary to overcome the presumption. That arbitration is compelled in such a situation is telling. The federal policy favoring arbitration must be broad indeed.

(2) Securities Indust. Assoc. v. Connolly96

91. Id. at 1921.
92. No. 13404 (11th Cir. Sept. 1, 1989) (LEXIS Genfed library, Cir. file).
93. Id.
94. Id.
95. Id.
96. No. 13081 (1st Cir. Aug. 31, 1989) (LEXIS, Genfed library, Cir. file).
At issue in Connolly was a Massachusetts statute that regulates predispute agreements to arbitrate. The statute requires that brokerage firms (1) not require, "individuals to enter PDAAs as a nonnegotiable condition precedent to account relationship," (2) "order the prohibition brought conspicuously to the attention of the prospective customers," and (3) provide "written disclosure of the 'legal effect of the pre-dispute arbitration contract'." The statute was held to be invalid under the preemption doctrine as it conflicted with the FAA.\textsuperscript{97}

Under the preemption doctrine the state regulation is preempted by the FAA if the two statutes are in conflict.\textsuperscript{98} The Connolly interpreted De Quijas as indicating that Congress' intent to mandate the enforceability of arbitration agreements must be fully protected.\textsuperscript{99} The court reasoned that the FAA forbids States from regulating arbitration any more strictly than an ordinary contract.\textsuperscript{100}

The decision in Connolly is striking. That the FAA represents a substantive body of federal law on arbitration is beyond dispute.\textsuperscript{101} That the federal law of arbitration established in the FAA overrides contrary state law under a preemption analysis is established.\textsuperscript{102} That the FAA prohibits states from regulating predispute agreements to arbitrate is novel.

The FAA attempts to place predispute agreements to arbitrate on an equal footing with other contracts;\textsuperscript{103} it does not prohibit states from regulating such contracts.\textsuperscript{104} The Massachusetts statute does not prohibit the use of arbitration.\textsuperscript{105} It merely requires safeguards to ensure investor protection.\textsuperscript{106} The statute prevented contracts of adhesion and requires informed consent on the part of the investor.\textsuperscript{107} The Connolly court's decision seems to pave the way for brokers to utilize contracts of adhesion, whereby investors will unknowingly waive the right to access a judicial forum. Further, it prohibits states from regulating to prevent such conduct. In light of Connolly, states may not regulate where such regulation would involve any potential conflict with the FAA.

IV. APPROACHES TO SECURITIES ARBITRATION

The historical development of the FAA mandate (enforcing agreements to arbitrate) and the parallel development of the enforceability of predispute agreements to arbitrate in securities cases, leave the party seeking to avoid arbitration in a difficult and perhaps insupportable position. McMahon and De

\begin{itemize}
  \item \textsuperscript{97} Id.
  \item \textsuperscript{98} Id.
  \item \textsuperscript{99} Id.
  \item \textsuperscript{100} Id.
  \item \textsuperscript{101} See supra note 24 and accompanying text.
  \item \textsuperscript{102} See supra note 43 and accompanying text.
  \item \textsuperscript{103} See supra notes 2 and 95.
  \item \textsuperscript{104} See supra note 22.
  \item \textsuperscript{105} MASS. REGS. CODE tit. 950, §§ 12.204 (G) (1) (a)-(c) (1978).
  \item \textsuperscript{106} See supra note 95.
  \item \textsuperscript{107} Id.
\end{itemize}
Quijas seem to indicate that all predispute agreements to arbitrate in brokerage contracts are enforceable. However, a careful analysis of De Quijas and the FAA leaves some room for hope that predispute agreements to arbitrate may yet be avoided in securities cases. Four approaches seem to be available for the party seeking to avoid arbitration:

1. Challenging the Appropriateness of Arbitration;
2. Arguing that Predispute Agreements to Arbitrate are Contracts of Adhesion;
3. Asserting Undecided Statutory Claims;

A. The Appropriateness of Arbitration

If arbitration is fundamentally fair to all parties, predispute agreements to arbitrate should be enforced according to their terms. Unfortunately, this may not be the case. The Court in McMahon felt that arbitration had progressed since the Wilko decision in 1953. However, the dissent questions the adequacy of arbitration, as the Securities and Exchange Commission (hereinafter referred to as SEC) does not have sufficient oversight, noting that the SEC lacks the ability to specifically review arbitration proceedings.

The arbitration system used in the securities industry is the product of industry and SEC cooperation. The parties to a securities arbitration agreement may choose either to arbitrate under the auspices of one of the self regulatory organizations (hereinafter referred to as SROs), such as the New York Stock Exchange, or the American Arbitration Association (hereinafter referred to as AAA). The SEC has no oversight over the AAA, but does possess oversight over the SROs. The SEC seeks, through its oversight, to strengthen the legitimacy of securities arbitration. However, this oversight over the SROs does not include the ability to overturn an arbitration award.

108. See supra notes 78-90 and accompanying text.
110. Id. at 240-242.
111. Id. at 262.
112. See supra note 14, at 681.
115. See generally Fletcher, supra note 10, at 136. (SEC seeks to increase its oversight capabilities as some courts preface their decisions on the adequacy of arbitral procedures).
116. Supra note 112, at 1129. The four factors are:
1. There was an undisclosed relationship between an arbitrator and a party or his counsel affecting the arbitrator's impartiality;
2. The arbitrator was corrupt;
3. The arbitrator failed to schedule or conduct the hearing in a fair and judicious manner; and
This inability to review arbitral decisions becomes critical when one realizes that the courts are almost equally unable to review an arbitral decision. The FAA lists four grounds upon which an arbitrator’s decision can be overturned.\footnote{9 U.S.C. § 10 (1982).} In addition, the Supreme Court has allowed an arbitration award to be overturned for manifest disregard of the law.\footnote{Wilko, 346 U.S. at 436-437.} Absent egregious behavior by the arbitrator, the arbitration award will be unassailable.

It is argued that to allow greater review of arbitration awards would be to lose the benefits of arbitration as an unsuccessful party would immediately appeal.\footnote{Bruff, Public Programs, Private Deciders: The Constitutionality of Arbitration in Federal Programs, 67 TEX. L. REV. 441, 477 (1989); \textit{See also} Katsoris, supra note 11, at 291 n.84.} This is not the case. Allowing more liberal review of arbitration does not destroy the efficacy of the arbitration process as the decision, if appealed, would be admissible as evidence in the later proceeding.\footnote{See supra note 23, at 687.}

With no meaningful review of the arbitration award available, the investor must accept the rough justice of arbitration. Discovery rules do not apply in arbitration,\footnote{Foremost Yam Mills, Inc. v. Rose Mills, Inc., 25 F.R.D. 9, 11 (E.D. Pa. 1960).} though arbitrators do have subpoena powers.\footnote{Burton v. Bush, 614 F.2d 389, 390 (4th Cir. 1980).} Arbitrators are not bound by the rules of evidence.\footnote{Bernhardt v. Polygraphic Co., 350 U.S. 198, 203 n.4 (1956).} Arbitrators are not bound by principles of substantive law.\footnote{University of Alaska v. Modern Constr., Inc., 522 P.2d 1132, 1140 (Alaska 1974).} Arbitrators are not bound by stare decisis.\footnote{M. HILL \& A. SINICROPI, EVIDENCE IN ARBITRATION 1, 40-41 (1980).} Arbitrators need not state their reasons for an award, nor are they required to make written findings of fact.\footnote{Supra note 14, at 676-678.} The rationale given for this truncated procedure is that arbitration is intended to be quick and efficient.\footnote{Herman \& MacLean v. Huddleston, 459 U.S. 375, 383 (1983).}

"But surely the mere resolution of a dispute is not proof that the public interest has been served."\footnote{Supra note 19, at 460 (citing King v. Sussex Justices, 1 K.B. 256, 259 (1924)).} The Securities Acts are intended to provide protection to purchasers of registered securities\footnote{Supra note 19, at 460 (citing King v. Sussex Justices, 1 K.B. 256, 259 (1924)).} and to promote investor confidence.\footnote{Supra note 19, at 460 (citing King v. Sussex Justices, 1 K.B. 256, 259 (1924)).} Congress, in enacting the Securities Acts, established a policy of protecting investors through specific statutory mechanisms. Yet arbitrators are

\footnote{(4) The arbitrator granted relief which he was not authorized to grant under the arbitration clause.}
not competent to deal with statutory claims.\textsuperscript{131} An arbitrator's authority is purely contractual.\textsuperscript{132} Public policy concerns are beyond the pale of an arbitrator's purview.\textsuperscript{133}

Equally, much arbitration is conducted by the SROs.\textsuperscript{134} To allow "those the law seeks to regulate to delimit public rights and duties... [is] real reason for concern."\textsuperscript{135}

Where the legislature has established strict standards, allowing arbitration to lessen those standards runs counter to the rule of law.\textsuperscript{136} It would seem fundamentally unfair to allow organizations made up of brokers to decide complaints made against brokers.

As "[t]he primary purpose of the securities laws is to protect investors who are not able to protect themselves,"\textsuperscript{137} it might be argued that the time has come for an unsophisticated investor exception to the De Quijas Doctrine. Namely, that the federal policy of protecting investors embodied in the 1933 and 1934 Acts is a countervailing federal policy\textsuperscript{138} which should override the FAA where one of the parties to an agreement to arbitrate is an unsophisticated investor; the very type of investor the Securities Acts were designed to protect. The FAA should not be construed to demand arbitration where one of the parties is unsophisticated, as to do so allows a private decision-maker to delimit federal rights. De Quijas, if applied broadly, will undermine Congress' intent to protect the unsophisticated investor, as embodied in the 1933 and 1934 Acts. The right to a federal forum under the Securities Acts is rendered nugatory by allowing mandatory arbitration.\textsuperscript{139}

The argument is made, however, that predispute agreements to arbitrate are merely forum selection devices.\textsuperscript{140} Here again, this is not the case. An arbitration clause is not a mere forum selection device. "To the degree that arbitration alters the combination of remedies and sanctions afforded by state law, it modifies substantive law in ways unintended by the drafters of the Federal Arbitration Act and interferes with the contractual expectations of parties to an arbitration agreement."\textsuperscript{141}

\textsuperscript{131} Barrentine v. Arkansas-Best Freight Sys., 450 U.S. 728, 743 (1981); Alexander v. Gardner-Denver Co., 415 U.S. 36, 57 (1974); McDonald v. City of W. Branch, 466 U.S. 284, 290 (1984) ("[A]lthough arbitration is well suited to resolving contractual disputes... it cannot provide an adequate substitute for a judicial proceeding in protecting federal statutory and constitutional rights. . . .").

\textsuperscript{132} Id.

\textsuperscript{134} See supra note 112.

\textsuperscript{135} See Edwards, supra note 14, at 676.

\textsuperscript{136} Id. at 677.

\textsuperscript{137} Fletcher, supra note 19, at 427.

\textsuperscript{138} Id. at 428.

\textsuperscript{139} Heinemann, supra note 1, at 552.

\textsuperscript{140} Fletcher, supra note 19, at 410-11.

\textsuperscript{141} Note, supra note 112, at 1114-1115.
Punitive damages provide a ready example. Punitive damages are unavailable under securities arbitration. Another example is the extent that arbitral considerations exclude punitive awards, the process sacrifices both systemic efficiency and investor protection, and weakens "deterrence of already outrageous conduct on Wall Street by reducing or eliminating potential exposure to punitive liability." A denial of punitive damage awards arguably interferes with arbitrations function of providing a substantially equivalent forum for dispute resolution. At best if arbitration is merely a forum selection device, it is an inappropriate and ineffective one, as the efficacy of arbitration to resolve questions of federal rights is suspect due to the inherent procedural limitations of the arbitral process.

The De Quijas Court citing Wilko notes; "There is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled." Thus, the burden falls on the plaintiff seeking to avoid arbitration to show why arbitration should not be compelled. By demonstrating the inappropriateness of arbitration to deal with federal rights under the Securities Acts, a plaintiff might avoid arbitration. The courts should not compel arbitration of securities disputes until arbitration has been improved.

B. Predispute Agreements to Arbitrate are Contracts of Adhesion

An adhesion contract arises when a party must accept or reject a contract without an opportunity to negotiate the terms. If such a contract of adhesion runs counter to a party's expectations or is oppressive, unconscionable or against public policy it will be unenforceable. If an adhesion contract removes all choice, in that a party has no alternative but to sign the contract, the contract should be per se unenforceable as against public policy. It is often said that to gain access to the securities markets an investor will have to sign an agreement to arbitrate. If this is strictly accurate, an argument could be made that the predispute agreements to arbitrate are adhesive in nature and ought not to be enforced on that ground, as they are oppressive, unconscionable and against public policy. In an attempt to ascertain the truth

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142. *Id.* at 1120. Punitive damages are unavailable for federal claims but are available for violations of state securities laws.

143. *Id.* at 1114.

144. *Id.* at 1127.

145. *Id.*


147. *De Quijas*, 109 S. Ct. at 1921.

148. Note, supra note 21, at 261.

149. Katsoris, supra note 11, at 306.

150. *Id.* at 307.

151. *Id.* at 292; See also supra note 21, at 245.

152. See supra note 21, at 259 n.107 (citing a case finding no adhesion).
or falsity of such claims, this author in preparing this Comment conducted a
survey of leading brokerage houses to determine to what extent access to the
securities markets is predicated on signing a predispute agreement to arbitrate.

The results of this telephone survey indicate that 100% of brokerage houses
require a customer to sign a predispute agreement to arbitrate where the customer
is opening a margin account. The universal reason given for this requirement is
that, as margin accounts involve an extension of credit by the brokerage house to
the customer, the brokerage houses desire an expeditious forum for resolving
disputes where their capital is being used. In cash accounts the situation is in flux.

Currently, approximately 50% of the brokerage houses surveyed require that
a customer sign a predispute agreement to arbitrate when opening a cash account.
While cash accounts involve no extension of credit to the customer by the
brokerage house, the trend is towards including predispute agreements to arbitrate
in cash accounts. Many of the brokers surveyed, indicated that the industry was
moving toward requiring predispute agreements to arbitrate in cash accounts. The
possibility that predispute agreements to arbitrate are adhesive in nature
when looking at the securities industry as a whole or are adhesive in any single
case raises, beyond the contract argument, serious questions of a constitutional
nature. The Seventh Amendment of the United States Constitution guarantees the
right to a jury trial. Arbitration does away with judicial niceties in favor of
a more efficient method of dispute resolution, including a jury. The

<table>
<thead>
<tr>
<th>FIRM</th>
<th>MARGIN</th>
<th>CASH</th>
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</thead>
<tbody>
<tr>
<td>A.G. Edwards</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Charles Schwab</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Dean, Witter, Reynolds</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Edward D. Jones</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Goldman, Sachs &amp; Co.</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Kidder, Peabody &amp; Co.</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>Merrill Lynch</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Paine Webber</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Shearson, Lehman, Hutton</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Smith Barney</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

153. These brokers include: Charles Schwab; Shearson Lehman, Hutton; A.G. Edwards; Dean,
       Whitter, Reynolds; and Edward D. Jones.
154. These brokers include: Kidder, Peabody & Co. and Shearson, Lehman, Hutton.
155. U.S. CONST. art VII.
156. See supra text this Comment, at § IV(A): The Appropriateness of Arbitration.
right to a jury trial can be waived, but such waiver must be voluntary and knowing. \textsuperscript{158} 

In order for arbitration to be binding and not run afoul of the Seventh Amendment right to a jury trial, the predispute agreement to arbitrate must be entered into voluntarily and knowingly. The investor can waive his right, but there needs to be choice and knowledge of the significance of the act to make the waiver meaningful. \textsuperscript{159} If the contract is classically one of adhesion, there is by definition no choice and thus an argument that the predispute agreement to arbitrate is violative of the Seventh Amendment and ought not be enforced.

In light of the author's research, it would seem that there is a strong argument that predispute agreements to arbitrate in brokerage contracts are adhesive. 100\% of all margin accounts and 50\% of all cash accounts require such agreements, if one is to gain access to the securities markets. Thus in 75\% of all cases, if a customer wishes to purchase or sell securities, she will have to sign a predispute agreement to arbitrate or be barred from entering the market through a brokerage house.

In \textit{De Quijas}, the Court notes "[a]lthough petitioners suggest that the agreement to arbitrate here was adhesive in nature, the record contains no factual showing sufficient to support that suggestion."\textsuperscript{160} The court's statement appears to leave open the possibility that a successful showing that a predispute agreement to arbitrate was adhesive could lead to a different result, namely avoidance of the predispute agreement to arbitrate.\textsuperscript{161}

C. Asserting Undecided Statutory Claims

The cause of action in \textit{De Quijas} was a section 12(2) claim under the 1933 Act.\textsuperscript{162} As this was the only section before the court, a narrow interpretation of the decision could limit the holding to section 12(2).\textsuperscript{163} Section 17\textsuperscript{164} would technically remain available to a party seeking to avoid arbitration, its arbitrability undecided by the Court in \textit{De Quijas}.

Unlike 12(2), 17(a) grants no express private rights, nor does the section grant a forum choice; further, the plaintiff must prove willfulness.\textsuperscript{165} Nevertheless, some courts have found an implied cause of action under section 17(a), while

\begin{itemize}
  \item \textsuperscript{157} See generally supra note 113.
  \item \textsuperscript{158} Edwards, \textit{supra} note 14, at 674.
  \item \textsuperscript{159} \textit{Supra} note 21, at 255.
  \item \textsuperscript{160} \textit{De Quijas}, 109 S.Ct. at 1921.
  \item \textsuperscript{161} See \textit{supra} note 21, at 259.
  \item \textsuperscript{162} 15 U.S.C. § 77(2) (1982); \textit{De Quijas}, 109 S. Ct. at 1919.
  \item \textsuperscript{163} \textit{But see Brown}, No. 13404 (11th Cir. Sept. 1, 1989) (LEXIS Genfed library, Cir. file); \textit{supra} note 92 and accompanying text.
  \item \textsuperscript{164} 15 U.S.C. § 77(q) (1982).
  \item \textsuperscript{165} \textit{Id}.
\end{itemize}
others have not.\textsuperscript{166} The split in the circuits would seem to make such an issue ripe for certification by the Supreme Court.

For the party seeking to avoid a predispute agreement to arbitrate, section 17(a) is one avenue of attack, albeit a weak one. One must be in a jurisdiction allowing the private cause of action and one must overcome the inherent weaknesses in a 17(a) argument. Because 17(a) does not include the special protections of section 12(2), it will be harder to satisfy a court that the \textit{Mitsubishi} test is met (that Congress intended to create an exception to the FAA).\textsuperscript{167} Further, 17(a) does not protect against broker fraud but only protects purchasers of securities.\textsuperscript{168} In light of the expansive reading given \textit{De Quijas},\textsuperscript{169} success in avoiding a predispute agreement to arbitrate by framing one's complaint as a 17(a) violation is highly problematic.

D. Asserting Traditional Contract Defenses

The FAA makes all agreements to arbitrate, "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."\textsuperscript{170} The last quoted clause would allow a party seeking to avoid a predispute agreement to arbitrate to plead contract defenses, as predispute agreements to arbitrate are contracts.\textsuperscript{171}

Such defenses would include arguments that the predispute agreement to arbitrate was unconscionable as a contract of adhesion.\textsuperscript{172} Additional arguments might be made that the predispute agreement to arbitrate was fraudulently entered into, that there was no valid offer and acceptance of the terms of the predispute agreement to arbitrate, mistake, misunderstanding or that predispute agreement to arbitrate was an unauthorized modification of the contract not within the contemplation of the parties.\textsuperscript{173} These and other contract arguments have rarely been argued and are beyond the scope of this Comment, but might have some viability.

\textsuperscript{166} For Circuits upholding a private cause of action see, Berger v. Bishop Inv. Corp., 695 F.2d 302, 305 (8th Cir. 1982); Kirshner v. United States, 603 F.2d 234, 241 (2d Cir. 1978); Newman v. Prior, 518 F.2d 97 (4th Cir. 1975); Surowitz v. Hilton Hotels Corp., 342 F.2d 596 (7th Cir. 1965), \textit{rev'd on other grounds}, 383 U.S. 363 (1966). \textit{But see In re Wash. Pub. Power Supply Sys. Sec. Lit.}, 823 F.2d 1349, 1353-1357 (9th Cir. 1987);

\textsuperscript{167} See supra note 49 and accompanying text.

\textsuperscript{168} See Fletcher, supra note 10, at 132.

\textsuperscript{169} See \textit{Brown}, No. 13404 (11th Cir. Sept. 1, 1989) (LEXIS Genfed library, Cir. file); \textit{supra} note 92 and accompanying text.


\textsuperscript{171} See T. \textit{Hazen}, \textit{supra} note 2, H.R. REP. NO. 96.

\textsuperscript{172} \textit{See supra} text this Comment, at § IV (B): Predispute Agreements To Arbitrate Are Contracts of Adhesion.

V. Conclusion

The Supreme Court's recent decisions in the field of securities arbitration leave little apparent room for a party opposed to arbitration. Yet, such opposition may be justified by the inherent inefficiencies of the arbitral process. The party seeking to oppose arbitration in the wake of the *De Quijas* decision must be prepared for an uphill battle. However, careful analysis of the FAA and the De Quijas decision leave room for hope. One can hope that securities arbitration will be improved to afford investors the protection Congress sought to afford them in the 1933 and 1934 Acts. Until such time, arbitration of securities disputes should not be compelled.

Jim Parks