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The Historical Basis of Securities Arbitration as an Investor Protection Mechanism Symposium

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I. INTRODUCTION

Since the very beginnings of stock and bond trading in the United States, the securities industry has used arbitration to resolve disputes among industry participants.[1] Despite securities arbitration's deep roots in American history, most descriptions of its background and use begin with the Supreme Court's 1987 watershed decision in *Shearson/American Express, Inc. v. McMahon,*[2] in which the Court held that claims arising under the Securities and Exchange Act of 1934 (Exchange Act)[3] were arbitrable.[4] Two years later, in *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[5] the Court held that claims arising under the Securities Act of 1933 (Securities Act)[6] also were arbitrable.[7] The Court's comfort level with securities arbitration in both cases was enhanced by the substantial oversight of the arbitration forum and its procedures exercised by the Securities and Exchange Commission (SEC).[8]

The *McMahon* and *Rodriguez* decisions led to an explosion in the use of arbitration to resolve investors' disputes with their securities firms.[9] Today, in fact,

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1. *See infra* Part II.B.
2. Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987).
3. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78ll (2014)).
4. *See* Barbara Black, *The Past, Present and Future of Securities Arbitration between Customers and Brokerage Firms*, *in* RESEARCH HANDBOOK ON SECURITIES REGULATION IN THE UNITED STATES 412-56 (J. Markham & R. Gjyshi, eds., 2014) (providing a thorough discussion of developments in securities arbitration after *McMahon*); *see also* Constantine N. Katsoris, *Securities Arbitration After McMahon*, 16 FORDHAM URBAN L. J. 361 (1987/1988); Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 998-1005 (2002) [hereinafter Black & Gross, *Making It Up*] (detailing changes in securities arbitration after *McMahon*).
5. Rodriguez de Quijas v. Shearson/Am. Express Inc., 490 U.S. 477 (1989).
6. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2014)).
7. *Rodriguez de Quijas*, 490 U.S. at 485-86.
8. *See McMahon,* 482 U.S. at 233-35; *see also* Jill I. Gross, McMahon *Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 493, 495 (2008) [hereinafter Gross, *McMahon Turns Twenty*] (discussing *McMahon* Court's reliance on SEC oversight of SRO arbitration).
9. *See* Gross, *McMahon Turns Twenty, supra* note 8, at 494.

most disputes between customers of broker-dealer firms and the firms and their associated persons must be arbitrated through FINRA Dispute Resolution,[10] a division of the Financial Industry Regulatory Authority (FINRA), the largest securities self-regulatory organization (SRO) in the United States.[11] These arbitrations are required either because the broker-dealer firm included a pre-dispute arbitration clause in its form customer agreement (PDAA)[12] or the customer invoked its unconditional right to demand arbitration under FINRA Rule 12200.[13]

As a result of the virtually mandatory nature of customer arbitration, investor advocates have argued that the process is unfair, inefficient, expensive, and biased towards the securities industry.[14] A FINRA-funded study published in 2008 found significant negative perceptions of the fairness of the process, particularly among investors.[15] In response to the negative critique, the securities industry touts arbitration as an efficient, inexpensive, and fair process to resolve customer disputes.[16]

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10. *See Mediation and Arbitration*, FIN. INDUS. REG. AUTH., http://www.finra.org/arbitration-and-mediation (last visited Jan. 17, 2016) (reporting that "FINRA operates the largest securities dispute resolution forum in the United States"); FIN. INDUS. REG. AUTH., http://www.finra.org (last visited Jan. 17, 2016) (stating that "FINRA handles more than 99 percent of the securities-related arbitrations and mediations in the U.S.").

11. *See Market Participants*, U.S. SECURITIES AND EXCHANGE COMMISSION, https://m.investor.gov/introduction-markets/how-markets-work/market-participants (last visited Dec. 4, 2015).

12. It is widely reported that virtually all broker-dealers include a pre-dispute arbitration clause in their retail customers' agreements. *See Final Rep. of the FINRA Disp. Res. Task Force* 46, FIN. INDUS. REG. AUTH. (2015), https://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf.

13. *12200. Arbitration Under an Arbitration Agreement or the Rules of FINRA*, Code of Arbitration Procedure for Customer Disputes, FIN. INDUS. REG. AUTH. (2008), http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=4106 [hereinafter FINRA CUSTOMER CODE]. Because FINRA does not define "customer" within the meaning of this rule, courts have struggled to come up with a precise definition. *See* Jill Gross, *The Customer's Non-Waivable Right to Choose Arbitration in the Securities Industry*, 10 BROOK. J. CORP. FIN. & COM. L. __ (forthcoming 2016).

14. *See, e.g.*, Mark Schoeff, Jr., *PIABA Claims Arbitrator Bias – FINRA Lashes Back*, INVESTMENTNEWS, Oct. 7, 2014, http://www.investmentnews.com/article/20141007/FREE/141009934/piaba-claims-arbitrator-bias-finra-lashes-back (reporting on PIABA study alleging FINRA arbitrator bias); Edward Brunet & Jennifer J. Johnson, *Substantive Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 459 (2008) (arguing that securities arbitration is substantively unfair); *The Arbitration Fairness Act of 2007: Hearing on S. 1782 Before the Subcomm. on the Constitution*, 110th Cong. (2007) (statement of the Public Investors Arbitration Bar Association (PIABA) in Connection With the Subcommittee's Review of the Arbitration System); Mark A. Tepper, *Survey Says—SRO Arbitration Unfair*, 12 PIABA BAR J. 11 (2005); Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123, 126 (2005) (arguing that "serious reforms are necessary in securities arbitration before one can support the claim that this system provides a principled alternative to adjudication").

15. *See* Jill Gross & Barbara Black, *When Perception Changes Reality: An Empirical Study of Investors' Views of the Fairness of Securities Arbitration,* 2008 J. DISP. RESOL. 349.

16. *See* FIN. SERVS. INST. & BRIGGS & MORGAN, P.A., THE EFFICACY OF SECURITIES ARBITRATION AND PROPOSALS FOR CHANGE (2010), http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/Resources_and_Reference/White_Papers/fsi_white_paper_april2010_final.pdf (concluding that FINRA arbitrations are more cost-effective and resolve more quickly than litigation); SEC. INDUS. & FIN. MARKETS ASS'N, WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY (2007), http://www.sifma.org/uploadedfiles/societies/sifma_compliance_and_legal_society/whitepaperonarbitration-october2007.pdf [hereinafter SIFMA WHITE PAPER] (arguing that securities arbitration is fair to investors). The Financial Services Institute is an advocacy organization for Independent Broker-Dealers. *About Us*, FIN. SERVS. INST., http://www.financialservices.org/about/ (last visited Dec. 4, 2015). The Securities Industry and Financial Markets Association ("SIFMA") is "the voice of the nation's securities industry, bringing together the shared interests of hundreds of broker-dealers, banks and asset managers." *About SIFMA*, SEC. INDUS. & FIN. MARKETS ASS'N, http://www.sifma.org/about/ (last visited Nov. 15, 2015).

As a result, FINRA, with its statutory obligation to enact rules that both facilitate trading in a "free and open market" and protect investors,[17] remains under constant pressure to reform its arbitration process to ensure it is fair to all users.

In 2010, the politically-charged clamor for stronger regulation of the financial services industry culminated in the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[18] One provision in that massive reform bill delegates to the SEC the task of deciding whether "the public interest" and "the protection of investors" requires it to ban arbitration clauses in customer agreements, and expressly authorizes the SEC to enact such a rule change.[19] Investor advocates repeatedly call on the SEC to exercise this power, citing the need for investors to have a choice of forum,[20] while the industry contends that the firms' right to mandate arbitration of disputes is a "vital component of this [securities arbitration] system" because "[s]uch agreements help shape the public policy in favor of arbitration that has been recognized by both Congress and the U.S. Supreme Court."[21] Ironically and significantly, in response to pressure on the SEC to ban PDAAs in customer agreements, the industry, through its trade association SIFMA, threatened to insert a forum selection clause in customer agreements to supersede a customer's right to arbitration under FINRA Rule 12200 if the SEC did in fact ban PDAAs.[22]

Why do broker-dealers fear a legal system in which the firms' customers have a unilateral right to demand arbitration of disputes? That scenario would return the industry to the pre-*McMahon* years, when, because the enforceability of PDAAs with respect to federal securities laws was in doubt, most brokerage customers had such a unilateral right. In fact, the pre-*McMahon* history of securities arbitration, written about only sparsely, reveals that, today, the primary stakeholders in the process—investors and brokerage firms—have lost sight of the original reason why the securities industry heavily relied on arbitration to resolve industry disputes. While offering a speedy, efficient, and fair forum was important to the industry when

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17. 15 U.S.C. §78o-3(b)(6) (2012).

18. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.
l. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of U.S.C.) (Dodd-Frank). For the legislative history and development of this provision, *see* Jill I. Gross, *The End of Mandatory Securities Arbitration?*, 30 PACE L. REV. 1174, 1180-83 (2010) [hereinafter Gross, *End of Mandatory Securities Arbitration*].

19. 15 U.S.C. § 78o(o) (providing that "[t]he Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors"). The provision provides no deadline for action, and, as of early 2016, the SEC has taken no action pursuant to this express power.

20. *Press Release: PIABA Announces Strong Support For Investor Choice Act Barring Mandatory Arbitration,* PUB. INVESTORS ARBITRATION BAR ASS'N (Feb. 27, 2015), https://piaba.org/piaba-news-room/press-release-piaba-announces-strong-support-investor-choice-act-barring-mandatory-ar.

21. *Pre-Dispute Arbitration Resource Center,* SEC. IND. & FIN. MARKETS ASS'N, http://www.sifma.org/issues/legal,-compliance-and-administration/pre-dispute-arbitration/overview/ (last visited Dec. 4, 2015).

22. *See* Kevin Carroll, *OpEd: Why Banning Mandatory Securities Arbitration Would be a Mistake*, WEALTHMANAGEMENT.COM (May 27, 2015), http://wealthmanagement.com/commentary/op-ed-why-banning-mandatory-securities-arbitration-would-be-mistake (predicting that, if the SEC banned mandatory arbitration clauses in customer agreements, "[s]ome [member firms] might elect to include forum selection clauses in their customer contracts in order to supersede the FINRA mandatory arbitration rule, and require that all disputes be resolved in court").

choosing to offer and encourage arbitration, far more important was the use of arbitration as a mechanism to protect investors from unscrupulous brokers and brokerage firms, thus building trust and credibility in the securities exchanges, and, in turn, facilitating investors' use of the exchanges for their securities trading.

This article describes a more accurate history of securities arbitration, and uncovers the original purpose of designating arbitration to resolve investor disputes. This article argues that both investors and the industry have disregarded this underlying purpose, causing them to view securities arbitration through a distrusting, critical lens. Rather than cynically viewing securities arbitration as a forum created by and favoring industry players, investors should view arbitration as a central and critical component in a system of investor protection. Likewise, rather than promoting mandatory arbitration as desirable because of its speed and economies, broker-dealers and SIFMA should advertise the investor-protective benefits of the process. By reframing modern securities arbitration as an investor protection device, both industry and investors' advocates can work within the system to improve it rather than fight to tear it down.

II. PRE-*MCMAHON* HISTORY OF SECURITIES ARBITRATION

A. The Formation of Securities Exchanges in the U.S.

Shortly after the birth of the United States, at the First Congress in 1789 and 1790, the federal government issued $80,000,000 in bonds (then called "stock") to finance the country's assumption of the Revolutionary War debts of the Continental Congress as well as of the separate colonies.[23] The need to trade in these newly-issued securities led to the rise of the stock brokerage business in New York. In 1792, a group of brokers reached an agreement to trade only with each other on behalf of their clients, and to charge a minimum commission of 0.25 percent.[24] Known as the "Buttonwood Agreement" because legend has it that it was signed under a buttonwood tree on Wall Street,[25] the Agreement of 1792 governed dealings among New York City stockbrokers until the founding of the New York Stock and Exchange Board (NYSE Board) in 1817.[26]

The NYSE Board was one of the first SROs in the U.S. securities industry.[27] Its first Constitution and bylaws set forth principles governing the stock brokerage practices of its members, banned certain sales practices, fixed commissions, and mandated suspension from the Board for any member who "fails to comply with

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23. FRANCIS L. EAMES, THE NEW YORK STOCK EXCHANGE 13 (1894).
24. *Id.* at 14.
25. Henry C. Lucas, Jr. et al., *Information Technology and the New York Stock Exchange's Strategic Resources from 1982-1999, #CIS-2002-08*, CIS WORKING PAPERS SERIES 5-6 (May 2002), http://cisnet.baruch.cuny.edu/papers/cis200208.pdf.
26. EAMES, *supra* note 23, at 17-18.
27. *The Institution of Experience: Self-Regulatory Organizations in the Securities Industry, 1792-2010, The Rules of the Club, Protecting the Members and the Market*, SEC. & EXCH. COMM. HISTORICAL SOC'Y, *http://www.sechistorical.org/museum/galleries/sro/sro02b.php* (last visited Dec. 21, 2015) [hereinafter *Rules of the Club*] (reporting that NYSE Board patterned its internal rules and regulations on those of the Philadelphia Stock Exchange).

his contracts."[28] The Constitution also called for expulsion of any member who refused to comply with NYSE Board rules.[29]

Membership in the NYSE Board continued to climb through the 1800s, as the securities industry grew. In the mid-1800s, a seat on the NYSE Board sold for a few hundred dollars.[30] The Civil War stimulated more speculative trading,[31] which propelled the price of a seat on the exchange to sell for $8,000 by 1868.[32] By then, the NYSE Board had changed its name to the New York Stock Exchange (NYSE),[33] and was known as an exclusive club, with caps on membership and monetary barriers to entry.[34] The NYSE attempted to monopolize trading so that investors could not take their business elsewhere. It also set its own rules to ensure that members treated traders equitably and only legitimate stocks backing stable issuers could be listed on the Board.[35]

Due, in part, to the NYSE's reputation for exclusivity, a group of brokers not admitted to membership formed the "Open Board of Brokers" in 1864 as a competitor to the NYSE.[36] In 1869, the Open Board of Brokers consolidated into the NYSE to form the stock exchange and SRO that existed until 2007,[37] when NYSE merged its regulatory and arbitration functions with the National Association of Securities Dealers (NASD), to form FINRA.[38]

B. *Arbitration at the NYSE*

Even in its early days, the securities industry used alternative dispute resolution mechanisms to resolve internal industry disputes. This likely was a carryover from England, where arbitration had been utilized to solve disagreements among members of trade groups since the fourteenth century.[39] In the United States, merchants

28. EAMES, *supra* note 23, at 22 (quoting CONSTITUTION OF THE NEW YORK STOCK AND EXCHANGE BOARD 1820, art. 13).

29. *Id.* (citing Article 15).

30. *Id.* at 85.

31. *See* JERRY W. MARKHAM & THOMAS LEE HAZEN, 23 BROKER-DEALER OPERATIONS UNDER SEC. & COMMODITIES LAW § 1:5, Westlaw (database updated Nov. 2015).

32. *Id.* § 1:7. Adjusted for inflation, that would cost approximately $136,000 in 2015 dollars. *See Inflation Calculator*, DAVEMANUEL.COM, http://www.davemanuel.com/inflation-calculator.php (last visited Feb. 12, 2016).

33. EAMES, *supra* note 23, at 43 ("On January 29, 1863, the title of the 'New York Stock and Exchange Board' was changed to the 'New York Stock Exchange.'").

34. *Id.*

35. *Rules of the Club*, *supra* note 27.

36. *The Institution of Experience: Self-Regulatory Organizations in the Securities Industry, 1792-2010, The Rules of the Club, Adaptability and Gentility*, SEC. & EXCH. COMM' HISTORICAL SOC'Y, http://www.sechistorical.org/museum/galleries/sro/sro02d.php (last visited Dec. 21, 2015).

37. *See American Stock Exchange Historical Timeline*, N.Y. STOCK EXCH., https://www.nyse.com/publicdocs/American_Stock_Exchange_Historical_Timeline.pdf (last visited Feb. 01, 2016); *see also* EAMES, *supra* note 23, at 50-52 (discussing the history of consolidation).

38. On July 30, 2007, NASD and NYSE Regulation, including their respective arbitration forums, consolidated and formed FINRA. *See Press Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority*, FIN. INDUS. REG. AUTH. (July 30, 2007), http://www.finra.org/Newsroom/NewsReleases/2007/P036329. FINRA is a "national securities association," a type of SRO registered with the SEC under the Exchange Act. *See* 15 U.S.C. § 78o-3(k) (2012).

39. Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion under the Federal Arbitration Act*, 77 N.C. L. REV. 931, 969-72 (1999) (describing the history of arbitration); Johnson, *supra* note 14, at 134.

used arbitration to resolve internal industry disputes since the colonial era.[40] In the late 1790s, NYSE Board clerks ruled on disputes over mismatched trades. Known as "out-trades," these were trades in which, during the trade settlement process, a buy order did not match a sell order, either in price, number of shares, or accrued interest.[41]

The very first constitution of the NYSE Board (1817) required disputes to be arbitrated before the full Board.[42] The NYSE Board Constitution of 1817 provided that "All questions of dispute in the purchase or sale of Stocks shall be decided by a majority of the Board."[43] At some point after 1817, as membership numbers increased, the NYSE Board appointed an ad hoc Arbitration Committee, made up of five NYSE members, to decide each case, and that committee would report to the full Board for action.[44] The Arbitration Committee heard and decided the case within days after its filing, and the NYSE itself forced members to comply with any award.[45] Moreover, the NYSE Board considered internal arbitration awards to be precedent.[46]

The ability of this early 1800s NYSE Board to accept jurisdiction over the arbitration of *customer* (non-member/member) disputes was critical. While Article 11 of the 1817 NYSE Board Constitution does not explicitly provide for jurisdiction over non-member/member disputes, it also does not appear to restrict the Board's jurisdiction to only intra-member disputes. Rather, it requires members to submit to arbitration for all disputes regarding securities trading without restriction on who brought the complaint to the NYSE Board. Moreover, at least as early as 1831, records from the NYSE Board reveal that its Arbitration Committee resolved non-member/member disputes.[47]

C. Why Arbitration?

Why did the securities industry designate arbitration as its preferred dispute resolution process from the very beginning? As discussed below, the historical evidence suggests it was primarily to ensure that industry norms would be enforced, even if those norms were unlawful and not enforceable in court, and secondarily to provide a rapid resolution of a dispute whose value changed quickly as the stock market rose or fell.

The overarching consideration of nineteenth century arbitration committees appears to have been the protection of the good name and reputation of the NYSE.[48]

40. Johnson, *supra* note 14, at 134.

41. *See* Lucas, et al, *supra* note 25.

42. EAMES, *supra* note 23, at 21.

43. Rule 17, Transcript of Constitution of the New York Stock & Exchange Board (Feb. 25, 1817), *available at* http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1810/1817_0225_NYSEConstitutionT.pdf.

44. EAMES, *supra* note 23, at 45, 74; *see also* STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION 272 (1998) (describing NYSE Board arbitration commitees). According to Eames, who was the President of NYSE in 1894, each year the NYSE Governing Committee designated standing committees, including the "Arbitration Committee of nine members, to which are referred all money claims arising from transactions in money or securities". EAMES, *supra* note 23, at 74.

45. *See* BANNER, *supra* note 44, at 272 (citing more than one dozen such disputes that were reflected in NYSE Board Arbitration Committee reports).

46. *Id.* at 274.

47. *Id.* at 272-73.

48. *Id.* at 273.

If one NYSE Board broker reneged on a commitment to another, the functioning of the exchange and smooth trading would be impeded. Moreover, if customers of NYSE Board brokers could not trust that their brokers would be held to their word and commitments, customers would take their business elsewhere. The NYSE Board believed it was important to accept complaints from non-members so it could enforce its own rules, customs, and practices and also ensure good conduct of its members.[49] Furthermore, it was widely understood that arbitrators treated member brokers more harshly than non-member customers because the NYSE Board could compel a member to comply with the arbitrators' award but could not compel a non-member to comply with an award.[50]

In addition, by requiring members to arbitrate disputes with non-members (usually customers) at the non-member's request, the NYSE created a "miniature legal system" to enforce the exchange's extra-legal rules and practices.[51] Certain speculative sales practices that NYSE brokers engaged in were not enforceable in court, such as "time bargains"–agreements to sell or transfer shares of government debt or corporate stock that the seller did not own at the time of the contract.[52] From 1792 to 1858, a series of New York statutes voided all contracts for the sale of stock in which the seller did not own the stock on the contract date.[53] Yet, NYSE brokers made money selling time bargains to investors and they did not want to give up commissions generated from selling that "product."[54] While courts would not enforce time bargains,[55] NYSE Board arbitrators would, as they did not have to follow only the law; they could base their decisions on rules, customs, and practices of the exchange or principles of equity.[56] Thus, disputes over time bargains would have to be resolved in arbitration to protect the customer so that the NYSE would remain a credible exchange on which to place trades. Customers could have confidence that NYSE arbitrators would enforce time bargains, if otherwise validly made.

Securities arbitration also provided a tribunal available immediately to render a predictable decision on a dispute arising in a fast-moving market. In *White v. Brownell*,[57] one of the few reported cases stemming from a nineteenth century securities arbitration, the New York Court of Common Pleas observed:

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49. *Id.*

50. *Id.*

51. BANNER, *supra* note 44, at 271.

52. *Id.* at 271-72.

53. *See id.* at 173 (quoting N.Y. LAW, ch. 62 (1792)) ("An Act to prevent the pernicious practice of stock jobbing, and for regulating sales at public auctions."). A series of amendments to the statute preserved this ban until 1958, when the New York legislature enacted "An Act to legalize the sale of stocks on time." *Id.* at 174 (quoting N.Y. LAWS, ch. 134, § 1 (1858)).

54. BANNER, *supra* note 44, at 280. Historians estimate that time bargains made up about 20% of the transactions on the NYSE Board between 1818 and 1840. *Id.* at 175. Indeed, the NYSE Board's 1817 Constitution, Article 11th, referred to time bargains, and sets forth a procedure if one party defaulted on a time bargain. EAMES, *supra* note 23, at 21.

55. Courts would not award legal or equitable relief to a plaintiff who suffered as a result of a counterparty's default on a time bargain, reasoning that the plaintiff was equally at fault for entering into an illegal contract in the first place. *See* BANNER, *supra* note 44, at 176 (collecting cases).

56. *Id.* Interestingly, one non-NYSE Board, three-member arbitration panel issued an award in the mid-1800s also enforcing a time bargain over a strong dissent arguing that only a panel of the NYSE Board could enforce a contract that was otherwise void at law. *See* DANIEL LORD, A VINDICATION OF THE AWARD BETWEEN BOORMAN, JOHNSTON & CO. AND JACOB LITTLE & CO. (1842) (enforcing a time bargain in favor of investor).

57. White v. Brownell, 3 Abb. Pr. N.S. 318 (N.Y. Com. Pl. 1867), *aff'd*, 4 Abb. Pr. N.S. 162 (N.Y. Com. Pl. 1868) (upholding arbitration award from Open Board of Brokers). Though it survived as a

> [T]he [New York] Open Board of Brokers, with its several hundred members, the business transacted at its rooms being daily large in amount, and the stocks and securities dealt in being ever fluctuating in value, it was not unreasonable to apprehend that there would be constantly occurring differences between members, acting as agents for others, in regard to the terms of contracts, and as to the obligations and duties of contracting parties under agreements often hastily made. The temptation to avoid a contract in a rapidly rising or falling market, as the pecuniary interest of a party might prompt, rendered it imperative that some tribunal in the body of the association, should be appointed and agreed upon, to take cognizance of and exercise jurisdiction over all claims and matters of difference which might arise between members of the board. This appears the more important, as confidence in each other, and in the engagements which they might make, one with the other, and in the fairness, openness, and uprightness of their transactions, and in the certainty that their engagements would be fulfilled are announced as the causes which led to the organization. To be effective, their decisions should be prompt. As these engagements would be constantly maturing, it was eminently proper that a tribunal should be near to render speedy and exact justice. Confidence is the real life of such engagements; hence, the appointment of a committee of arbitration is a prominent feature in the constitution of this board, and, by the express assent of each member, jurisdiction is awarded to this committee in advance of all claims and matters of difference which might arise between the members.[58]

In addition to speed and predictability, the *Brownell* court favored the mechanism of arbitration as implementing the membership's will to establish and bind other members to precedent as established by the arbitrators, and instilling confidence in the members and users of the exchange that justice—defined by equitable rather than legal principles—would prevail.

In 1869, after the consolidation of the Open Board of Brokers with the NYSE Board to form the NYSE, the NYSE amended its constitution to officially require members of the Exchange to submit to arbitration whenever requested by a non-member.[59] At that time, the NYSE established a more permanent nine-member

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competitor to the NYSE Board for only a short time (1864-1869), the Open Board of Brokers used arbitration, too, as its mechanism to resolve trading disputes. *Id.*

58. *Id.* at 328-29.

59. *See* CONSTITUTION AND BY-LAWS OF THE NEW YORK STOCK EXCHANGE, at Const. Art. III (JULY 28, 1869), https://books.google.com/books?id=9-QZAAAAYAAJ&pg=PA7&lpg=PA7&dq=new+york+stock+exchange+constitution+of+1869&source=bl&ots=2ReEsJN9ks&sig=z7O9vKgck550bpWGTXqnKKPR-4A&hl=en&sa=X&ei=b-qbVe3PCoaayASOj7b4AQ&ved=0CDIQ6AEwAw#v=onepage&q=new%20york%20stock%20exchange%20constitution%20of%201869&f=false (establishing an "Arbitration Committee, to consist of nine members, whose duty it shall be to investigate and decide all claims and matters of difference arising between members of the Exchange; they shall also adjudicate such claims as may be preferred against members by non-members, when such non-members shall agree to abide by the rules of the New York Stock Exchange, in such cases provided"); *id.,* By-laws Art. LII, Arbitration of Claims of Non-Members 35-36 ("Any person not a member of the Exchange shall have the right to bring a claim arising from any transaction against a member of said Exchange, before the Arbitration Committee, …"); Norman S. Poser, *Making Securities Arbitration Work*, 50 S.M.U.L. REV. 277, 280 (1996) ("The NYSE Constitution of 1869 not only provided for arbitration of 'all claims and matters of difference' between members but

Arbitration Committee to hear and decide claims. The committee met regularly: In 1894, the Arbitration Committee met every Tuesday and Friday.[60] The arbitrations that took place in the 1800s were in fact speedy and thus inexpensive, and the arbitrators held NYSE members to their word, thus upholding investors' bargains. Though used infrequently to resolve investor disputes,[61] the NYSE arbitration forum and its guarantee of access to investors served a critical investor protection function.

Consistent with this impetus to protect customers, the NYSE retained in all subsequent incarnations of its Constitution and rules the right of a customer to demand arbitration of a stock exchange member firm.[62] This clause of the NYSE Constitution has been described as "the most significant of the measures taken to implement the self-regulation contemplated by the 1934 Act."[63]

By the end of the nineteenth century, arbitration was established as the primary mechanism to resolve disputes in the securities industry. Nineteenth-century authors praised the NYSE for developing arbitration: "The New York Stock Exchange has distinguished itself in many respects, but there is probably nothing for which it is likely to become more famous in history than its solution to the great problem of settling disputes and misunderstandings by arbitration."[64] While speed and cost contributed to its acceptance by exchange members, the historical record shows that investor protection was an indispensable feature of securities arbitration, thus ensuring its continued success.

*D. Twentieth Century Pre-*McMahon *SRO Arbitration*

From the late 1800s until the passage of the federal securities laws in the 1930s, the securities industry and securities arbitration remained largely unregulated. However, one important legislative development marginally related to the securities industry ultimately did impact SRO arbitration. In 1925, Congress passed the Federal Arbitration Act (FAA),[65] which declared pre-dispute arbitration agreements valid, irrevocable, and enforceable.[66] The Supreme Court declared that the passage

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also gave non-members the right to arbitrate disputes with members if they agreed to abide by the rules of the Exchange."). I have not located any historical documents that explain why this provision was added at this time.

60. EAMES, *supra* note 23, at 84.

61. *Id.* at 69-70 (describing state of NYSE arbitration as of 1894 and noting that "[a]s an evidence of the good business methods prevailing, only about seven cases a year have of late been brought before the Arbitration Committee").

62. N.Y. STOCK EXCHANGE CONST., art. XI (Westlaw through 2006); N.Y. STOCK EXCHANGE ARBITRATION RULE 600(a) (Westlaw through Aug. 6, 2007). Before its 2007 merger with NASD, NYSE Rule 600(a) provided: "Any dispute, claim or controversy between a customer or non-member and a member, allied member, member organization and/or associated person, arising in connection with the business of such member, allied member, member organization and/or associated person, in connection with his activities as an associated person shall be arbitrated under the Constitution and Rules of the New York Stock Exchange, Inc. as provided by any duly executed and enforceable written agreement or upon the demand of the customer or non-member." *Id.*

63. Coenen v. R. W. Pressprich & Co., 453 F.2d 1209, 1215 (2d Cir. 1972).

64. HENRY CLEWS, TWENTY-EIGHT YEARS IN WALL STREET 561 (1888). I am indebted to Robert S. Clemente, former Director of NYSE Arbitration, for finding this gem in Mr. Clews' book. *See* Robert S. Clemente, *Trends in Securities Industry Arbitration: A View of the Past, Present and the Future: 'The Dream, the Nightmare and the Reality*,'" 68 N.Y.S.B.A. BAR J. 18, 19 (Sept./Oct. 1996).

65. Pub. L. 68–401, 43 Stat. 883 (codified as amended at 9 U.S.C. §§ 1-16 (2012)).

66. FAA, 9 U.S.C. §2 (2012). That section provides:

of the FAA reflects "an emphatic federal policy in favor of arbitral dispute resolution,"[67] thus giving rise to the widespread use of arbitration clauses in commercial contracts. Over the subsequent 90 years, the Court's decisions interpreting the FAA created a body of law enforcing arbitration agreements strictly according to their terms and elevating the arbitration clause to a "super-contract."[68]

After the stock market crash of 1929 led to the Great Depression, a concerned Congress enacted the federal securities laws to restore investor confidence in and facilitate the healthy functioning of capital markets.[69] Premised on a philosophy of full disclosure rather than caveat emptor for investors, the Exchange Act imposed a complex regulatory scheme on the securities industry and created a new federal agency, the SEC, to enforce that scheme.[70]

The SEC quickly involved itself in arbitration of investor claims. Just one year after its creation, in 1935, the Securities and Exchange Commission (SEC) recommended to Congress that the NYSE offer an independent arbitral tribunal for customer cases.[71] Fueled by a new skepticism about the honesty and integrity of brokers, the SEC supported arbitration of securities disputes but did not want NYSE members serving as arbitrators. In a memorandum to the NYSE, the Chairman of the SEC stated: "The right to arbitration before the arbitration committee of the exchange is at present granted to any customer regardless of the contract between the member and the customer."[72] To address its concerns regarding the composition and neutrality of arbitration panels for those customer arbitrations, the SEC recommended to the NYSE that it maintain this right for customers but also provide an option for arbitration before independent arbitral tribunals rather than just before the NYSE.[73]

At first, the NYSE responded that the customer could elect to go to court in lieu of arbitration before the Exchange. The SEC replied that the NYSE could circumvent this election by "encourag[ing] its members to offer customers a standard arbitration agreement requiring that resort be had to arbitration at the election of

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

67. Marmet Health Care Ctr., Inc. v. Brown, 132 S. Ct. 1201, 1203 (2012) (quoting KPMG LLP v. Cocchi, 132 S.Ct. 23, 25 (2011) (*per curiam*); *see also* Southland Corp. v. Keating, 465 U.S. 1, 10 (1984) (declaring the FAA reflects a "national policy favoring arbitration").

68. *See* Jill I. Gross, *Justice Scalia's Hat Trick and the Supreme Court's Flawed Understanding of Twenty-First Century Arbitration*, 81 BROOKLYN L. REV. 111 (2015). Because securities transactions "involve commerce," the FAA governs PDAAs in the securities industry. *See* Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79 (2002).

69. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. Sec. & Exch. Comm'n, http://www.sec.gov/about/whatwedo.shtml (last visited Dec. 21, 2015).

70. *See* Gross, *McMahon Turns Twenty, supra* note 8, at 512.

71. *See* Sec. & Exch. Comm'n, Opinion Letter, Release No. 34-131 (Mar. 21, 1935), *as reprinted in WestLaw*, 1935 WL 29028, at *3. In the memorandum, the SEC set forth its views on a variety of arbitration and non-arbitration issues as part of a review of the NYSE's rules and procedures.

72. *Id.*

73. *Id.* ("Since the customer can at any time prior to arbitration choose to seek his remedy in the courts, continued maintenance of this policy possesses no disadvantage, provided that the Exchange also encourages arbitration before independent arbitral tribunals as an additional remedy available to customers."). The NYSE did not follow this recommendation.

either the customer or the member, and providing for arbitration before independent arbitral tribunals at the election of the customer."[74] Thus, the SEC itself seems to have promoted the very practice it now is empowered to abolish: broker-dealers' insertion of PDAAs in their retail customer agreements.

Gradually, more and more broker-dealers inserted PDAAs in their retail customer form agreements, and litigated customers' challenges to their enforceability.[75] However, until the 1960s, very few customer disputes ended up in arbitration because Supreme Court precedent at the time declared PDAAs unenforceable with respect to claims arising under the federal securities laws.[76] As long as investors alleged a cause of action arising under a federal securities law, they could bring their complaint in federal court. And, until 1985, courts often would exercise supplemental jurisdiction over pendent state law claims.[77]

In the 1960s, several federal courts began granting firms' motions to compel arbitration if the only viable claims in a customer's complaint arose under state law.[78] As a result, brokerage firms started enforcing—against their customers' wishes—previously ignored PDAAs.[79] At the same time, the SROs began enhancing the formality of their arbitration forums and establishing procedural rules for these modern arbitrations. In 1964, AMEX started administering an arbitration program.[80] The NASD, an SRO that was growing in size and importance to the industry, adopted its first Code of Arbitration Procedure in 1968, providing an alternative to the NYSE for the arbitration of customer disputes.[81] The Chicago Board Options Exchange, Inc. (CBOE) adopted arbitration for options disputes in 1973.[82] To increase the use of arbitration, the securities SROs further developed their arbitration procedures through the 1970s.[83]

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74. *Id.*

75. *See* Norman S. Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration,* 59 BROOK. L. REV. 1095, 1097 (1993) (noting that the "securities industry fought persistently for mandatory arbitration").

76. Wilko v. Swan, 346 U.S. 427 (1953) (holding claims arising under the Securities Act of 1933 are not arbitrable), *overruled by* Rodriguez de Quijas v. Shearson/Am. Express Inc., 490 U.S. 477 (1989) (holding claims arising under the Securities Act are arbitrable).

77. *See* Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985). Before the Supreme Court's holding in *Dean Witter Reynolds* that district courts must compel arbitration of pendent state law claims even if parallel federal claims were not arbitrable, lower courts would either refuse to compel arbitration of pendent state claims or stay arbitration pending the outcome of the federal court litigation. *Id.* at 221-22 (citing examples).

78. *See, e.g.,* Colonial Realty Corp. v. Bache, 358 F.2d 178 (2d Cir. 1966) (affirming dismissal of all federal causes of action and grant of motion to compel arbitration of a NYSE customer dispute); Robinson v. Bache & Co., 227 F. Supp. 456, 458 (S.D.N.Y. 1964) (granting motion to refer customer dispute to arbitration that was "barren of any allegation" that defendant violated federal law).

79. *See* Deborah Masucci, *Securities Arbitration-A Success Story: What Does The Future Hold?,* 31 WAKE FOREST L. REV. 183, 185 (1996) (tracing back to the 1970s rise of use of arbitration in the securities industry as a response to the increase of small investors investing in the stock market).

80. *See* Margaret M. Harding, *The Cause and Effect of the Eligibility Rule in Securities Arbitration: The Further Aggravation of Unequal Bargaining Power*, 46 DEPAUL L. REV. 109, 181 n.30 (1996).

81. *See* Masucci, *supra* note 79, at 185. NASD first offered only a purely voluntary arbitration system, but, in 1972, NASD amended its rules requiring member firms and associated persons to submit to arbitration at the request of a customer. *Id.*

82. Lewis D. Lowenfels & Alan R. Bromberg, *Securities Industry Arbitrations: An Examination and Analysis*, 53 ALB. L. REV. 755, 769 (1989).

83. *See* Constantine N. Katsoris, *The Arbitration of a Public Securities Dispute,* 53 FORDHAM L. REV. 279, 283-84 (1984); Norman S. Poser, *Making Securities Arbitration Work,* 50 SMU L. REV. 277, 280-87 (1996); *see also* Black & Gross, *Making It Up, supra* note 4, at 998-1005 (discussing development of arbitration procedures).

In 1975, Congress amended the securities laws to enhance the SEC's oversight over SROs. In particular, the Exchange Act now required the SEC to review and approve all SRO rule proposals and amendments, after a period for public comment.[84] Pursuant to the amendments, the SEC could not approve an SRO rule unless it was:

> designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; . . . .[85]

In the late 1970s, the SEC helped form the Securities Industry Conference on Arbitration (SICA) to develop uniform arbitration rules.[86] The SEC approved proposals by all the SROs to adopt the Uniform Code of Arbitration as their arbitration code, including the unilateral right of a customer to demand arbitration with a member.[87] This accelerated the evolution, already begun in the early twentieth century, of securities arbitration from an informal, speedy hearing before an expert, industry-affiliated panel to a protracted, litigation-like, heavily regulated hearing before non-expert neutrals with virtually no industry experience or knowledge.

The next section turns to the more well-known, post-*McMahon* securities arbitration, which signals a shift away from the investor-protection benefits of the process.

III. POST-*MCMAHON* SECURITIES ARBITRATION

In the late 1980s, the Supreme Court reversed its long-standing precedent[88] and held that federal securities claims arising out of customer account agreements were arbitrable.[89] The Court concluded that arbitrators were competent to apply the law and therefore the forum permitted investors to pursue their statutory rights as well as in court.[90] Notably, the Court's comfort with SRO arbitration, grounded on its

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84. *See* Gross, *McMahon Turns Twenty, supra* note 8, at 512-13 (describing 1975 Amendments as "adding an indispensable layer of statutory regulation over SRO arbitration with an express statutory purpose of enhancing investor protection").

85. 15 U.S.C. § 78o-3(b)(6) (2012).

86. *See* Jill I. Gross, AT&T Mobility *and the Future of Small Claims Arbitration,* 42 SW. L. REV. 47, 64 (2012); Black & Gross, *Making It Up, supra* note 4, at 998.

87. *See, e.g., In re* NASD, Order Approving Proposed Rule Change, Exchange Act Release No. 34-16860, 20 SEC Docket 233 (May 30, 1980) (approving NASD's adoption of Uniform Code of Arbitration); *see also* Implementation Of An Investor Dispute Resolution System, Exchange Act Release No. 34-13470, 12 S.E.C. Docket 186 (Apr. 26, 1977) (inviting SROs to submit proposals to SEC).

88. Wilko v. Swan, 346 U.S. 427 (1953), *overruled by* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477 (1989) (expressly overruling *Wilko* and holding that Securities Act claims are arbitrable).

89. Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987). *See* Black & Gross, *Making It Up, supra* note 4, at 995-98 (providing a more in-depth discussion of the reasons behind the Supreme Court's overruling of *Wilko*).

90. *McMahon*, 482 U.S. at 229-32.

view that arbitrators follow the law, ignores the founding premise of SRO arbitration as a forum in which arbitrators could ignore the law and apply equity instead to protect investors from brokers.

After *McMahon* and the sharp increase in the use of SRO arbitration, the SROs regularly engaged in reviews of their arbitration processes to ensure they offered a fair forum.[91] However, unlike the historical focus on investor protection, modern reforms, at least publicly, focused on maintaining a speedy, cost-effective, and balanced dispute resolution mechanism. For example, in 1994 the NASD Board of Governors appointed an Arbitration Policy Task Force to study the securities arbitration process administered by the NASD and to make suggestions for its reform.[92] The resulting 1996 Report on Securities Arbitration Reform, also known as the Ruder Report,[93] concluded that securities arbitration is a "relatively efficient, fair, and less costly forum for resolution of disputes involving public investors, member firms, and firm employees" but the Task Force "believes that many areas of improvement of the system exist."[94] The Ruder Report did not inform its readers that it focused on the investor-protection benefits of the system, nor did it appear to take into account NASD's investor protection mandate when recommending improvements. Rather, most of its recommendations focused on countering and reducing the increasing litigiousness of arbitration.[95]

Following the Ruder Report, the NASD embarked on an ambitious program to adopt many of the report's recommendations. Between 1997 and 2007, NASD filed more than 65 rule proposals.[96] In a 2007 Report Card assessing the post-Ruder Report reforms, NASD stated that it had implemented "nearly every key recommendation" of the Report.[97] NASD reiterated its objectives in reforming the process: "to preserve and respect the basic elements of a fair and efficient dispute resolution system, while responding to the changing needs of our customers by embracing the modifications needed to enhance the system."[98] Again, investor protection was not mentioned.

More recently, in July 2014, FINRA recognized that it had been almost 20 years since the publication of the Ruder Report, so it convened a new task force.[99] As FINRA announced,

> FINRA Dispute Resolution is committed to providing a fair, efficient, and economical forum to resolve disputes among investors, securities firms,

91. Black & Gross, *Making It Up, supra* note 4, at 998-1005.

92. DAVID S. RUDER, ET. AL., SECURITIES ARBITRATION REFORM: REPORT OF THE ARBITRATION POLICY TASK FORCE TO THE BOARD OF GOVERNORS NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. 1 (1996).

93. The Task Force was chaired by David S. Ruder, then a Professor of Law at Northwestern University School of Law. See *David S. Ruder*, NORTHWESTERN PRITZKER SCH. L., http://www.law.northwestern.edu/faculty/profiles/davidruder/ (last visited Feb. 3, 2016).

94. RUDER, ET. AL., *supra* note 92, at 1.

95. *Id.* at 7.

96. Gross, *McMahon Turns Twenty*, *supra* note 8, at 514.

97. NASD Dispute Resolution, *The Arbitration Policy Task Force Report – A Report Card*, FIN. INDUS. REG. AUTH. 5 (July 27, 2007), https://www.finra.org/sites/default/files/Industry/p036466.pdf (noting that "in several areas the path to implementation and the final outcome may be different than the Task Force recommended or envisioned").

98. *Id.* at 27.

99. *See News Release, FINRA Announces Arbitration Task Force*, FIN. INDUS. REG. AUTH. (July 17, 2014), https://www.finra.org/newsroom/2014/finra-announces-arbitration-task-force.

> and individual brokers. . . . FINRA has formed a task force to consider possible enhancements to its arbitration and mediation forum.[100]

Chaired by Barbara Black,[101] FINRA populated the Task Force with lawyers who regularly represent customers, broker-dealers, and associated persons, as well as neutrals, a state securities regulator, and an investor advocate. FINRA asked the Task Force to suggest strategies to "enhance the transparency, impartiality, and efficiency of FINRA's securities dispute resolution forum for all participants."[102] Nowhere in its charge does FINRA expressly ask the Task Force to focus on investor protection. As a result, not unexpectedly, the Task Force's December 2015 Report does not analyze whether FINRA DR satisfies its investor protection obligations.[103]

This article does not argue that FINRA arbitration is, in fact, unfair, nor does it argue that FINRA DR neglects its investor protection mandate. In fact, FINRA immediately promised to fight to retain Rule 12200 for investor protection purposes in response to the securities industry's threat to advocate for its repeal if the SEC were to ban mandatory arbitration.[104]

Moreover, no doubt as a result of the post-*McMahon* reforms implemented with robust SEC oversight over SRO arbitration,[105] customer arbitration today at FINRA DR (which administers more than 99% of securities arbitrations in the country)[106] offers many features that protect investors. In addition to subsidizing fees for customer claimants,[107] FINRA DR provides customers with the right to select a panel consisting of no arbitrators with ties to the securities industry[108] and the right to presumptively discoverable documents from respondents.[109] Forum rules sharply restrict respondents from filing pre-hearing dispositive motions.[110] These features collectively ensure that a customer claimant has an opportunity for a full hearing before a panel of unbiased arbitrators. Also, the forum enforces its policy of not accepting class arbitrations, instead preserving by rule an investor's right to bring

100. *Id.*
101. Retired Professor of Law, University of Cincinnati College of Law. *See Barbara Black*, UNIV. OF CINCINNATI, COLL. OF L., http://www.law.uc.edu/faculty-staff/faculty/barbara-black (last visited Feb. 4, 2016).
102. *FINRA Dispute Resolution Task Force*, FIN. INDUS. REG. AUTH., http://www.finra.org/arbitration-and-mediation/finra-dispute-resolution-task-force (last visited Jan. 26, 2016).
103. *See Final Report and Recommendations of the FINRA Dispute Resolution Task Force*, FIN. INDUS. REG. AUTH. (Dec. 16, 2015), http://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf. Of course, the presence of investor advocates on the Task Force itself does reflect FINRA's sensitivity to its investor constituencies.
104. *See Open Meeting of the SEC Investor Advisory Committee*, U.S. SEC. & EXCHAN. COMM'N (May 17, 2010), http://www.sec.gov/news/otherwebcasts/2010/iacmeeting051710.shtml (video recording of Linda Fienberg, President (now retired), comments at the 2:07-2:09 mark).
105. Gross, *End of Mandatory Securities Arbitration*, *supra* note 18, at 1186.
106. FIN. INDUS. REG. AUTH., https://www.finra.org/ (last visited Dec. 4, 2015).
107. Gross, *End of Mandatory Securities Arbitration*, *supra* note 18, at 1188.
108. *See* FINRA Manual, *FINRA Customer Code 12403(c)(1)(A)*, FIN. INDUS. REG. AUTH. (Sept. 30, 2013), http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=4141 (providing parties with right to strike all arbitrators from the non-public list).
109. *See* FINRA Manual, *FINRA Customer Code 12506(a)*, FIN. INDUS. REG. AUTH. (May 16, 2011), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4160.
110. *See* FINRA Manual, *FINRA Customer Code 12504*, FIN. INDUS. REG. AUTH. (June 6, 2011), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=7377.

any aggregable claims as a class or collective action in court.[111] To enhance transparency, the forum now requires arbitrators to issue an explained award if all parties jointly request one.[112] And, most significantly, a member firm and/or an associated person's failure to pay an arbitration award to an investor results in membership suspension or revocation.[113]

Yet, FINRA's public pronouncements in the area of dispute resolution—often in the context of fending off criticism of its arbitration procedures—focus on the efficiencies and level playing field of securities arbitration, not on its investor protection characteristics.[114] Likewise, when FINRA broadly promotes its investor protection efforts, it does not include arbitration.[115] Joining FINRA in its focus, investor groups also urge FINRA to offer a level playing field in its arbitration forum.[116] The industry, while recognizing investor protection characteristics, similarly aspires to an "equal protection" system.[117] Rather than depicting FINRA arbitration as an alternative dispute resolution process offering a level playing field, FINRA, as well as industry and investor advocates, should recall and reinforce the historical basis of securities arbitration as a mechanism to protect investors.

IV. CONCLUSION

I have no doubt that the securities arbitration system has played and continues to play a critical, even irreplaceable, role in the national scheme of investor protection. Yet, that role—confirmed by the historical record as dating back to the origins

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111. *See* FINRA Manual, *FINRA Customer Code 12204*, FIN. INDUS. REG. AUTH. (Dec. 15, 2008), http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=4110. In April 2014, the FINRA Board of Governors sanctioned Schwab for inserting a class action waiver in its customer agreements, in violation of FINRA rules. *See FINRA Department of Enforcement v. Charles Schwab, Board of Governors Decision*, FIN. INDUS. REG. AUTH. (Apr. 24, 2104), https://www.finra.org/sites/default/files/NACDecision/p496824.pdf; *see also* Barbara Black & Jill Gross, *Investor Protection Meets the FAA*, 1 STAN. J. COMPLEX. LITIG. 1 (2012) (providing a detailed analysis of the issues ultimately resolved by the Board of Governors).

112. *See* FINRA Manual, *FINRA Customer Code 12904(g)*, FIN. INDUS. REG. AUTH. (Apr. 17, 2009), http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=4192.

113. *See* FINRA Manual, *FINRA By-Laws, Article VI, Section 3(b), Suspension or Cancellation*, FIN. INDUS. REG. AUTH. (July 30, 2007), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4625.

114. One recent example is FINRA's defensive response to public comments on its proposal to merge FINRA DR into and with its regulatory subsidiary, FINRA Regulation, Inc. *See Letter from Meredith Cordisco, Financial Industry Regulatory Authority, to Brett J. Fields, U.S. Securities and Exchange Commission*, FIN. INDUS. REG. AUTH. 2 (Dec. 1, 2015), http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2015-034-response-to-comments.pdf ("FINRA disagrees that the proposed rule change would in any way impact the continued operation of its dispute resolution forum as a fair, efficient and economical alternative to costly and complex litigation to resolve monetary and business disputes between and among investors, brokerage firms and individual brokers.").

115. *About FINRA*, FIN. INDUS. REG. AUTH., https://www.finra.org/about (last visited Dec. 21, 2015).

116. *About PIABA*, PUB. INV'RS ARBITRATION BAR ASS'N, https://piaba.org/about-piaba (last visited Dec. 6, 2015) ("The mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process, such as those associated with document production and discovery; making securities and commodities arbitration as just and fair as systematically possible; and creating a level playing field for the public investor in securities and commodities arbitration.").

117. Kevin Carroll, *Arbitration Works,* FORBES (June 17, 2009) ("We need, and investors deserve, a system that protects everyone equally–it just so happens the current system provides that equal protection in a manner that is fair, and both faster and less expensive than courts.").

of U.S. stock exchanges—is neglected in the current narrative of securities arbitration, as stakeholders are focused on the fight over mandatory PDAAs. Investor advocates' push to ban mandatory arbitration led to the securities industry's reflexive counter-push for a repeal of the long-standing right of a customer to demand arbitration of member firms. This backlash ultimately hurts the retail investor, because it threatens to undermine the integrity and viability of arbitration,[118] possibly eliminating a forum that offers investors a more equitable alternative to court for the resolution of disputes with firms.[119] Backlash against the process will continue unabated until process participants reframe their narrative and rehabilitate the process as an investor protection mechanism.

118. *See* Gross, *End of Mandatory Securities Arbitration, supra* note 18, at 1194 (arguing that banning mandatory arbitration ultimately would be bad for investors).
119. *See* Black & Gross, *Making It Up, supra* note 4, at 1047 (concluding that investors fare better in SRO arbitration as compared to court).