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Answering a Call That Was Never Made: The Unwarranted Congressional Assault on *Shearson/American Express, Inc.* *v. McMahon*

BRANDON M. THOMPSON[†]

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*Some book reviewer whose name I forget recently called me a
“vicious misanthrope” . . . or maybe it was a “cynical misanthrope”
. . . but either way, he (or she) was right; and what got me this way
was politics. Everything that is wrong-headed, cynical and vicious in
me today traces straight back to that evil hour . . . when I decided to
get heavily involved in the political process.*

—Hunter S. Thompson¹

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¹ HUNTER S. THOMPSON, *FEAR AND LOATHING: ON THE CAMPAIGN TRAIL '72*, at 225 (1973).

I. INTRODUCTION

Arbitration is the wave of the future in the legal world. This cost-efficient process has become wildly popular in a variety of areas of the law, and, up until recently, there were no indications that its growth would be stopped. A new day was dawning for the world of alternative dispute resolution. But, perceived flaws in the process and allegations of corporate abuse in the consumer context have forced Congress's hand.² There is a proposed amendment to the Federal Arbitration Act (FAA) that would drastically change the landscape for arbitration by significantly curtailing the enforceability of predispute arbitration clauses in a variety of consumer agreements. The original proposed amendments to the FAA are set forth in the Arbitration Fairness Act of 2007 (AFA),³ and they contain staggering changes to a law that was originally enacted to reverse centuries of judicial hostility towards arbitration agreements.⁴ If the bill passes in its current form, 9 U.S.C. §2 will be amended so that no predispute arbitration agreements will be allowed if they are in employment, consumer, or franchise-dispute agreements.⁵

One area that would be substantially affected by this proposed amendment would be consumer-securities arbitration. It is a long-standing practice of the securities industry to require customers to sign contracts containing clauses stating that the customer agrees to arbitrate any dispute that arises.⁶ As a result of these predispute arbitration agreements, there are thousands of consumer-securities cases arbitrated each year through the Dispute Resolution Department at the Financial Industry Regulatory Authority (FINRA).⁷ The passage of the AFA would

2. For a detailed explanation of how arbitration at FINRA is perceived, see Jill L. Gross & Barbara Black, *Perceptions of Fairness of Securities Arbitration: An Empirical Study*, U. Cin. Public Law Research Paper No. 08-01 (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1090969. The results of this survey will be analyzed in more detail in Part III.

3. H.R. 3010, 110th Cong. (2007), available at http://thomas.loc.gov/home/gpoxmlc110/h3010_jh.xml. The bill has since been reintroduced to the Senate in a different version that contains all relevant provisions from the 2007 version titled "The Arbitration Fairness Act of 2009." See S. 931, 111th Cong. (2009), available at <http://www.govtrack.us/congress/billtext.xpd?bill=s111-931>.

4. *Sherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 (1974).

5. H.R. 3010, 110th Cong. (2007), available at http://thomas.loc.gov/home/gpoxmlc110/h3010_jh.xml.

6. Jean R. Sternlight, *Creeping Mandatory Arbitration: Is it Just?*, 57 STAN. L. REV. 1631, 1636 (2005).

7. In 2009, 4,481 cases were filed with FINRA as of July. Dispute Resolution Statistics, <http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm> (last visited Sept. 4, 2009). FINRA is an independent securities regulator that is composed of over 5,000 brokerage firms throughout the country. Along with its dispute resolution department, FINRA also serves as an industry regulator and an enforcer of federal-securities laws. For a general overview of FINRA's operations, see About the Financial Industry Regulatory Authority, <http://www.finra.org/AboutFINRA/index.htm> (last visited Jan. 2, 2009).

mean that these cases would end up in court instead of at FINRA.

As Congress attempts to shed light on fairness in arbitration, the *McMahon*⁸ decision's shadow is being completely eliminated. This seminal case that allowed claims under §10(b) of the Securities Exchange Act of 1934 to be sent to arbitration via predispute agreements is in danger of becoming obsolete.⁹ Although there is no mention that the bill is made to directly overturn *McMahon*, it will not be of much use if the proposed amendments to the FAA are enacted.¹⁰ Congress has every right to overturn a nonconstitutional judicial decision by enacting legislation, but in this case their decision goes too far.¹¹ The *McMahon* Court's reasoning remains true to this day, and recent developments in FINRA's procedural rules bolster the argument that consumer-securities arbitration should not fall under the umbrella of the AFA.¹² The point of this article is not to argue that Congress cannot do this,¹³ but that it should not. As will be discussed throughout this paper, consumer-securities arbitration is special because of the procedure it employs to ensure fair treatment for consumers. There may be areas of arbitration that need to be changed. In all likelihood, there are, and Congress may be justified in taking action in those fields. But consumer securities is not one of them, and Congress should consider its unique qualities before making any drastic changes.

After examining the *McMahon* decision, I will analyze whether there was any external pressure on Congress from the public that led the proponents of the bill to include consumer-securities arbitration. "[T]he pressure of public opinion, sometimes manifested in Congressional action, may force a change in government policy."¹⁴ If there is overwhelming support for change in the field, then Congress would have a reason to act. "Citizens influence legislators' actions to the extent that legislators' decisions reflect in some way citizens' preferences or poten-

8. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

9. *See Id.* at 238.

10. I would not expect Congress to mention any case specifically by name when passing this bill, given the general, all-encompassing language it uses.

11. For an interesting discussion of why consumer-securities arbitration could be considered state action and challenged by a party on constitutional grounds, see Sarah Rudolph Cole, *Arbitration and State Action*, 2005 B.Y.U. L. REV. 1 (2005).

12. The most important recent rule change tightens the standard for motions to dismiss before a full hearing in the FINRA forum. For a brief discussion of this rule, see David E. Robbins, *A Sea Change Comes to Securities Arbitration: Codifying the Practice of Motions to Dismiss*, LexisNexis Expert Commentary, 2008 EMERGING ISSUES 2359 (2008).

13. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) ("Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies . . .").

14. Robert A. Sedler, *The Media and National Security*, 53 WAYNE L. REV. 1025, 1033 (2007).

tial preferences about policy issues.”¹⁵ For these reasons, the necessary starting point for analyzing Congressional action is to look at the perception of consumer-securities arbitration among three influential subsections of the population—the judiciary, the general public, and the academic community—in order to see if any one group has rung the alarm to spur Congress into action. Part II of this paper will analyze the *McMahon* decision and the reasoning that led the court to hold that §10(b) claims could be sent to arbitration through predispute agreements. This will give an accurate assessment of the current judicial perception of consumer-securities arbitration. Part III deals with public perception of the FINRA forum itself. The public perception of the forum is important in determining whether Congress would be encouraged to include consumer-securities arbitration under the umbrella of the AFA. Part IV concerns academic perceptions of consumer-securities arbitration—including perceived past errors by Congress in attempting to regulate arbitration—as well as both the positive and negative academic reactions to the developments in consumer-securities arbitration since the *McMahon* decision.¹⁶ The paper is organized this way because, in order for Congress to be vindicated in choosing to use the AFA to swallow up consumer-securities arbitration, there must be some constituency that is crying out for them to act. As will be discussed in Parts II-IV, the reality of the situation is quite the opposite. By and large, none of these groups has issued a resounding call to arms.

Next, the AFA itself will be examined to show that regardless of perceptions, the evils that the bill is trying to address are not present in consumer-securities arbitration. Part V details the AFA and gives a brief glimpse into the reasoning of the main proponent of the bill. I am waiting until Part V to discuss in detail the legislation I am attempting to attack for a distinct purpose. In order to understand my strong opposition to the AFA, it is essential to first understand the current perception of consumer-securities arbitration. After examining precedent in the field

15. R. DOUGLAS ARNOLD, *THE LOGIC OF CONGRESSIONAL ACTION* 11 (1992).

16. For the purpose of this paper, it is not necessary to examine in detail the way the securities industry perceives FINRA arbitration. It is overwhelmingly supportive, but, if the AFA is meant to protect consumers, then most people will likely assume that the current system must benefit the industry and would be skeptical of its support for arbitration. There is little wisdom in asking a butcher what he thinks about vegans—the taint of self-interest (whether real or imagined) obscures one’s ability to perceive whatever truth may lurk in his response. Even so, the industry’s benefit does not have to be the consumer’s loss. Not every legal issue is a zero-sum game. The current system may be—and I will argue *is*—beneficial for both sides. For an intuitive look into the specifics of the securities industry’s support for mandated arbitration, see SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, *WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY: THE SUCCESS STORY OF AN INVESTOR PROTECTION FOCUSED INSTITUTION THAT HAS DELIVERED TIMELY, COST-EFFECTIVE, AND FAIR RESULTS FOR OVER 30 YEARS* (2007), available at <http://www.sifma.org/regulatory/pdf/arbitration-white-paper.pdf>.

and both the positive and negative academic opinions regarding this type of arbitration, the stage will be set to put the AFA under the microscope. Part VI of this paper will begin by highlighting some distinguishing characteristics of consumer-securities arbitration by comparing consumer-securities arbitration at FINRA to critiques of general mandated arbitration. FINRA arbitration procedural guidelines and the process provided by the forum are more than adequate and pass muster under the requirements set forth in judicial decisions about arbitration in other fields. In light of the process provided, it is clear that consumer-securities arbitration at FINRA should not fall under the unnecessarily broad umbrella that the AFA has carelessly strewn over the arbitration world. I will explain that not only are these amendments unnecessary for consumer-securities arbitration, but that they could end up doing more harm than good.¹⁷ This bill is an overzealous attempt by its creators to garner political favor by seeming to protect the little guy, and its negatives far outweigh its positives. These potentially harmful mistakes should not be allowed to masquerade as a victory for consumer protectionism.¹⁸

II. THE *McMAHON* DECISION & JUDICIAL PERCEPTION OF CONSUMER-SECURITIES ARBITRATION

Shearson/American Express, Inc. v. McMahon was a landmark decision in the field of consumer-securities arbitration. In that case, the plaintiffs sued their brokerage firm for a number of claims, one of which was brought under §10(b)¹⁹ of the Securities Exchange Act of 1934 (Exchange Act). The holding relevant to this paper was that consumers with claims under the Exchange Act could be compelled to have them decided in arbitration pursuant to predispute agreements.²⁰ The Court of Appeals had held that the Supreme Court's decision declining to compel arbitration of claims brought under §12(2) of the Securities Act of 1933 (Securities Act) in *Wilko v. Swan*²¹ should be extended to cover §10(b)

17. For a discussion of relevant changes in pretrial dismissal procedures in the federal court system compared to relevant procedures in consumer-securities arbitration, see *infra* Part VI(c).

18. I feel obligated to note that I spent twelve weeks working for FINRA in their Dispute Resolution Department. I believe I have a moral—as well as an academic—responsibility to disclose this so the reader can take it for what it's worth and make his or her own educated decision. I have no bias to hide. I have excluded research from this paper that I think to be both relevant and helpful to my thesis solely because it was commissioned by FINRA or another organization composed of members of the securities industry, and I want to avoid any perception of partiality.

19. Claims alleging the use of fraud or deception in the sale of securities are brought under this rule. 15 U.S.C. §78j (2000).

20. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 238 (1987).

21. 346 U.S. 427 (1953).

claims as well.²² The *McMahon* Court disagreed with this line of reasoning because of the enormous advances that had taken place in consumer-securities arbitration since the time of the *Wilko* decision.

A. Importance of Wilko Rejection

The logic behind the *Wilko* decision—and the Court's reasons for declining to follow it—are illustrative of improved judicial confidence in arbitration. In *Wilko*, the Court observed that any stipulation that attempts to waive compliance with any provision of the Securities Act is void.²³ The *Wilko* Court then went on to explain that at that time—*Wilko* was decided in 1953—the arbitration forums in place were not adequate to enforce the provisions of the Securities Act that were favorable to the purchasers of securities.²⁴ The *McMahon* Court sent an unmistakable message by saying "The conclusion in *Wilko* was expressly based on the Court's belief that a judicial forum was needed to protect the substantive rights created by the Securities Act"²⁵

The *McMahon*'s petitioned the Court to follow this same logic by arguing that compelling arbitration would make it less likely that they would recover on their Exchange Act claims, and the Court recognized this line of reasoning as "the heart of the Court's decision in *Wilko*."²⁶ Nevertheless, the Court did not accept the *McMahon*'s argument this time around. The seeds for the *McMahon* Court's rejection of this proposition were planted in the dissent in *Wilko*. Justice Frankfurter refused to follow the majority because he believed their distrust of arbitration did not have any distinct factual or evidentiary basis.²⁷ The *McMahon* Court agreed with the dissent and found the conclusion that the *Wilko* Court arrived at to "reflect a general suspicion of the desirability of arbitration and the competence of arbitral tribunals—most apply with no greater force to the arbitration of securities disputes than to the arbitration of legal disputes generally."²⁸

The *McMahon* Court pointed out that the reasons that the *Wilko* Court espoused have been systematically dismantled in the time since it

22. *McMahon*, 482 U.S. at 224.

23. *Wilko*, 346 U.S. at 434.

24. *Id.* at 435 ("Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings.").

25. *McMahon*, 482 U.S. at 228.

26. *Id.* at 231.

27. *Wilko*, 346 U.S. at 439 (Frankfurter, J., dissenting).

28. *McMahon*, 482 U.S. at 231. This type of overgeneralization is being repeated by Congress today. By lumping all consumer arbitration into the same group in lieu of actually examining the process each forum provides, they have crafted a piece of legislation that ignores the distinctive positive qualities of FINRA consumer-securities arbitration.

was decided. In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, the Court recognized that arbitral tribunals had the capacity to handle complex antitrust claims²⁹ and were capable of utilizing streamlined procedural systems without consequently restricting substantive rights.³⁰ The Court had also already declined to apply *Wilko*'s logic to international agreements. In *Scherk v. Alberto-Culver Co.*, the Court upheld a predispute arbitration agreement to arbitrate the same type of Exchange Act claim that was brought in *McMahon*, albeit in an international context.³¹ After this slow deterioration of *Wilko*'s impact, the final step in the progression came when the *McMahon* Court unequivocally stated:

Thus, the mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time. This is especially so in light of the intervening changes in the regulatory structure of the securities laws. Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC's oversight authority.³²

The Court then went on to list the array of regulatory protections that the rules of arbitration at the National Association of Securities Dealers (NASD, which is now FINRA³³) are subject to.³⁴ The details of the FINRA procedure will be discussed in more depth in Part VI, but at this time it is important to note that, even over twenty years ago, the Court recognized the distinguishing characteristics present in consumer-securities arbitration. Both FINRA and the Securities and Exchange Commission (SEC) put a great deal of effort into making sure that the process offered by the forum's arbitration meets the precipitous levels of fairness and trustworthiness that the American court system demands.³⁵ As Congress begins an assault on all consumer arbitration, it would serve these legislators well to go back and read the *McMahon* decision and reconsider whether consumer-securities arbitration is in need of such a drastic shake-up. If they did, they would find that all of the evils they are looking to cure were not present in the forum in the first place. *McMahon* embodied the judicial recognition of the fairness of consumer-securities

29. 473 U.S. 614, 633–34 (1985).

30. *Id.* at 628.

31. 417 U.S. 506, 515 (1974).

32. *McMahon*, 482 U.S. at 233.

33. The NASD merged with the NYSE regulatory arm to create FINRA in July 2007. Stephen J. Ware, *What Makes Securities Arbitration Different from Other Consumer and Employment Arbitration?*, 76 U. CIN. L. REV. 447, 449 (2008).

34. *McMahon*, 482 U.S. at 233–38 (noting the extensive oversight the SEC has over the procedural rules of the forum).

35. *Id.*

arbitration, and, if the basic tenets of the Court's argument are still true today, then Congress should be hesitant to attack this particular brand of arbitration.

B. *Recent Developments in Buckeye Check Cashing*

The current judicial sentiment towards arbitration mirrors the faith in these tribunals that the *McMahon* Court demonstrated over twenty years ago. In 2006, the Court gave another vote of confidence to arbitral tribunals in their decision in *Buckeye Check Cashing, Inc. v. Cardegna*.³⁶ That case involved a class-action suit brought against a check-cashing company claiming that their predispute arbitration agreements violated several lending and consumer-protection laws.³⁷ The contract originally signed by the plaintiffs contained a predispute arbitration clause that they were seeking to invalidate.³⁸ While the case did not specifically concern consumer-securities arbitration, the holding is worth noting because it is illustrative of the current judicial attitude towards arbitration. First, the Court held that "as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract."³⁹ Next, the Court held that unless the challenge was to the actual arbitration clause, any decisions about the validity of the contract as a whole must be decided *by the arbitrator*.⁴⁰ Lastly, this arbitration law applies regardless of whether the case is in state or federal court.⁴¹

Even though this decision did not deal directly with the FINRA forum, the substantive law that the plaintiffs brought their claims under was analogous to the laws that claims were brought under in *McMahon*. Both cases involved consumer-protection laws—lending laws in *Buckeye Check Cashing* and securities laws in *McMahon*—and, in both cases, the Court ruled in favor of arbitration. It goes without saying that it is the province of Congress to make its own policy judgments about protecting consumers, and it is well within their power to overturn the courts and regulate arbitration in any way they see fit. Even so, they have completely ignored the sound logic of the judiciary in coming to their latest conclusion.

36. 546 U.S. 440 (2006).

37. *Id.* at 443.

38. *Id.* at 442.

39. *Id.* at 445.

40. *Id.* at 445–46.

41. *Id.* at 446.

III. PUBLIC PERCEPTIONS OF CONSUMER-SECURITIES ARBITRATION

The Supreme Court has given resounding support to arbitration, but Congress has to take into account more than just those nine opinions when they make decisions. Public perception of political matters is also extremely important, and arbitration presents several difficult questions for the academic, legislator, and practitioner alike. The appeal of the process to large, institutional litigators who have to deal with a wide variety of lawsuits is unmistakable, but, when government-created courts are essentially removed from the picture, eternal vigilance is needed to ensure fairness. This leads to the question of when arbitration needs to be regulated, and, if regulation is desired, how it should be enacted. Public sentiment is one of the many forces at work when Congress attempts to answer this question.

A. *The Caseload at FINRA*

Congress serves at the will of the people and “presumptively has popular authority for the value judgment it makes.”⁴² Therefore, it is important to determine whether the public has given Congress a clear mandate to act to cure unfairness in consumer-securities arbitration. With the enactment of the FAA, Congress was misled by a well-known commercial litigator into believing that the FAA was necessary.⁴³ In attempting to determine the necessity of congressional intervention here, there is no need to resort to the transcripts of impassioned speeches by lobbyists; there is actual empirical data on how the public perceives the forum. There is a vast body of statistical research dedicated to assessing the public perception of consumer-securities arbitration, but, before looking into how FINRA arbitration is perceived, it is helpful to obtain a better understanding of what actually happens to the cases filed there. In 2008, 4,982 cases were filed with FINRA. The most common types of claims in these cases were misrepresentation, negligence, breach of contract, and breach of fiduciary duty. The most common instruments involved in the cases were common stocks, mutual funds, and derivative securities. In 2008, only twenty-four percent of cases filed were actually decided by the arbitrators. Forty-seven percent were settled directly by the parties, and ten percent were settled by mediation. Forty-two percent of cases that were decided by the arbitration panel resulted in an award to the investor. Last, an astounding *seventy-four percent* of all cases that were filed resulted—either through settlement or award by the arbitra-

42. *Oregon v. Mitchell*, 400 U.S. 112, 208 (1970).

43. Michael H. LeRoy, *Misguided Fairness? Regulating Arbitration by Statute: Empirical Evidence of Declining Award Finality*, 83 NOTRE DAME L. REV. 551, 559 (2008). This will be discussed in more detail in Part IV.

tor—in some sort of recovery for the investor.⁴⁴

These statistics provide an important detail that must be taken into account before looking at the public perception of FINRA arbitration—most of the cases decided *in the forum* are never actually decided *by the forum*. Reader beware—any criticism of this arbitration process that claims investors are mistreated has to be reconciled with the fact that only a small fraction of cases filed each year actually get decided by the forum that is being challenged.⁴⁵ The majority of cases are decided by the parties, without interference. It is completely within reason to assume that if the plaintiffs in these cases are agreeing to the settlements, then their terms cannot be so egregious and anti-investor as to warrant congressional intervention.

B. *Public Perception*

Having set forth the objective statistics about the volume and resolution of arbitrations at FINRA, I will move on to the public perception of the forum. Any statistics must be taken with a grain of salt, given the potential for bias among those who filed claims and were not able to recover the amount they originally sought, regardless of whether their claims had merit.⁴⁶ With that being said, there are two main reasons why the importance of the perception of the forum cannot be understated. First, the public's faith in the rule of law is intrinsically tied to their perception of the forum that adjudicates disputes among private citizens—no matter what the forum is. As will be discussed more in Part V, the proponents of the AFA support the bill because they believe it will cure a perceived unfairness that exists within consumer arbitration. Public perception of the forum is one of the factors—but not the only one—

44. All statistics taken from Dispute Resolution Statistics, *supra* note 7. It is also important to note that the low percentage of cases actually being decided by the arbitrators has been consistent in the last five years. In 2004–08, only twenty-seven, twenty-four, twenty-one, twenty-one, and twenty-four percent of cases were decided by arbitrators, respectively. *Id.*

45. Dispute Resolution Statistics, *supra* note 7.

46. It is important to note that this survey carries a risk of being biased by the overall lack of responses. The response rate for the survey was only 13.0%. Gross, *supra* note 2, at 13. The first point that might indicate potential bias is the fact that of those surveyed, only 23.4% responded that the customer won an award at the hearing. *Id.* at 23. This is significantly lower than the forty-two percent that was reported by FINRA. Dispute Resolution Statistics, *supra* note 7. Therefore, a large segment of people that did win awards at hearings did not respond to this survey. This does not mean that the study is necessarily tainted, but it is worth mentioning because of the possibility that those who responded to the survey would have a more negative perception of the process than the average user because they won awards at a significantly lower rate than the average person who participated in FINRA arbitration. Also, although this survey pertains to NYSE and NASD arbitration, it can be said to mirror perception of FINRA arbitration because, in between the time the study was commissioned and the time it was published, NASD and NYSE merged to become FINRA. Ware, *supra* note 33, at 449.

that is rightfully taken into account when deciding whether the AFA should apply to consumer-securities arbitration.⁴⁷ Second, these perceptions are important because the fairness of the forum cannot readily be measured in any other way.⁴⁸

The survey contained a great deal of data and a number of questions that need not be discussed here.⁴⁹ I am including this study in the paper only to examine whether there is a strong public sentiment that consumer-securities arbitration is an unfair process. It is important to note that the participants in this survey were not just customers. The groups polled also included lawyers, persons employed by brokers, and corporate representatives of the firms that are members of FINRA.⁵⁰ The survey started by asking people if they had any concerns about the fairness of the process before it actually took place. Thirty-nine percent of participants had concerns about the fairness of the process before they filed their claims, and twenty-eight percent were concerned that the arbitrators would be biased.⁵¹ This is important, because it shows that the majority of the people who have not used the forum do not have concerns about its fairness. It also raises a warning flag about disputants being biased against the forum before they ever began the process. Concerning the qualifications of the arbitrators themselves, fifty-eight percent of participants selected that they “Agree” or “Strongly Agree” that the panel was competent to resolve the dispute, against only 20.6% of participants who did not believe that the panel was competent to resolve the dispute.⁵² 40.4% believed the arbitration panel was open-minded; compared to 33.3% percent that did not.⁵³ The vast majority of those polled believed that the arbitrators listened to what all sides had to say⁵⁴ and gave ample time for all parties to present their case.⁵⁵ Concerning the procedural aspects of the forum, the number of participants who believed that the discovery process allowed them to get the information they needed for the hearing was nearly double the number that did not find the process to be helpful.⁵⁶

47. Clearly the judiciary does not believe that it should, see *supra* Part II concerning the *McMahon* decision.

48. Gross, *supra* note 2, at 6.

49. It is worth noting—as an example of the SEC’s close watch on FINRA—that this extensive study was done at the behest of the SEC to monitor public reaction to working with the forum. *Id.* at 4.

50. *Id.* at 17.

51. *Id.* at 21. This does not mean that sixty-seven percent of the participants had initial concerns, because they were permitted to answer “Yes” to both questions.

52. *Id.* at 27.

53. *Id.* at 29.

54. *Id.* at 34.

55. *Id.* at 36.

56. The exact percentages were that 49.5% of participants agreed the discovery process

The most noticeable dissatisfaction with the process does not concern the forum itself, but the ultimate result.⁵⁷ In spite of this, the number of people who said they would recommend arbitration to others slightly exceeded the number of people who said they would not.⁵⁸ Although less people viewed the forum favorably compared to those who viewed it unfavorably,⁵⁹ 35.6% of those polled said they would use the forum again *rather than use the court system*, compared to only twenty-nine percent who said they would not.⁶⁰

When looking at these results, it is important to keep in mind that they only represent how people view the process, and not the legitimate fairness of the process itself. The conductors of the study put it best, "Thus, these empirical findings shed light on *subjective* perceptions by arbitration participants and do not address *objective* standards of substantive or procedural fairness."⁶¹ That being said, I included this set of statistics with the purpose of showing there is a general lack of consensus among the public about the fairness of the FINRA forum. Given the possibility for disdain or preference for the forum based solely on whether or not the person won their case, it is hard to take these numbers as an absolute measure of fairness. At best, they can be used to show that there is no prevalent, overwhelming public perception of the forum that would serve as a mandate to Congress that would vindicate them in passing a bill that would eliminate a great deal of the cases that pass through the forum.

IV. ACADEMIC PERCEPTIONS OF CONSUMER-SECURITIES ARBITRATION

Having addressed the judicial and public opinions about the forum, it is now time to see how the academic world perceives arbitration. "Legal scholarship might be said to have two functions: to increase our knowledge and understanding of the law and legal institutions, and to shape their development."⁶² Arbitration has become an increasingly pop-

provided them with the information they needed, and 29.2% percent disagreed with this statement. *Id.* at 32.

57. 55.1% of those polled were not satisfied with the outcome of the arbitration. *Id.* at 38. However, forty-six percent of respondents said they would be more satisfied if the award contained a full explanation of how the arbitrators reached their decision. *Id.* at 39. A satisfaction rate as low as fifty percent is probably still indicative of a fair process. In every case that goes to hearing, there must of course be a winner and a loser. So, it is hard to distinguish whether people were upset about the outcome because of its lack of explanation or because of its specific substance. This uncertainty about the origin of the discontent makes it difficult to place great significance on these particular numbers.

58. *Id.* at 43.

59. *Id.* at 44.

60. *Id.* at 48.

61. *Id.* at 59.

62. David S. Schwartz, *If You Love Arbitration, Set it Free: How "Mandatory" Undermines*

ular topic among the legal-scholarship community, and the number of papers published on it has risen accordingly.⁶³ I start by looking a historical lesson about the passing of the FAA noted by one professor. This example will be illustrative because it shows an academic's perception that Congress can be manipulated into passing unnecessary regulations concerning arbitration specifically. I will then conclude by examining the academic reaction specific to consumer-securities arbitration.

A. *Historical Lesson from the Passing of the FAA*

Before delving into academic perception concerning consumer-securities arbitration specifically, it will be helpful to detail one past perceived error by Congress in a situation analogous to this one. Michael H. LeRoy presents an interesting question about whether the FAA was entirely necessary in the first place. His article focuses on empirical evidence concerning vacatur of arbitration awards and what he perceives as a misstep by Congress in originally enacting the FAA.⁶⁴ He argues that Congress unnecessarily enacted the FAA, explores the history of courts' treatment of arbitration at common law, and explains why he thinks the FAA was actually detrimental to the arbitral process.⁶⁵ The situation he critiques presents a valuable analogy by detailing how susceptible Congress can be to overreacting.

LeRoy argues that judicial hostility to arbitration before the FAA was nothing more than a myth, and presents a line of cases showing that judges at common law routinely ruled in favor of arbitration.⁶⁶ Prior to the adoption of the FAA, judicial policy actually favored arbitration. But there was popular political support for the bill, and so Congress passed a law to protect something that needed no protection.⁶⁷ LeRoy puts it best

"Arbitration" 30 (Univ. of Wis. Law Sch. Legal Studies Research Paper Series, Working Paper No. 1052, 2007), available at <http://ssrn.com/abstract=1006826>.

63. *Id.* Schwartz notes that

An obscure area generating a small handful of published scholarly articles at the beginning of the 1980s, arbitration scholarship has boomed: the 300–400 articles on arbitration now published annually in the pages of the journals included within the Westlaw database represent a fivefold increase in arbitration articles relative to published legal scholarship generally.

Id.

64. LeRoy, *supra* note 43, at 553–56.

65. *Id.* at 557–58.

66. While it is not necessary to go into the details of these cases here, they are helpful and can be found *id.* at 559–60 for state-court cases (*Brush v. Fisher*, 38 N.W. 446 (Mich. 1888); *Campbell v. Western*, 3 Paige Ch. 124 (N.Y. Ch. 1832); *Tankersley v. Richardson*, 2 Stew. 130 (Ala. 1829)) and *id.* at 575 for Supreme-Court cases (*Colombia v. Cauca Co.*, 190 U.S. 524 (1903); *Lutz v. Linthicum*, 33 U.S. 165 (1834); *Carnochan v. Christie*, 24 U.S. 446 (1826)).

67. LeRoy, *supra* note 43, at 560–63.

when he says that “Truth lost to political expedience”⁶⁸ Although in this case Congress was acting to expand the power of arbitration—and with the AFA they are trying to curtail it—the situation is nonetheless demonstrative of the tendency of Congress to overact.⁶⁹

B. *Academic Perceptions of Consumer-Securities Arbitration*

As noted previously, scholarly research and publication on arbitration has sky-rocketed in the last two decades.⁷⁰ The debate on the subject has been quite heated, and—as with any topic in academia—commentators have brought up a variety of unique arguments for and against.⁷¹ For the sake of brevity, I will only discuss the academic perceptions of consumer-securities arbitration in a limited capacity. This is not because what’s being said is not worthwhile, but there is some degree of repetition amongst the themes—though not the details—of the arguments from both sides, and they often mirror the challenges that will be discussed in the Part VI(a) detailing the academic criticism of mandatory arbitration generally.

One interesting point brought up by Professor Gross is the possibility that the arbitration process itself is, fair, but that investors whose cases did not turn out as they had hoped are being lead to believe that it was a problem with the forum—and not their case—that caused them to get a disappointing result. “If an investor believes that broker misconduct caused losses in his trading account but an arbitrator does not award damages to the investor after a hearing on that misconduct, then the investor blames the arbitrators”⁷² In the aftermath of a loss at the hearing or a settlement that was not as lucrative as they wanted, it is much easier for disputants or their lawyers to complain about the fairness of the forum rather than question whether their complaint was as strong as they had originally hoped for. *Mea culpa* is never as satisfying as slinging mud. It very well could be that it is the outcome of the case—and not the procedure of the forum⁷³—that leads the jilted inves-

68. *Id.* at 563.

69. The analogy to the current situation is striking. Congress is again acting to protect a group that needs no protection—consumer-securities investors.

70. Schwartz, *supra* note 62, at 30.

71. For a discussion of the contract-law principles evoked in challenging and defending the various clauses themselves that are sometimes included in these contracts, see Yvette Ostolaza, *Overview of Arbitration Clauses in Consumer Financial Services Contracts*, 40 TEX. TECH L. REV. 37 (2007).

72. Jill I. Gross, *McMahon Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 493, 518 (2008).

73. For a discussion of many of the positive procedural protections the FINRA forum provides, see Barbara Black, *The Irony of Securities Arbitration Today: Why do Brokerage Firms Need Judicial Protection?*, 72 U. CIN. L. REV. 415, 446–53 (2003) (“Reasonable Notice . . . Right

tor to cry foul.

One critic of arbitration procedure has called for an empirical investigation about the quality of results in mass arbitration as opposed to litigation. He wants to test the assumption that proponents of arbitration are often quick to back—that the results in arbitration are at least equal to results in traditional court litigation.⁷⁴ An in-depth study into this question would certainly help to shed light on whether consumer-securities arbitration is fair to both sides involved in the dispute. Given the dearth of research in the area, the results of a study looking into this would be invaluable. For all we know, the forum could actually be more fair to the consumer. There is a wealth of data concerning consumer-securities arbitration awards that is publicly available.⁷⁵ Unfortunately, this data measured by itself would be largely meaningless. The most effective way to measure the fairness of the results in consumer-securities arbitration would be to compare them to results from comparable cases in the court system. The stand-alone analysis would not be completely useless, but without an analysis of what the alternative—the courts—provides, it would be less informative about whether arbitration gives the same opportunities that litigation does.

That said, gathering this type of data to make a comparison may be troublesome, given the widespread use of consumer-securities arbitration. Court-case statistics may not be plentiful enough to provide an accurate sampling. On the other hand, if it were possible to conduct such a study, it could be the first step in answering two very important questions. First, are the results in consumer-securities arbitration more or less favorable to the consumer than courts are? Second, if they are less favorable to the consumer, is this why investors feel negatively about the process? Being able to answer these questions with empirical data would be invaluable.

Having finished Parts II-IV of this paper, it is clear that there is no specific group that is crying out to Congress for help concerning predispute clauses in consumer-securities arbitration agreements. Judicial reaction to arbitration has been largely positive. Public perceptions of the forum are inconclusive—if anything, the majority of people believe that

to Representation by Counsel; Right to Present Evidence . . . Right to Present a Case in a Fair Geographic Forum . . . Right to Adequate Relief . . . Unbiased Decision-Maker . . . Right to Adequate Discovery . . . Right to Know Something of the Panel's Rationale . . . Arbitration Costs . . . Right to Judicial Review.”).

74. Jeffrey W. Stempel, *Mandating Minimum Quality in Mass Arbitration*, 76 U. CIN. L. REV. 383, 405 (2008).

75. Shelly R. James, *Arbitration in the Securities Field: Does the Present System of Arbitration Between Small Investors and Brokerage Firms Really Protect Anyone?*, 21 J. CORP. L. 363, 376 (1996). All FINRA arbitration awards are publicly available. FINRA Arbitration Awards Online, <http://finraawardsonline.finra.org/> (last visited Feb. 6, 2009).

the forum is fair. The results of the survey are certainly nowhere near a mandate by the people or a definite call to arms. Academic perception of the forum is both positive and negative, but again, there is no clear voice one way or the other.⁷⁶ There is no absolute consensus among the groups about the fairness of the process, but there is also no ringing endorsement. Even though Congress has not been forced to act, it is completely within their power to resolve the uncertainty in this debate against predispute agreements. Yet, after reviewing the bill itself, the concerns it aims to address, and the procedure of the FINRA forum, it will be clear that the AFA should not apply to consumer-securities arbitration.

V. THE ARBITRATION FAIRNESS ACT (AFA)

Having examined and analyzed the various perceptions about consumer-securities arbitration, it is now time to look at the bill that wants to change it all. Having seen the arguments for and against this unique type of arbitration, it will be clear why this bill should not swallow consumer-securities arbitration under its vast umbrella. Upon comparing the concerns it is meant to address—as well as the statements of those in support of the bill—to the procedure at FINRA, it will be shown that this bill should not apply to consumer-securities arbitration.

A. *The Bill Itself*

The first part of the bill that warrants examination is the “Findings” section where the author of the bill has the findings of fact he has made in order to deem the bill necessary. It starts by saying that the FAA was meant to apply to disputes “between commercial entities of generally similar sophistication and bargaining power.”⁷⁷ Then it says that “A series of United States Supreme Court Decisions have changed the meaning of the Act so that it now extends to disputes between parties of greatly disparate economic power”⁷⁸ Later it says that “Private arbitration companies are *sometimes* under great pressure to devise systems that favor the corporate repeat players who decide whether those companies will receive their lucrative business.”⁷⁹ One last important finding to note is that author of the bill said “Mandatory arbitration is a

76. For a positive perception, see Gross, *supra* note 72. But see William B. L. Little, *Fairness is in the Eyes of the Beholder*, 60 BAYLOR L. REV. 73 (2008).

77. H.R. 3010, 110th Cong. §2(1) (2007), available at http://thomas.loc.gov/home/gpoxmlc110/h3010_ih.xml.

78. *Id.* §2(2).

79. *Id.* §2(4) (emphasis added). This argument about generating revenue is largely inapplicable to FINRA because they are a non-profit organization. BrokerCheck Frequently Asked Questions, <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/P015174> (last visited Feb. 6, 2009).

poor system for protecting civil rights and consumer rights because it is not transparent.”⁸⁰ These findings show the evident dissatisfaction with the Supreme Court’s recent decisions, but Congress should take a second look at whether all the decisions regarding the FAA—specifically *McMahon*—should be overturned.

Upon considering these findings, the bill then proposes a series of changes to the FAA. If it gets passed, these changes will have a drastic effect on the world of consumer-securities arbitration. The bill would amend the FAA so “No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of an employment, consumer, or franchise dispute; or a dispute arising under any statute intended to protect civil rights”⁸¹ It will also change the FAA so that “[T]he validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator,”⁸² irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.”⁸³ The language is comprehensive and clear; this bill is meant to put an end to consumer arbitration, regardless of the forum or context.

B. *Statements by Senator Feingold*

Senator Russ Feingold is the person sponsoring the bill, and his opening statement to the senate committee he presented it to is informative. He begins by saying that “One of the most fundamental principles of our justice system is the right to take a dispute to court.”⁸⁴ There are

80. H.R. 3010, 110th Cong. §2(6) (2007), available at http://thomas.loc.gov/home/gpoxmlc110/h3010_ih.xml. Many of these considerations about mandated arbitration *generally*—as well as how consumer-securities arbitration addresses them—will be discussed in Part VI of this paper.

81. *Id.* §4.

82. For a discussion of the law regarding arbitrability of claims and who decides this question, see *First Option of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (“Just as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute, so the question ‘who has the primary power to decide arbitrability’ turns upon what the parties agreed about *that* matter.”(emphasis in original) (citations omitted)).

83. H.R. 3010, 110th Cong. §4 (2007), available at http://thomas.loc.gov/home/gpoxmlc110/h3010_ih.xml.

84. Senator Russ Feingold, Opening Statement of U.S. Senator Russ Feingold Senate Judiciary Subcommittee on the Constitution on “The Arbitration Fairness Act of 2007,” <http://feingold.senate.gov/~feingold/statements/07/12/20071212.htm> (last visited Jan. 8, 2009). Interestingly enough, this first statement can already be exposed as mere puffery just by looking at the bill itself. The bill carves out a special exception so that it will not affect any arbitration clause that is part of a collective bargaining agreement. H.R. 3010, 110th Cong. §4 (2007), available at http://thomas.loc.gov/home/gpoxmlc110/h3010_ih.xml. It is true that a union and a company are probably of more equal sophistication than a customer and a large business, but, if this right to access to the court system is so sacred, why is someone else allowed to give it away for you just because you happen to work in a field that has been unionized?

several other central concerns that Senator Feingold has about mandatory arbitration. He thinks that mandatory arbitration clauses have a deteriorating effect on the protections our justice system is meant to afford, that mandatory arbitration clauses are now utilized to deny people their civil rights, and that the costs associated with arbitration act as a bar to people entering the forum.⁸⁵ When speaking about the bill, he also makes it unequivocally clear that “First, it is intended to cover disputes between investors and securities brokers. I believe that such disputes are covered by the definition of consumer disputes . . . we will make the intent even clearer when we mark up the bill in committee.”⁸⁶ These are serious allegations against arbitration generally⁸⁷—and consumer arbitration specifically—and they will now be addressed.

VI. FINRA GUIDELINES & FAIRNESS

Having heard the arguments of the main proponent of the AFA, it is now time to respond directly to those criticisms. I will start by addressing some of the main concerns relating to general mandated arbitration. Juxtaposing these criticisms against the realities of the FINRA forum will highlight the extra steps that are taken to ensure fundamental fairness. Then I will examine the procedural concerns the AFA raises about the forum itself. Lastly, I will look at the much broader question of the Constitutional implications of mandatory arbitration clauses in light of the Seventh Amendment. That said, in order to fully understand the implications of what arbitration may or may not be taking away, it will again be helpful to examine what the alternative—the court system—provides. After looking at the trend regarding motions to dismiss in federal courts, the procedural protections of the FINRA forum will look considerably more attractive.

85. Feingold, *supra* note 84.

86. *Id.* Senator Feingold has made good on his promise to lump consumer-securities arbitration in with the rest of consumer arbitration generally. The new version of the bill specifically includes “services relating to securities and other investments” under the definition of “consumer dispute.” S. 931, 111th Cong. §3 (2009), available at <http://www.govtrack.us/congress/billtext.xpd?bill=s111-931>.

87. For testimony further in support of the AFA that also argues about the Constitutional implications of mandatory arbitration, see W. Stephen Westermann, *Testimony to Constitution Subcommittee of the U.S. Senate Judiciary Committee Regarding the Arbitration Fairness Act of 2007 and the Constitutional Duty of Congress to Restore Citizens’ Seventh Amendment Rights*, 3 (December 12, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1095542 (“The primary assertion of this testimony is that . . . the Framers’ election to preserve the common law right to civil jury trial in the Bill of Rights rather than in a statute, or not at all, means that businesses may not remove this right from citizens by making its waiver a precondition . . .”).

A. *General Perceptions of Mandatory Arbitration Measured Against Realities of Consumer-Securities Arbitration*

The way the academic world perceives mandatory arbitration generally is the starting point for this segment of the paper. It is prudent to focus on the academic reaction to this broader topic before delving into issues specific to consumer-securities arbitration. Assessing the validity of these general arguments when applied to FINRA arbitration is the first step.

One common argument against mandatory arbitration is that there is a perceived unfairness that manifests when the predispute clause does not allow a group of consumers to bring a class-action claim. One scholar cites these clauses as another way for companies—particularly in the consumer context—to avoid liability because each consumer’s loss will be too financially insignificant to justify them bringing a claim on their own.⁸⁸ They say that because the transactional cost of the potential litigation—lawyers’ fees, filing fees, etc.—will likely outweigh any possible recovery, consumers will not bring these meritorious claims as individuals.⁸⁹ “It is well understood that, but for class actions, many kinds of legal violations committed on a large scale can go unremedied, if the damages caused by each individual violation is small enough to make the filing of individual lawsuits economically unfeasible.”⁹⁰ The importance of this procedural device cannot be understated, and FINRA’s arbitration proceedings protect it accordingly. Once a class action has been brought in the court system, the NASD⁹¹ Code of Arbitration Procedure for Consumer Disputes (the “Code”) specifically forbids a member firm or associated person from enforcing an arbitration agreement against a member—or potential member—of the class.⁹² Unlike many arbitration administrators, the FINRA forum for consumer-securities arbitration specifically protects a group of plaintiffs’ right to bring a suit as a class in the traditional government-sponsored court system.⁹³ This protection is not mandated by the judiciary or the legislature, but was implemented by the forum itself. Class actions are seen by busi-

88. Sternlight, *supra* note 6, at 1652.

89. *Id.*

90. Schwartz, *supra* note 62, at 20.

91. This Code is also used by FINRA, but is still referred to as the NASD code after the July 2007 merger.

92. NATIONAL ASSOCIATION OF SECURITIES DEALERS, CODE OF ARBITRATION PROCEDURE FOR CONSUMER DISPUTES §12204(d) (2007), available at <http://www.finra.org/web/groups/arbitration/mediation/@arbmed/@arbrul/documents/arbmed/p117546.pdf>.

93. Even without this protection from the Code, this problem is unlikely to exist in consumer-securities arbitration because of the substantial amount of money these cases tend to involve. 65.4% of claims brought in FINRA arbitration ask for relief between \$100,000–\$1,000,000, and only 12.1% of all claims brought are for less than \$25,000. Gross, *supra* note 2, at 22.

nesses as one of the “evils” they wanted to avoid by including arbitration clauses in their contracts,⁹⁴ and FINRA has voluntarily enacted a provision in the Code to make sure this fundamental right of the individual is preserved. This is just one distinguishing characteristic that sets consumer-securities arbitration apart from other forums that are perceived as procedurally unfair.

Another frequent complaint about mandatory arbitration concerns the procedural rules of the forums used by businesses. Commentators cite several deficiencies in arbitration forums, including shortening of the statute of limitations in order to preclude consumers from bringing meritorious claims or barring arbitrators from awarding disputants punitive damages.⁹⁵ Here again, FINRA procedure distinguishes it from the field by extending several protections to the consumer. The statute of limitations for FINRA arbitration is six years, and, even if a claim is dismissed under this rule, the Code allows for the claim to be refiled in court after being dismissed from arbitration.⁹⁶ Also, if a claim is filed in court, the six-year statute of limitations does not run while the case is ongoing.⁹⁷ This set of regulations guarantees that not only will the consumer have at least as much time as they would if they were filing the case in the court system, but that, if their court case does not turn out as they wanted it to, they will still have the option to come back to arbitration. The scheme insures that anyone with a claim has more than enough time to decide whether to file it, and there is no deliberate attempt by the forum to strip the consumer of their right to sue. Concerning punitive damages, arbitrators at FINRA are becoming increasingly likely to award them—despite the fact that there has been litigation about the propriety of arbitrators doing this.⁹⁸ This is yet another example of FINRA distinguishing itself by trying to make sure their forum is as fair to the consumer as possible while still maintaining a neutral playing field.

Another important critique of mandated arbitration procedure revolves around the selection of arbitrators. Studies have shown that in the minds of the parties involved, the procedural aspects of any system of dispute resolution are more important in influencing perceptions of fairness than the results that system produces.⁹⁹ An important part of that procedure is the arbitrator-selection process. The FAA recognizes the importance of an impartial arbitrator by providing that an award can

94. Sternlight, *supra* note 6, at 1638.

95. *Id.* at 1652.

96. NASD Code, *supra* note 92, §12206(a)–(b).

97. *Id.* §12206(d).

98. Black, *supra* note 73, at 448.

99. Sternlight, *supra* note 6, at 1666–67.

be vacated by the district court where it was issued if the aggrieved party can prove “there was evident partiality or corruption in the arbitrators.”¹⁰⁰ It is of paramount importance that the parties involved in any arbitration have faith in the procedure used to select the arbitrators and are satisfied with the level of impartiality demonstrated by the arbitrators that were selected.

There are two arguments promulgated to prove that arbitration selection is fair in the consumer-securities context. The first is an observation about arbitrator selection in general and the second is specific to the procedure of the forum. One commentator reasoned that it is sound fiscal policy for the businesses involved in these agreements to pick arbitrators that are fair. It follows that if the arbitrators are corrupt, then surely the award will be overturned in court later on, and that would cost more time and money for the company.¹⁰¹ This line of reasoning appears sound on the surface, but for it to have any teeth and really scare businesses into behaving, it requires a substantial amount of faith in the process by which arbitration awards are overturned for impartiality. First, the customer must recognize when an arbitrator is impartial. Next, the customer has to have the funds to pay for a lawyer to challenge the arbitrator’s partiality in court. Last—but not least—the court hearing the case must correctly recognize any potential partiality in the arbitrator(s) and vacate the award accordingly. There are too many events that need to happen for the company to be held accountable for their faulty selection. Therefore, this concept of finding motivation for fairness through the detrimental economic consequences of impartial arbitrator selection—although well intentioned—does not reach the punctilio of fairness that our justice system and logical scrutiny demand.

The second guarantee of fairness is specific to how arbitrators are selected to hear cases at FINRA. FINRA uses a computer system that randomly creates a selection of arbitrators for the parties to choose from.¹⁰² As of August 14, 2009, there were 6,156 arbitrators serving.¹⁰³ From this enormous pool, three lists containing eight potential arbitrators are sent to each party.¹⁰⁴ Once they’ve received these lists, each party can automatically disqualify up to four arbitrators from each list

100. 9 U.S.C. §10(a)(2) (2002).

101. Eric J. Mogilnicki & Kirk D. Jensen, *Arbitration and Unconscionability*, 19 GA. ST. U. L. REV. 761, 780–81 (2003). The authors also apply this logic to explain why the companies drafting these contracts would want to leave out any unconscionable provisions, lest they should be challenged in court and make the business subject to further litigation. *Id.* at 784.

102. NASD Code, *supra* note 92, §12400.

103. Dispute Resolution Statistics, *supra* note 7.

104. NASD Code, *supra* note 92, §12403.

and then rank the remaining four according to their preference.¹⁰⁵ Once this is finished, FINRA combines each party's lists and uses their ratings to select one arbitrator from each group.¹⁰⁶ Each arbitrator is required to disclose any possible conflict he currently has—or may possibly obtain while the dispute is ongoing—because of any past or present financial, business, familial, or social interest he may have in the dispute.¹⁰⁷ Then, if a party feels that an arbitrator should not be sitting on the panel, they can challenge him and attempt to get him recused. The arbitrator can make the decision whether he should recuse himself,¹⁰⁸ and, if the arbitrator refuses, the party can appeal to a FINRA Director who will then make the decision to remove the arbitrator “if it is reasonable to infer, based on information known at the time of the request, that the arbitrator is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration.”¹⁰⁹ This allows a person who is not a party to the dispute or an appointed decision-maker to examine the facts and decide whether it is in the interest of fairness to allow the arbitrator to serve. In sum, a tiny number of arbitrators from a pool of thousands is chosen at random, then both parties have a chance to disqualify half of them, and, after the arbitrators have seated themselves and disclosed any conflicts of interest, a dissatisfied party has two routes to attempt to recuse an arbitrator. Since neither party has any say in the random generation of the lists and both parties have a chance to automatically strike half the arbitrators selected, this system goes to great lengths to ensure that the men and women who sit down to decide these cases are truly impartial.

The perceived lack of public scrutiny of what some believe to be a secretive process is another problem commonly associated with mandatory arbitration.¹¹⁰ “[P]rinciples of justice require that disputants have access to a dispute resolution process that is transparent and open to public scrutiny.”¹¹¹ This proposition is certainly true. It is common knowledge that people have a hard time trusting the unknown, and arbitration forums should be open about the procedure that takes place within their doors. This is another positive distinguishing characteristic about consumer-securities arbitration—it is subject to public oversight by the SEC. When talking about the procedure at self-regulatory organi-

105. *Id.* §12404.

106. *Id.* §§12405–06.

107. *Id.* §12408.

108. *Id.* §12409.

109. *Id.* §12410(a)(1).

110. Sternlight, *supra* note 6, at 1635.

111. *Id.*

zations (SRO) like the NASD—which is now FINRA¹¹²—the Supreme Court was particularly impressed with the level of regulation:

No proposed rule change may take effect unless the SEC finds that the proposed rule is consistent with the requirements of the Exchange Act, 15 U.S.C. §78s(b)(2); and the Commission has the power, on its own initiative, to ‘abrogate, add to, and delete from’ any SRO rule if it finds such changes necessary or appropriate to further the objectives of the Act, 15 U.S.C. §78s(c). In short, the Commission has broad authority to oversee and to regulate the rules adopted by the SROs relating to customer disputes, including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights.¹¹³

Oversight like this is a sufficient guarantor of openness and fairness that is unique to consumer-securities regulation. If FINRA wants to change any rule, the SEC must be convinced that the change is fair to investors; and they can even make changes to the procedure of the forum *sua sponte*. When deciding whether or not to enact the proposed rule change, the SEC also makes the changes available for public comment.¹¹⁴ This way the public gets to have their voice heard by the SEC when they are deciding whether the changes should be enacted.¹¹⁵ This protocol is one of the many procedural safeguards employed to ensure that the forum is fair.

When tested against the general criticisms of mandated arbitration, consumer-securities arbitration more than passes muster. For every complaint about arbitration, FINRA offers an appropriate response that acts to ensure a fair process for investors. Still, the drafters of the AFA had specific concerns about arbitration that also need to be addressed.

B. Responses to AFA Concerns

The first concern raised by Senator Feingold was that mandatory arbitration was denying citizens the right to the legal protections that the court system is meant to provide for them.¹¹⁶ Although it is impossible—as well as against the basic purpose of arbitration¹¹⁷—to recreate the exact conditions of the court system, the FINRA forum does an ade-

112. Ware, *supra* note 33, at 449.

113. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 233–34 (1987).

114. Sarah Rudolph Cole, *Fairness in Securities Arbitration: A Constitutional Mandate?*, 26 PACE L. REV. 73, 79 (2005).

115. Current events have further demonstrated the close relationship between the SEC and FINRA. FINRA CEO Mary Shapiro has recently been nominated by President Obama to head the SEC. Amit R. Paley, *Obama Pick to Lead SEC is Veteran Wall St. Regulator*, WASH. POST, Dec. 18, 2008, at D01.

116. Feingold, *supra* note 84.

117. Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1214 (2d Cir. 1972) (“[T]he very purpose

quate job of ensuring people that their cases are tried fairly. Many of the procedural protections provided by the forum were discussed in the previous section, including—but not limited to—making sure the statute of limitations is preserved, allowing the awarding of punitive damages, and creating a selection process that goes to great lengths to ensure arbitrator neutrality. There is no need to reprint those arguments here, but it is important to note that for every question, complaint, or gripe, FINRA procedure—embodied by the Code—had an answer for all of the most common complaints about mandatory arbitration. During this persistent pursuit of fairness, consumer-securities arbitration has already evolved in order to prevent the forum from turning into a one-sided kangaroo court—without any pushing from the legislature.

Perhaps the most important asset FINRA consumer-securities arbitration has that helps guarantee that people get the legal protections our democracy demands is the transparency of how these arbitrations are run, and the ease with which the government can step in to change the process. The SEC mandates that securities brokers and their employees register with a self-regulatory organization (SRO) such as FINRA, which administers the arbitration,¹¹⁸ and the SEC having oversight of FINRA is one of the critical factors that serves to guarantee fairness in this process. As discussed in the previous section, the procedural rules of the forum are subject to strict oversight by the SEC. This type of transparency is the hallmark of the first step to fairness in a democracy. With this process, there can be no question about what is happening behind closed doors, because FINRA and the SEC have flung the doors wide open and let the crowd comment on what they see.

Another main critique espoused by Senator Feingold in his opening statement is that mandatory arbitration is being used to deny people their statutorily guaranteed civil rights.¹¹⁹ This allegation is no longer at issue in consumer-securities arbitration. FINRA Dispute Resolution used to hear cases regarding statutory employment-discrimination claims, but a perceived unfairness in this practice became a catalyst for change. In 1998, a rule change was adopted that excused employment statutory discrimination claims from mandatory arbitration at FINRA and allowed aggrieved employees to bring their cases to court.¹²⁰ Nine years before Senator Feingold introduced this bill and made an opening statement clarifying that he was going after the securities industry, the forum that administers arbitration in the securities industry had preemptively cor-

of arbitration . . . is to provide a relatively quick, efficient and informal means of private dispute settlement.”).

118. Cole, *supra* note 11, at 28–29.

119. Feingold, *supra* note 84.

120. Cole, *supra* note 114, at 77–78.

rected one of the wrongs he was going to cite in support of the need for a disallowance of predispute arbitration clauses in consumer contracts. This willingness to evolve and adapt to cure problems as they arise—without Congressional intervention—is another move that is indicative of the fundamental fairness that the FINRA forum aims to provide.

Another complaint cited by Senator Feingold in support of the AFA was that arbitration is often far too expensive, and that the administrative costs associated with the process will often inhibit people from bringing meritorious claims.¹²¹ It is true that if large costs are associated with having a case heard then this could scare people away from trying a case. It would be untenable to argue that it is fair to force someone to pay more in administrative costs than they could win at the hearing.¹²² However, FINRA already has provisions in place to ensure that no person is driven away from filing a claim because of the potential costs associated. If a disputant makes a showing of “financial hardship,” then the filing fee associated with the claim can be waived.¹²³ Even if the customer originally pays a filing fee, if he or she settles the claim more than ten days before the scheduled final hearing, part of the filing fee is refunded to them.¹²⁴ After the initial filing fee, there are only costs associated with the process occur when the disputants have a hearing session, and, for small claims, the fee is only fifty dollars per session.¹²⁵ In contrast to the low expenses consumers incur, firms that are sued in the forum are forced to pay most of the costs. Their filing fees are higher,¹²⁶ they are forced to pay an additional fee as soon as they bring a claim or are named as a party,¹²⁷ and they are forced to pay fees when the arbitrator lists are sent out and—in some cases—when the hearing dates are set.¹²⁸ The distribution of costs in consumer-securities arbitration distinctly favors the consumer. Also, FINRA provides a wide range of geographic options for people to present their cases, holding arbitrations in

121. Feingold, *supra* note 84.

122. For a discussion of what effect distribution and imposition of costs have on the enforceability of arbitration provisions, see *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000).

123. NASD Code, *supra* note 92, §12900(a)(1). §12900 also contains the list of fees for filing a claim. For a customer who claims losses equal to or under \$1,000, the fee is only \$50. For a customer who claims losses from \$1,000.01–\$2,500, the fee is only \$75. The highest possible fee is \$1,800, and that is for customers who are claiming they have lost over \$1,000,000.

124. *Id.* §12900(c)(1).

125. *Id.* §12902(a)(1).

126. *Id.* §12900(b)(1). As shown *supra* note 123, a customer pays a fifty dollars filing fee for a claim at or below \$1,000. By contrast, a member pays a \$225 fee. *Id.*

127. *Id.* §12901(a)(1).

128. *Id.* §12903(a).

seventy-two different cities with at least one location in each state.¹²⁹ This ensures that disputants will not be forced to endure a long, cost-intensive journey to have their claims heard; they will be able to find a forum relatively close to where they live to ensure maximum convenience.¹³⁰ The value of having a forum for the dispute close to home also goes to rebut Senator Feingold's argument that the prohibitive costs of arbitration lead people to not bring claims. With possible fee waivers, extra fees to securities firms, and relatively inexpensive hearing session fees, it is hard to argue that the costs of FINRA arbitration could act as a bar against someone bringing a claim. If the potential plaintiff is destitute, the fee will be waived, and—as discussed above—the multitude of hearing locations ensure that there will be one relatively close to the disputant's home.

C. *Be Careful What You Wish For—Pretrial Dismissal—
FINRA v. Federal Courts*

So much time is spent criticizing arbitration for its flaws, and yet commentators rarely expand the focus of their investigation to look at the broader picture of how results in arbitration compare with results in the court system. When one such comparison was done in the employment field, the findings were distinctly supportive of arbitration. Of employment arbitrations conducted by the American Arbitration Association (AAA), employees won sixty-three percent of all arbitration cases filed, which is enormous compared to similarly situated employees' success rate of fifteen percent in federal court.¹³¹ A different study revealed that individual employees won fifty-one percent of the arbitrations they filed, while the Equal Employment Opportunity Commission only won twenty-four percent of the cases they filed in the court system.¹³² Admittedly, these surveys suffer from two glaring weaknesses. One, they only deal with a small cross-section of the cases handled in arbitrations each year. Two, when giving up the right to a jury trial is at issue, it can be the sacrificing of that right, and not the ensuing result, that is problematic. Nevertheless, these numbers serve as an encouraging sign about the fairness of arbitration, and an important *caveat* for the proponents of the AFA—will the court system ultimately be any more beneficial to consumers than arbitrations are? If the AFA passes, will the courts offer a

129. FINRA Dispute Resolution Fact Sheet, <http://www.finra.org/ArbitrationMediation/AboutFINRADR/Overview/FactSheet/index.htm> (last visited Jan. 16, 2009).

130. For a discussion of the propriety of forum-selection clauses based on contract-law principles, see *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972) and *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991).

131. Mogilnicki, *supra* note 101, at 763–64.

132. *Id.* at 764.

harsh dose of reality or a sanctuary from the much-maligned world of arbitration? Comparing the procedure for pretrial dismissal in federal courts to the analogous procedure in consumer-securities arbitration offers a chilling wake-up call for the proponents of the AFA.

The argument that mandatory arbitration agreements infringe on a consumer's Seventh Amendment right to a jury trial has been made by both Senator Feingold¹³³ and academics alike.¹³⁴ The central focus of this paper was to prove that the process at FINRA is fair enough so that people signing contracts with predispute arbitration clauses are not getting their rights revoked by agreeing to arbitrate there. The last part of this paper will focus on comparing the showing that needs to be made to get a claim dismissed from consumer-securities arbitration before trial to the showing required for this in federal courts. While detractors of arbitration—like Senator Feingold—have argued that predispute arbitration clause may pose Seventh Amendment¹³⁵ problems, critics have also argued that federal courts' new enthusiasm for motions to dismiss under Federal Rule of Procedure 12(b)(6)¹³⁶ *also violates the Seventh Amendment*.¹³⁷ Looking at the trends in the two systems regarding pretrial dismissal is informative.

In the last quarter century, the Supreme Court has fallen in love with any procedural device that helps them get rid of cases faster.¹³⁸ There are two hallmark cases in this field, *Celotex Corp. v. Catrett*¹³⁹ and *Bell Atlantic Corp. v. Twombly*.¹⁴⁰ *Celotex* made an important declaration opening up the availability of summary judgment¹⁴¹ when Justice Rehnquist said, "Summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the

133. Feingold, *supra* note 84.

134. *E.g.*, Sternlight, *supra* note 6, at 1643.

135. "In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved . . ." U.S. CONST. amend. VII.

136. Under this rule, judges can dismiss a case for "failure to state a claim upon which relief can be granted." FED. R. CIV. P. 12(b)(6).

137. See Suja A. Thomas, *Why the Motion to Dismiss Is Now Unconstitutional*, 92 MINN. L. REV. 1851 (2008).

138. For a discussion of this Seventh Amendment problem in securities litigation in federal courts, see Suja A. Thomas, *The PSLRA's Seventh Amendment Problem*, U. Cin. Public Law Research Paper No. 07-03, 6 (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968893 ("[T]he standards established by the Courts of Appeals interpreting the strong inference requirement are problematic under the Seventh Amendment. The standards set forth thus far involve one or more improper steps by which the courts assess the reasonableness of the facts and corresponding inferences pled by the plaintiffs.").

139. 477 U.S. 317 (1986).

140. 550 U.S. 544 (2007).

141. For a critique questioning the constitutionality of the use of summary judgment in light of Seventh Amendment concerns, see Suja A. Thomas, *Why Summary Judgment is Unconstitutional*, 93 VA. L. REV. 139 (2007).

Federal Rules as a whole”¹⁴² More recently, *Twombly* has throttled the legal world by overturning *Conley v. Gibson*’s “no set of facts” language in regards to the requirements of what must be presented at the pleading stage in order for a complaint to survive a Rule 12(b)(6) motion to dismiss.¹⁴³ Justice Souter reshaped the pleading standard when he said

Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement. . . . The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) agreement reflects the threshold requirement of Rule 8(a)(2) that the “plain statement” possess enough heft to “sho[w] that the pleader is entitled to relief.”¹⁴⁴

This type of language signifies the Court’s current movement toward allowing procedural devices to be used more liberally in order to get cases dismissed at an earlier stage. With these types of decisions being issued, plaintiffs in federal court have a quickly shrinking chance of being able to have their complaints heard at a full trial. At the same time, FINRA is moving to curtail an arbitrator’s ability to dismiss a complaint before a hearing on the merits.¹⁴⁵ There was a recent amendment to the rule governing motions to dismiss at FINRA, and it increased access to the forum by making it significantly harder for motions to dismiss to be granted prior to a full hearing.¹⁴⁶ Under the new rule, motions to dismiss are to be strongly discouraged;¹⁴⁷ will have to be unanimously agreed upon by all arbitrators and include a written explanation of why the motion was granted;¹⁴⁸ and can only be granted if the arbitrators decide there was a prior settlement agreement that the nonmovant is not honoring¹⁴⁹ or the plaintiff has sued the wrong respondent.¹⁵⁰ Juxtaposing this trend towards making it harder to grant motions to dismiss at FINRA against the trend towards liberalization of the procedures to dismiss cases in federal courts, it becomes clear that the proponents of this bill

142. *Celotex*, 477 U.S. at 327.

143. See *Twombly*, 550 U.S. at 560–63.

144. *Id.* at 556–57. *Twombly* was an antitrust case. But, the Supreme Court has recently held that the *Twombly* interpretation of Rule 12(b)(6) is applicable to all cases regardless of subject matter. See *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1953 (2009).

145. In a recent study, only 2.1% of survey participants reported that their claim was dismissed before a hearing. Gross, *supra* note 2, at 23. Even before the proposed rule change, only this very small number of cases got dismissed before a hearing.

146. See NASD Code, *supra* note 92, §12504 for rule regarding motions to dismiss at FINRA.

147. *Id.* §12504(a)(1).

148. *Id.* §12504(a)(7).

149. *Id.* §12504(a)(6)(A).

150. *Id.* §12504(a)(6)(B).

should be careful what they wish for. By attempting to give consumers back their chance to go to court, they might actually be taking away the chance for them to get their case heard. When set in the context of the harsh procedural realities of the federal court system, this seemingly proconsumer piece of legislation is more chimerical illusion than talismanic cure for what ails the common investor. What sounds good in principle may turn out to be a nightmare in practice. Cases that would have satisfied FINRA's lax grounds for inclusion and made it to an evidentiary hearing may be kicked out of federal court at the pleading stage.

VII. CONCLUSION

Throughout this article I have set out to prove that consumer-securities arbitration administered by FINRA should fall outside the umbrella of the AFA. Even though the AFA was created because members of Congress believed that the Supreme Court has changed the meaning of the FAA,¹⁵¹ the legislators should look back at *McMahon*—as well as FINRA's procedural guarantees of fairness—and reconsider whether they need to strike a killing blow to this decision. We are in the midst of an academic and legislative assault on mandatory arbitration, and some of the claims that its detractors make may have a logical basis when brought against other arbitration forums, but FINRA is different. The forum has been approved by the judiciary, has gotten only mixed—if not moderately positive—reviews from the public, and academics' main criticisms of mandated arbitration do not pass muster in light of the protection given to investors who are looking to bring claims in this specific forum.

Government oversight—in the form of the SEC—also provides a unique guarantee of trustworthiness within the forum. If Congress is not happy with the way the SEC is regulating the arbitration at FINRA, then they should take a more moderate step to cure the problem. Since the SEC currently has the power to do whatever it pleases within FINRA, Congress should start by keeping a closer eye on the SEC, FINRA, and the procedure at the forum before they completely wipe it out. If they have specific problems with any one aspect, they have the power to legislate that the SEC should change it. It would be a shameful waste to let this sophisticated system which administers thousands of cases every year idly rot because of one flawed bill. Before Congress eliminates it and subsequently dumps all of these cases on the already overcrowded

151. H.R. 3010, 110th Cong. §2(2) (2007), available at http://thomas.loc.gov/home/gpoxmlc110/h3010_jh.xml.

federal docket, they should consider a more active role in the monitoring of the forum as opposed to a complete destruction of it.

Before members of Congress go to vote on the AFA, they should thoroughly reconsider whether they are using a brush with too broad of a stroke to amend the FAA. They owe it to their constituents to read *McMahon* again and to examine just what happens at FINRA Dispute Resolution. Compared to the alternative—the federal-court system—they might find that consumer-securities arbitration is actually quite beneficial. The procedural realities of the federal-court system could turn out to be a wolf in sheep's clothing for investors looking to get their claims past the pleading stage, and right now they have somewhere they can go to get their voices heard. Congress should also go back and look at who is really challenging them with this call to arms. If the people are not dissatisfied with the forum, and the judiciary is not dissatisfied with the forum, then the individual members of Congress should look into the subject and make their own informed policy decision instead of following the lead of a few men on a mission. What they find might surprise them.