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JUSTICE BLACKMUN AND SECURITIES ARBITRATION: *McMAHON* REVISITED

JAMES A. FANTO*

I. INTRODUCTION

When the *North Dakota Law Review* approached me to write a tribute to Justice Blackmun, I thought that, given my own background and interests,¹ an appropriate topic would deal with Justice Blackmun and corporate, securities, or financial institutions law.² Work on this topic might complement the writings on Justice Blackmun that appeared before and after his retirement. Many of these writings have focused upon *Roe v. Wade*,³ a decision that, for better or for worse, constitutes Justice Blackmun's main judicial legacy.⁴ When abortion rights are not linked to Justice Blackmun, he is generally tied to other, equally controversial social issues or marginal groups.⁵

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1. After my clerkship with Justice Blackmun, I worked for the Washington, D.C. and Paris, France offices of Davis Polk & Wardwell as a corporate lawyer with specialties in financial institutions regulation and securities offerings. I now teach courses on Corporations, Corporate Finance, and Banking Law.

2. To my knowledge, there have been few general articles on this subject, as opposed to articles on a given business or financial law case authored by Justice Blackmun. Some have written about Justice Blackmun's contribution to related business areas, such as commercial speech. See, e.g., Karen Nelson Moore, *Justice Blackmun's Contributions on the Court: The Commercial Speech and State Taxation Examples*, 8 *HAMLIN L. REV.* 29 (1985) (discussing how, in commercial speech cases, Justice Blackmun wanted the consumer to be provided with as much information as possible concerning professions and commercial interests that hindered competition and thus caused economic harm to the consumer). A related relevant area is tax law, for Justice Blackmun was a tax lawyer. Again to my knowledge, no one has written an article about Justice Blackmun's general contribution to tax jurisprudence. Cf. Dan T. Coenen, *Justice Blackmun, Federalism and Separation of Powers*, 97 *DICK. L. REV.* 541, 548-49 (Spring 1993) (discussing Justice Blackmun's opinions on the effect of the Commerce Clause on state taxation of interstate commerce).

3. 410 U.S. 113 (1973).

4. See, e.g., Randall P. Bezanson, *Emancipation as Freedom in Roe v. Wade*, 97 *DICK. L. REV.* 485 (Spring 1993). For other writings that focus on Justice Blackmun's judicial legacy in *Roe v. Wade*, see Norman Dorsen, *A Tribute to Justice Harry A. Blackmun*, 97 *DICK. L. REV.* 607 (Spring 1993); William J. Brennan, Jr., *Harry A. Blackmun*, 43 *AM. U. L. REV.* 694 (1994); Estelle H. Rogers, *Thank You Justice Blackmun*, 43 *AM. U. L. REV.* 734 (1994); Sarah Weddington, *Parting Praise for Justice Harry A. Blackmun*, 43 *AM. U. L. REV.* 750 (1994) (providing a tribute from counsel for petitioner in *Roe*).

5. See, e.g., Pamela Karlan, *Bringing Compassion into the Province of Judging: Justice Blackmun and the Outsiders*, 97 *DICK. L. REV.* 527 (1993) (discussing, among other things, Justice Blackmun's opinions on rights of prisoners, aliens, Native Americans, poor women, pregnant teenagers, gays, and lesbians); Harold Hongju Koh, *Equality with a Human Face: Justice Blackmun and the Equal Protection of Aliens*, 8 *HAMLIN L. REV.* 51 (1985) (discussing Justice Blackmun's opinions concerning aliens' rights); Herman Schwartz, *Justice Blackmun*, 43 *AM. U. L. REV.* 737

My topic selection, however, presented some problems. It is probably accurate to say that, in recent times at least, Supreme Court Justices, like many judges, are not particularly interested in reviewing and deciding specialized issues of corporate, securities, or financial law. Supreme Court Justices are, after all, human beings: like others who have arrived at a preeminently political position, they care, in varying degrees, about the publicity that naturally comes to them. They thus realize that, except in the specialized financial press and financial circles, cases on corporate, securities, and financial law rarely receive the national publicity and attention that are accorded cases on the "great" constitutional issues touching on socially significant matters. Accordingly, corporate, securities, and financial law cases are not greeted with much enthusiasm by the Justices, who rank them in interest next to cases on tax, pension law and, perhaps, water disputes between States.⁶ A good example of this preference is the persistence of rumors that, when a Chief Justice wishes to "punish" an Associate Justice, he assigns him or her cases from these "humdrum" areas.⁷

The lack of enthusiasm for corporate, securities, and financial law cases also reflects that, in recent times, the Justices have not been by training or background familiar with the complexities of securities markets (including international markets) and corporate finance that increasingly characterize these areas of the law. Even if a Justice has had some business law background, chances are that this experience is of a regional nature; he or she generally has not spent years of practice on Wall Street or in one of the other world financial centers, in a firm or

(1994) (discussing, among other things, Justice Blackmun's writings in *Callins v. Collins* and *Bowers v. Hardwick*).

6. As in all general statements, there are some obvious exceptions to the above remarks. Justice William O. Douglas, known for his First Amendment decisions, was one of the authors of the Securities Act of 1933 and a former chairman of the Securities and Exchange Commission. Prominent judges who have shown great expertise in business law areas readily come to mind: Henry Friendly, Richard Posner, Ralph Winter, and Frank Easterbrook (to say nothing of Justices of the Supreme Court of Delaware).

7. The best example of this statement is Justice Blackmun. Chief Justice Burger, a boyhood friend of Justice Blackmun's, was instrumental in the nomination of Justice Blackmun to the Court. It is rumored that the Chief Justice, dissatisfied with Justice Blackmun's independence, "punished" him by assigning him to write opinions in various technical areas, such as state taxation cases. See Stephen L. Wasby, *Justice Blackmun in the Burger Court*, 11 *HAMLIN L. REV.* 183, 184, 196-197 (1988).

organization devoted to a specialized corporate and financial practice.⁸ In addition, if the Justices have been law teachers, they have usually pursued traditional academic specialties that have little to do with corporate, securities, or financial law.⁹

In my experience, law clerks do a fair amount of work for the Justices.¹⁰ However, usually we had even *less* experience on corporate,

8. In my year as a clerk on the Court, of all the Justices, Justice Powell appeared to have the most experience in the corporate and securities law area. He had been a partner in a Richmond, Virginia law firm, Hunton, Williams, Anderson, Gay and Moore, and had specialized in corporate law with prominent corporate clients. See THE SUPREME COURT JUSTICES ILLUSTRATED BIOGRAPHIES, 1789-1993 at 492 (Clare Cushman ed., 1993). However, then, as now, Hunton, Williams was somewhat regional in its practice and was not one of the firms one would immediately associate with a global financial practice. Other Justices, such as Justices Rehnquist, Brennan, Marshall, White, and O'Connor, had little financial law experience. New appointments have not necessarily changed the situation. See *id.* at 517 (discussing Justice Kennedy's general law practice in Sacramento that focused upon corporate work for small businesses); *id.* at 522 (discussing Justice Souter's practice of taxation and real estate in a Concord, New Hampshire law firm); *id.* at 528 (discussing Justice Thomas's energy and environmental practice).

Several Justices have experience and expertise in antitrust law, an important business law subject. See *id.* at 502 (explaining that Justice Stevens practiced and taught antitrust law); *id.* at 512 (explaining that Justice Scalia also practiced and taught antitrust law). However, this practice area tends to be distinct from, although related to, corporate, securities, and financial institutions law practice. An article has yet to be written concerning the effect that the unfamiliarity of Justices with specialized business law subjects has had on the development of securities markets and financial institutions.

9. See David Von Drehle, *Conventional Roles Hid a Revolutionary Intellect; Discrimination Helped Spawn a Crusade*, THE WASH. POST, July 18, 1993, at A1 (observing that Justice Ginsburg taught constitutional law and conflicts of law); Search of Westlaw, WLD-Judges, Anthony /s Kennedy (Nov. 10, 1994) (pointing out that Justice Kennedy taught constitutional law). Some Justices taught antitrust law. See THE SUPREME COURT JUSTICES, *supra* note 8, at 502 (observing that Justice Stevens taught antitrust law); Search of Westlaw, WLD-Judges, Stephen /s Breyer, (Nov. 10, 1994) (observing that Justice Breyer taught antitrust, administrative law, and economic regulation).

10. It has become fashionable, even among those who should know better, to disparage the work of law clerks of Supreme Court Justices. Some are even surprised that a clerk might draft a Supreme Court opinion. I am at a loss to explain why anyone, whether a Supreme Court Justice or other judge, would be ashamed of admitting that a law clerk does much opinion and other writing. This is why the clerk is hired in the first place! Given the workload of the Justices, it makes sense, in division of labor terms, to have clerks do as much writing as possible. The Justice, at the top of the "pyramid," can edit and rewrite as he or she sees fit. In my experience, this is no different from the situation in law firms, where mid-level and senior partners supervise the work of large numbers of associates.

One could argue that this system no longer makes possible the "great" opinions of former times. See, e.g., Charles W. Collier, *The Use and Abuse of Humanistic Theory in Law: Reexamining the Assumptions of Interdisciplinary Legal Scholarship*, 41 DUKE L.J. 191, 229 (1991) ("There are increasingly indications that the function of the Court has changed over time, and that one is no longer entitled to consider the work of a Justice as analogous to that of a poet or philosopher, i.e., as the intellectual product of a unified mind."). One might well question whether this "golden" age of judicial opinions ever existed and, in any event, we are well past the time when we can confidently assert that an earlier historical time was somehow closer to the truth or the true way of behaving (or, in this case, judging). Cf. JACQUES DERRIDA, OF GRAMMATOLOGY 49 (Gayatri Chakravorty Spivak trans., 1976).

Peirce goes very far in the direction that I have called the de-construction of the transcendental signified, which, at one time or another, would place a reassuring end to the reference from sign to sign. I have identified logocentrism and the metaphysics of presence as the exigent, powerful, systematic, and irrepressible desire for such a signified.

Id. Moreover, opinions have always been, to some degree, institutional products; the judicial institutions are simply now more complex.

securities, or financial law matters than did they. At best, we had some summer work experience in corporate law firms or had paid attention to our business law professors.¹¹

In my experience, the Justices and their clerks take their responsibilities seriously and only occasionally display some impatience with the complex business and legal issues that can baffle even seasoned securities and financial market professionals.¹² This occasional impatience, or even hostility, may arise from what Professor Mark Roe has shown to be a traditional American populist distrust of Wall Street and concentrated financial power.¹³ Our country, locked as it is in a fierce global competition in product and capital markets that can threaten the well-being of any nation, may little afford *any* such insensitivity to this business world, especially from political appointees with lifetime tenure.¹⁴

11. Of course, law school introductions to business law can be somewhat startling, at least from a real world perspective. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991) (arguing for the elimination of limited liability for shareholders in mass tort situations); *but see* Joseph A. Grundfest, *The Limited Future of Unlimited Liability: A Capital Markets Perspective*, 102 YALE L.J. 387 (1992) (pointing out the real-world capital market problems with such a proposal).

12. In my term on the Court, I believe that this impatience was displayed in *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1 (1987), a case involving various challenges by Texaco to a Texas jury's award of enormous damages (\$10.53 billion) against it. Some members of the Court, particularly on the "left," clearly felt that, but for the large sums involved in the controversy, the Court would never have reviewed the case:

Because a wealthy business corporation has been ordered to pay damages in an amount hitherto unprecedented, and finds its continued survival in doubt, we and the courts below have been presented with arguments of great sophistication and complexity, all concerned with a case which under clearly applicable principles should never have been in the federal courts at all.

Id. at 26-27 (Marshall, J., concurring). Justice Blackmun had the good sense not to react cavalierly and hostilely to a world-class company (which, incidentally, employed large numbers of people). In a footnote to his own concurrence, he made the following observation: "Moreover, while there has been some discussion about a 'special law' for multi-billion-dollar corporations, I would have thought that our proper concern is with constitutional violations, not with our sympathy, or lack thereof, for a particular litigant." *Id.* at 28 (Blackmun, J., concurring).

13. *See* Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 52 (1991). "First, American public opinion has always mistrusted large institutions. That populist story is well known as part of antitrust attacks on big business that endured beyond the populist politics of the 1890s. Less well known is that a similar sentiment militated in favor of fragmenting financial institutions." *Id.*

14. *E.g.*, Klaus Schwab & Claude Smadja, *Power and Policy: The New Economic World Order*, HARV. BUS. REV. 40, 41 (Nov.-Dec. 1994).

In fact, it has become a matter of life and death for corporations to take advantage of such opportunities [delocalization of industrial production] in the face of what can truly be termed megacompetition—yet another crucial aspect of the global economic revolution. Corporations and countries must now compete not only against rivals in their own league but also against a continual stream of newcomers, while at the same time playing catch-up with competitors claiming to have made the latest break-throughs. These competitive realities are creating intense pressure to rationalize production, cut internal costs, and search for the least expensive production base.

Id. *See also* Frank J. Comes & Christopher Power, *21st Century Capitalism*, BUS. WK., Nov. 18, 1994, at 12, 13 (Special Bonus Issue).

The topic of Justice Blackmun and corporate, securities, and financial law does have several advantages, however. Because it does not focus on socially sensitive constitutional issues, it will likely not give rise to impassioned public debate. Considering the global economic changes now occurring that may significantly alter civil society, perhaps business issues, rather than topics such as abortion and privacy rights, should be the main subject of such debate. Accordingly, I need not address the charge that has been leveled against Justice Blackmun as he neared retirement: that he based his decisions on emotion, rather than on legal reasoning.¹⁵

In the following pages, I first briefly discuss Justice Blackmun's background and familiarity with corporate, securities, and financial institutions matters, legal or otherwise. Although not from a Wall Street practice and on the bench for a significant period in the transformation of American business and securities markets, Justice Blackmun exhibited some familiarity with these issues. In this connection, I shall also refer to Justice Blackmun's general attitude towards securities markets and large financial institutions: a populist and somewhat pragmatic suspicion of

Will optimism about 21st century capitalism ultimately prove misguided? Hundreds of millions of people will not benefit from this new economic order. Victims include an older generation of unemployable Russians, the uprooted of India, and the newly idle of Europe and the U.S. In its most unbridled form, capitalism certainly delivers wealth but stumbles when it comes to distributing its rewards equitably enough. Resentment against capitalism could provoke a backlash against free trade and its sponsors. And few institutions now exist to regulate the excesses of global finance and post-cold-war geopolitics.

Id.

15. See Jeffrey Rosen, *Sentimental Journey: The Emotional Jurisprudence of Harry Blackmun*, THE NEW REPUBLIC, May 2, 1994, at 13.

But feeling deeply is no substitute for arguing rigorously; and the qualities that made Blackmun an admirable man ultimately condemned him to be an ineffective justice. By reducing so many cases to their human dimensions and refusing to justify his impulses with principled legal arguments, Blackmun showed the dangers of the jurisprudence of sentiment. He committed liberals to the unfortunate and inaccurate proposition that justices must resort to personal sympathy in order to justify liberal results.

Id. The charge has been made with respect to Justice Blackmun's dissent in *Deshaney v. Winnebago County Dep't of Social Servs.*, 489 U.S. 189, 212 (1989) ("Poor Joshua! Victim of repeated attacks by an irresponsible, bullying, cowardly, and intemperate father, and abandoned by respondents who placed him in a dangerous predicament and who knew or learned what was going on, and yet did essentially nothing . . ."), and in his dissent from a denial of certiorari in *Collins v. Collins*, 114 S. Ct. 1127, 1128 (1994) (announcing opposition to the death penalty). There have been spirited defenses of Justice Blackmun's "emotionalism," generally by former law clerks. See William Alden McDaniel, Jr., *Breathing Life into the Law*, CONN. L. TRIB., Apr. 18, 1994, at 26.

One wonders if the people who pronounce these criticisms have ever read the justice's opinions that they decry. If they had, they would have seen that big as his heart is, Blackmun is and has been an outstanding lawyer whose expressions of constitutional and moral values in his opinions have always been supported by sound legal analysis.

Id. I would have to agree with Mr. McDaniel's point of view: I never found Justice Blackmun deciding a case purely on the basis of emotion.

them and a concern about protecting the small investor in his or her dealings with these sophisticated centers of financial power.

Next, I shall discuss how his dissent in a case on securities arbitration, *Shearson/American Express, Inc. v. McMahon*,¹⁶ particularly exemplifies this suspicion and concern. In the final section, which examines the impact of the dissent, I suggest that it had a long life. The very problems with securities arbitration that he highlighted were the ones with which the securities industry and market regulators grappled from 1987 up to the present. He helped to encourage that industry, as well as Congress and the Securities and Exchange Commission (the "SEC"), to effect needed reforms in securities arbitration. Moreover, in a development foreseen by Justice Blackmun, once such reforms were effected, arbitration came to resemble the litigation system it had been designed to replace.

II. THE BUSINESS LAW BACKGROUND OF JUSTICE BLACKMUN

It is a tribute to Justice Blackmun that, considering his background, he has shown an admirable ability to deal with the difficult questions of corporate, securities, and financial institutions law that he encountered on the bench. His family background was a modest, but not poor, one, and he grew up in St. Paul, Minnesota, far from Wall Street or other centers of financial power.¹⁷ He had an extremely privileged education for the period, receiving his B.A. and law degree from Harvard. However, his life in this elite setting was not necessarily an easy one. He was a scholarship student who also worked part-time to help fund his schooling. No doubt, this education occasionally brought him into contact with some members of the financial elite.¹⁸

Upon graduation, Justice Blackmun did not turn to Wall Street for his career. Rather, he returned to Minnesota, where he served first as a law clerk to Judge John B. Sanborn on the Court of Appeals for the Eighth Circuit, and then became associated with Dorsey & Whitney (then Dorsey, Colman, Barker, Scott, and Barber), a prominent Minneapolis firm. This experience in a firm with corporate clients no doubt brought

16. 482 U.S. 220 (1987) [hereinafter *McMahon*].

17. I picked up some biographical information from Justice Blackmun himself, although he is not one to dwell upon his own past. For other biographical accounts, see THE SUPREME COURT JUSTICES, *supra* note 8, at 486-87; John A. Jenkins, *A Candid Talk with Justice Blackmun*, N.Y. TIMES MAG., Feb. 20, 1983, at 20; Wasby, *supra* note 7, at 184-86; Gregg Orwoll, *Harry Andrew Blackmun*, 43 AM. U. L. REV. 731 (1994).

18. Justice Blackmun is a precise man with an excellent memory. I thus fear inaccurately repeating his recollections. At the risk of being slightly mistaken, however, I recall that he stated that he was acquainted at Harvard with a "Morgan" who was on the crew team (Justice Blackmun earned money by driving a boat for the crew team).

Justice Blackmun considerable familiarity with business and business law, especially since his specialties were, among other things, tax and trust and estates. Like the experience of many other Justices, Justice Blackmun's corporate and other business law experience was regionally based and not tied to the sophisticated financial markets in New York or abroad.

As is well known, Justice Blackmun left Dorsey & Whitney to become the first resident counsel to the Mayo Clinic, a position that was ideal for him in light of his longtime interest in medicine. The experience was unlikely, however, to have been as useful in improving his expertise in sophisticated corporate, securities, and financial law as would have been, say, a position of general counsel of an investment bank or major commercial bank. Any general counsel would be involved in some questions of finance, however.¹⁹

Justice Blackmun was then appointed to the Court of Appeals for the Eighth Circuit in 1959 and became an Associate Justice of the United States Supreme Court in 1970. Thus, for thirty-four years until his retirement in 1994 he was on the federal bench. This period was a time of significant change in corporations, corporate finance, and financial intermediaries, and saw a virtual transformation of Wall Street.²⁰ As a judge and later Justice, Justice Blackmun may have had more occasions to consider these changes in the financial landscape than he did as a practicing attorney. However, episodic reviews of a subject that are made possible by judicial decision-making are not equivalent to day-to-day experience in fields as complex as corporate, securities, and financial institutions law.

From this background of considerable business and business law sophistication and familiarity, even with a lack of professional activity in the centers of corporate, securities, and financial institutions law, Justice Blackmun developed a certain kind of jurisprudence in cases involving the securities industry and large financial institutions, particularly when they were in disputes with retail investors or consumers.²¹ Justice

19. Once again, I seem to remember that Justice Blackmun met his Harvard Morgan acquaintance at the Morgan Bank when on business there for the Mayo Clinic.

20. See, e.g., MARSHAL E. BLUME ET AL., *REVOLUTION ON WALL STREET: THE RISE AND DECLINE OF THE NEW YORK STOCK EXCHANGE* (1993).

21. The following generalizations must be qualified by the observation that Justices are not generally free to make their own pronouncements on legal matters in opinions. See, e.g., Moore, *supra* note 2, at 30 ("Certain factors largely beyond the control of a Justice will impact heavily on his ability to develop the precise contours of a particular field."). They must await a case, although they can influence which cases are selected for review. The case is further narrowed by the issues accepted for review, and the Justices' views are further circumscribed by the parties' arguments. Moreover, writing a majority, and sometimes a dissenting, opinion requires that the Justice make an effort to please the other Justices (and their law clerks) who are interested in joining the opinion. This process suggests why it is difficult for a Justice to produce a series of developed opinions on a given

Blackmun's opinions, especially dissenting opinions, on complex corporate transactions, securities markets, and financial institutions often exhibit a concern to protect retail investors from the manipulatory schemes of corporate, market, and financial professionals.²² Justice Blackmun appears to have a populist skepticism about, and suspicion of, complex corporate transactions and financial dealings and markets, while all the time understanding their complexity. This attitude is based on a kind of pragmatic feeling that, because of the enormous amounts of liquid assets (i.e., money and securities) at issue and because of the special expertise involved in securities and other financial transactions, market professionals are invariably tempted to profit from their position at the expense of retail investors or consumers.²³ Justice Blackmun would thus favor any legal efforts to improve the position of the investor with respect to these professionals. This approach has long made Justice Blackmun an ally of the SEC in its administration of the securities laws.

As I stated above, Justice Blackmun is in good company with his populist suspicion of the securities and financial industry. But, as many of our financial institutions have suffered in the last few years in their global competition with foreign institutions,²⁴ perhaps this attitude should give way to a concern about their competitive abilities. The steady focus on retail investors and consumers might also be somewhat

subject. It appeared to be especially difficult for Justice Blackmun, who, because of his respect for the legal process, was not inclined to manipulate it to put his views forward on a particular issue.

22. The best example of this attitude is in Justice Blackmun's opinions, generally dissenting, dealing with the right of investors to bring a private right of action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and with the elements of that cause of action. See WILLIAM L. CARY & MELVIN ARON EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* 796-888 (6th ed. 1988) (referring to Justice Blackmun's dissents in, among others, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), *Dirks v. Secs. and Exch. Comm'n*, 463 U.S. 646 (1983), in a section devoted to a discussion of Section 10(b) and Rule 10b-5). Justice Blackmun believed that investors needed this private right of action to address the abuse by market professionals to which they were subject. This view, coupled with a broad interpretation of the securities laws, characterized the Court that Justice Blackmun entered in 1970. However, the Court's changing composition in ensuing years produced a new majority whose members for varying reasons (e.g., hostility to plaintiffs' attorneys or to private rights of action in general, or a desire to protect markets from "strike" suits) wanted to cut back on, or even to eliminate, the Section 10(b) private right of action and to narrowly interpret the securities laws. Accordingly, Justice Blackmun, whose views had not changed, found himself in dissent.

23. Other students of Justice Blackmun's jurisprudence have highlighted, in other contexts, his pragmatism. See Coenen, *supra* note 2, at 555-57 (discussing Justice Blackmun's "meticulous regard for factual nuance" and his emphasis on practical realities). His approach must be partly attributable to his years as a practicing lawyer, who, unlike one who has spent an entire life in academia or on the bench, would have the experience to realize that solutions, particularly in the business world, involve pragmatic accommodations, and rarely absolute principles or extreme positions.

24. See, e.g., Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Dec. 1, 1987, 74 FED. RES. BULL. 91 (1988), cited in JONATHAN R. MACEY & GEOFFREY P. MILLER, *BANKING LAW AND REGULATION* 557, 561 (1992) (describing problems created by the restrictions placed on United States banking securities activity and the ability of the banks to compete effectively on a global scale).

out of date at a time when large institutional investors increasingly dominate financial markets.²⁵

On the other hand, perhaps it is too soon to dismiss this focus upon retail investors.²⁶ That these investors have simply moved up the "chain" of investment holdings, i.e., they are now mutual fund shareholders and beneficiaries of pension funds, rather than direct shareholders in companies, does not get rid of, but only displaces, concerns about market abuses.²⁷ Furthermore, technological advances may change the way retail investors deal with foreign or domestic financial institutions, markets, and companies.²⁸ Thus, the concern Justice Blackmun exhibited for the retail investor may become increasingly relevant in the market conditions of the future.²⁹

III. THE *McMAHON* CASE

The Court had agreed to hear *Shearson/American Express, Inc. v. McMahon*,³⁰ to which Justice Blackmun would dissent, in its 1986 term.³¹ The McMahons had several brokerage accounts with the then

25. The literature on institutional investors and their increasing dominance of the world financial markets is plentiful. See, e.g., Ian Ayres & Peter Cramton, *Relational Investing and Agency Theory*, 15 CARDOZO L. REV. 1033, 1035 (1994).

26. Judges, like Justice Blackmun, cannot ignore these investors when the federal securities acts have investor protection as a primary goal.

27. In fact, recent SEC efforts are directed at dealing with abuse at this indirect holding level. See, e.g., *SEC to Propose Rules on Fund Disclosure of Derivatives, Insider Trading Policies*, BNA Banking Daily (Sept. 28, 1994) available in LEXIS, Banking Library, BNABD file (discussing SEC Chairman Levitt's concern with personal investing by fund managers).

28. See Ross A. Kaplan, *Annual Meetings: Put Them On-Line*, N.Y. TIMES, Oct. 16, 1994, Sec. 3, at 1 (discussing methods by which annual meetings could be held "online"); Michael R. Sesit, *Direct Access to World Markets Is Said to Be Easier and Cheaper*, WALL ST. J., Oct. 19, 1994, at C1 (discussing a new computerized system for trading securities around the world designed for institutional traders, but capable of expansion to individual investors).

29. The present focus of the current SEC chairman, Arthur Levitt, is clearly upon protection of the individual investor. See *Levitt Reiterates Views on Plan to Merge SEC, CFTC*, BNA Banking Daily (Dec. 7, 1994) available in LEXIS, Banking Library, BNABD file ("The SEC chairman spoke on a wide range of subjects within his agency's jurisdiction, and drew on the broad theme of protection of the individual investor as the agency's guiding mission.") Whether this will be an enduring concern, or only the product of a Democratic administration, remains to be seen.

30. 482 U.S. 220 (1987).

31. I was the clerk in Justice Blackmun's chambers assigned to work on the case with him. In my time, this meant that, after reading all of the briefs, relevant cases, and law review articles, I wrote a memorandum on the case, with my recommendations, to prepare Justice Blackmun for oral argument. After the oral argument, when Justice Brennan (the senior Justice in dissent) asked Justice Blackmun to write the dissent, I drafted the dissent under his direction. Again in my time, for a clerk to draft an opinion did not mean producing a rough draft and conducting constant discussions with the Justice to fill it out and perfect it. Justice Blackmun had an enormous amount of work to do: he was preparing for and hearing other oral arguments; he was editing or writing other opinions; and he was reviewing petitions for certiorari and emergency demands for relief from the Court of Appeals for the Eighth Circuit over which he presided. Justice Blackmun thus wanted nothing less than as finished an opinion as a clerk could produce.

Shearson/American Express, Inc. ("Shearson").³² As was standard in certain kinds of customer agreements in the securities industry, the Shearson agreements with the McMahons provided that any dispute would be settled by arbitration under the rules of one of the industry's Self-Regulatory Organizations ("SROs").³³ A dispute arose when the McMahons claimed that their broker engaged in excessive trading on their accounts and had otherwise engaged in fraudulent behavior.³⁴ The McMahons brought suit in federal court in New York, alleging, among other things, that their broker had violated Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder.³⁵ The District Court granted Shearson's motion to compel arbitration on the Section 10(b) claims, but the Court of Appeals for the Second Circuit reversed this disposition.³⁶

It was true during Justice Blackmun's time on the Court that, if one wanted a full, impartial understanding of the development of a legal issue and the background of a particular case, it was best to read one of his opinions.³⁷ He simply insisted upon thoroughness in writing to which his name was attached. This fact alone shows why statements that his jurisprudence is primarily sentimental or emotional are themselves ridiculous.

In Part I of his dissent in *McMahon*, Justice Blackmun set forth the history of the arbitrability of Section 10(b) claims.³⁸ He observed that in *Wilko v. Swan*,³⁹ the Court had declined to enforce a predispute agreement to compel arbitration of claims under the Securities Act.⁴⁰ For thirty-two years following *Wilko*, all lower courts that had considered the arbitrability of claims under the Exchange Act had taken the same approach, using *Wilko's* reasoning.⁴¹ Although faced directly with the

32. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 222-23 (1987).

33. *Id.* at 223.

34. *Id.*

35. *Id.* The McMahons also alleged a RICO claim, and the arbitrability of such a claim was also an issue for the Court. *Id.* at 224. However, I shall not discuss this issue here.

36. *Id.* at 223-24.

37. This characteristic of Justice Blackmun's writing contrasted with that of certain other Justices who were known for keeping opinions to a minimum size or for cutting entire sections from opinions. While the merits of this other form of writing or editing can be debated, it produced opinions that were often disjointed and unpersuasive, and that gave the impression of a judicial fiat. Justice Blackmun's approach, by which he would attempt to address all of the parties' arguments, the reasoning of lower courts, and the contentions of opposing opinions, did much, I think, for enhancing the Court's authority, which, after all, owes much to the persuasive force, or rhetoric, of its opinions.

38. *McMahon*, 482 U.S. at 243-49 (Blackmun, J., dissenting).

39. 346 U.S. 427 (1953).

40. *McMahon*, 482 U.S. at 245 (Blackmun, J., dissenting) (citing *Wilko v. Swan*, 346 U.S. 427 (1953)).

41. *See, e.g.*, *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

issue in *Scherk v. Alberto-Culver Co.*,⁴² the Court did not reach it because the dispute involved sophisticated commercial parties and international business concerns. However, the Court mentioned in dicta an argument that *Wilko* should not literally be applied to Exchange Act claims.⁴³ The lower courts did not take up this argument, and the legislative history of 1975 amendments to the Exchange Act suggested that Congress approved of both *Wilko* and its extension to Exchange Act claims.⁴⁴ In Justice White's concurrence to *Dean Witter Reynolds, Inc. v. Byrd*,⁴⁵ this argument resurfaced without any discussion or refinement.⁴⁶ The repetition of the argument triggered, for the first time, some conflict in the lower courts⁴⁷—always *the* major criterion for a grant of certiorari.

Justice Blackmun's discussion of the background to the issue of the arbitrability of Section 10(b) claims says something about his jurisprudence. He does not believe that, surreptitiously or by indirection, Justices should keep an issue alive so that they, or their successors, might have another chance to address it and to have their views prevail, perhaps when the Court's composition has changed.⁴⁸ This silent activism is not the Court's role, particularly with respect to a settled issue. In Justice

42. 417 U.S. 506 (1974).

43. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 513-14 (1974) (characterizing the argument as a "colorable argument"), discussed in *McMahon*, 482 U.S. at 244 n.1 (Blackmun, J., dissenting) (providing the best description of the "colorable argument").

The "colorable argument" amounted to a listing by the *Scherk* Court of the differences between a [Section] 12(2) action, as it had been described by the *Wilko* Court, and a [Section] 10(b) action under the Exchange Act. First, the Court noted that, while [Section] 12(2) of the Securities Act provided an *express* cause of action, [Section] 10(b) did not contain on its face such a cause of action, which, instead, had been implied from its language and that of Rule 10b-5. Second, the Court explained that the Exchange Act did not set forth the "special right" that the *Wilko* Court found established in [Section] 12(2). Finally, the Court observed that the jurisdictional provisions of the two Acts were not the same. Under [Section] 22(a) of the Securities Act, suit could be brought in federal or state court, whereas, under [Section] 27 of the Exchange Act, suit could be brought only in federal court. In sum, the overall thrust of the "colorable argument," as stated by the Court in *Scherk*, seemed to be as follows: The *Wilko* Court declined to enforce arbitration of [Section] 12(2) claims because it found significant the special nature of that cause of action, but a similar concern does not apply to [Section] 10(b) claims, which are neither "special" nor "express".

482 U.S. at 244 n.1 (Blackmun, J., dissenting) (citations omitted).

44. *Id.* at 246-48.

45. 470 U.S. 213 (1985).

46. See 482 U.S. at 248 & n.7 (Blackmun, J., dissenting) (analyzing the resurgence of the argument in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985)).

47. *Id.* at 248-49.

48. When Justice Blackmun wanted to keep an issue alive, especially an unpopular one, he was at least open about it. See, e.g., *Callins v. Collins*, 114 S. Ct. at 1138.

I am more optimistic, though, that this Court eventually will conclude that the effort to eliminate arbitrariness while preserving fairness 'in the infliction of [death] is so plainly doomed to failure that it—and the death penalty—must be abandoned altogether.' . . . I may not live to see that day, but I have faith that eventually it will arrive.

Id.

Blackmun's view, the "colorable argument" was just a way for Justices, like Justice White, who were hostile to the private right of action under Section 10(b), to keep alive an issue that would enable them, someday, to cut back this private right.

In their briefs, petitioner Shearson advanced a form of the "colorable argument," contending that, among other things, an implied right of action under Section 10(b) did not deserve the same protection that the *Wilko* Court had extended to an express right of action under Section 12(2).⁴⁹ They also argued that the *Wilko* Court's view of securities arbitration was dated, given the improvements in arbitration, and thus they suggested that the Court should overrule *Wilko*.

In an *amicus* brief, the SEC agreed with the position of overruling *Wilko* based upon improvements in arbitration and its oversight of the SROs.⁵⁰ This position was surprising because, before this brief, as Justice Blackmun observed, the SEC

consistently took the position that [Section] 10(b) claims, like those under [Section] 12(2), should not be sent to arbitration, that predispute arbitration agreements, where the investor was not advised of his right to a judicial forum, were misleading, and that the very regulatory oversight upon which the Commission now relies could not alone make securities-industry arbitration adequate.⁵¹

The McMahons contended that *Wilko* should be extended to Exchange Act claims and questioned whether arbitration had in fact improved.⁵²

McMahon was not an easy case for Justice Blackmun. He was not against arbitration per se, for he had recently authored an oft-cited opinion favoring the arbitration of antitrust claims.⁵³ However, as suggested above, he was an ardent defender of the private right of action

49. See Brief for Petitioners at 14-33, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (arguing for a distinction between Section 10(b) and Section 12(2) rights of action).

50. See Brief for the Securities and Exchange Commission at 8-21, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (*amicus curiae*). The SEC filed something of a schizophrenic brief. On the one hand, it opposed any effort to undercut the authority of private rights of action under Section 10(b) and thus did not support the "colorable argument." See *id.* at 21-26. On the other hand, the SEC thought that its oversight of the SROs' arbitration procedures justified the arbitration of Section 10(b) claims. *Id.*

51. 482 U.S. at 262 (Blackmun, J., dissenting).

52. See Brief for Respondents at 21-34, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

53. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626-27 (1985) ("[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.")

under Section 10(b) and a believer in the policy of the federal securities laws to protect individual investors against the abuses of the securities industry. He was thus not inclined to undermine *Wilko* or to fail to extend the case to Exchange Act claims on the basis of their "implied" status.

My recommendation to Justice Blackmun was that, given his general position on Section 10(b) claims and the SEC's suspicious change in position, he should vote to extend *Wilko* to Exchange Act claims. It was, however, unclear to me how he would vote. His custom generally was to read the bench memorandum and the parties' briefs, to do whatever supplemental research interested him, perhaps to ask us a question or two about a particular point and then to go into oral argument without always revealing how he might be leaning.

My recollection of the oral argument was that it did not really disclose where the votes would fall. Justice White, who clearly was in favor of the arbitration of Section 10(b) claims, said nothing, as was typical of him. Neither did Justice Blackmun, as was also characteristic of him. The then new Justice Scalia closely questioned both sides, as did Justice O'Connor. Both of them were particularly interested in the adequacy of arbitration procedures for investors' claims.

At the conference held at the end of the week, where the Justices voted on the cases that had been argued, *McMahon* was decided by a 5-4 vote in favor of enforcing the pre-dispute arbitration clause and thus of sending the Section 10(b) claims to arbitration. In my time, law clerks were never present when the Justices voted on cases. However, some Justices, including Justice Blackmun, would explain to their clerks the views and votes of the other Justices, as articulated at the conference. From a collective pooling of information, we clerks could often determine what had occurred in conference and be in a better position to draft opinions.

Some Justices simply thought, without more articulation of their reasoning, that *Wilko* had been wrongly decided in the first place and thus they were reluctant to extend it. Others in the majority, particularly Justice Powell and Justice O'Connor, found persuasive the SEC's contention that arbitration was much improved. On the losing side, both Justices Blackmun and Stevens were disturbed by the fact that a decision to send Section 10(b) claims to arbitration might in effect overrule *Wilko*, which had been the law for over thirty years and which Congress had appeared to approve in its 1975 amendments to the Exchange Act. Moreover, both Justices were suspicious of the SEC's eleventh hour change in position.

Chief Justice Rehnquist assigned the majority opinion to Justice O'Connor. In her opinion, she emphasized the strong federal policies in favor of arbitration and read *Wilko* as basically resting upon a concern with the 1953 inadequacies of securities arbitration.⁵⁴ She then observed that, as the Court examined arbitration in the years following *Wilko*, it found that many of the *Wilko* concerns had vanished: "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."⁵⁵ She found further support for her position in the SEC oversight of arbitration and Congress' failure *expressly* to extend *Wilko* to 1934 Act claims.

As Professors Loss and Seligman observe in their treatise, Justice Blackmun's dissent, in which Justices Brennan and Marshall joined, "had a bite."⁵⁶ The opening sentences of the dissent suggest Justice Blackmun's main focus and owe something to his populist skepticism of the securities industry. First, he observed that federal securities acts were designed "to protect investors from predatory behavior of securities industry personnel."⁵⁷ Second, he pointed out that the Court was "leav[ing] [the] claims [under the Exchange Act] to the arbitral forum of the securities industry at a time when the industry's abuses towards investors are more apparent than ever."⁵⁸

Thus, in Part II(A) of his dissent in *McMahon*, he could disagree with the majority's assertion that *Wilko* was only about the former inadequacies of arbitration. Rather, the *Wilko* Court recognized that the "policy of investor protection in the Securities Act" revealed Congress' decision to exempt Securities Act claims from the reach of the Arbitration Act.⁵⁹ Similar reasoning applied to claims under the Exchange Act, which had the same investor protection policy. In Justice Blackmun's view, an investor's right to a judicial forum for his Securities Act claims helped to put him "on an equal footing with those in the securities industry."⁶⁰ If Congress had determined that many investors

54. 482 U.S. at 228-29.

55. *Id.* at 233.

56. See LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 4568 (3d ed. 1993).

As was his wont, Justice Stevens wrote separately to state that given the uniformity of views among the lower courts before Justice White had revived the "colorable argument," the "longstanding interpretation [that *Wilko* applied to 1934 Act claims] creates a strong presumption, in my view, that any mistake that the courts may have made in interpreting the statute is best remedied by the Legislative, not the Judicial, Branch." 482 U.S. at 268-69 (Stevens, J., concurring in part and dissenting in part). Although not joining Justice Blackmun's dissent, he referred favorably to Justice Blackmun's views expressed there. *Id.* at 269.

57. 482 U.S. at 243 (Blackmun, J., dissenting).

58. *Id.*

59. *Id.* at 252-53.

60. *Id.* at 251.

were in a situation of unequal bargaining power with the securities industry, their right to a judicial forum would correct the imbalance. That the securities industry had long campaigned for arbitration showed that the judicial forum was not in *its* interest.

If arbitration had so greatly improved since *Wilko's* time and if it thus offered the “functional equivalent” of a judicial forum for investors with Section 10(b) claims, a strong argument existed for not extending *Wilko's* reasoning to such claims. Justice Blackmun recognized the force of this argument, which the SEC advanced. However, he felt that this argument, which amounted to an overruling of *Wilko*, should be explored not by the Court, but by Congress, which had the resources to examine improvements in arbitration. Moreover, Justice Blackmun thought that the features of arbitration that the *Wilko* Court found problematic—absence of a record, no arbitrator opinions, limitation on judicial review—were still present in 1987.⁶¹ He also recognized that, despite the increasing codification of arbitration procedures, the public still felt that the forum was “slanted” in favor of the securities industry.

The SEC's *amicus* brief, upon which the majority placed great reliance,⁶² particularly surprised Justice Blackmun. Justice Blackmun traced the history of the SEC's position on arbitration of securities disputes, observing that it had long opposed pre-dispute agreements to arbitrate.⁶³ He also observed that the SEC's vaunted oversight of arbitration amounted only to reviewing SRO rule proposals dealing with arbitration, not to monitoring actual arbitration results and procedures.⁶⁴ He thus chastised the SEC for inexplicably giving in to the securities industry on an investor protection issue.

My experience as a law clerk suggested to me that politics is generally present, either directly or indirectly, in most Court cases. Here the activist conservative majority, consisting of the Chief Justice and Justices White, Powell, O'Connor, and Scalia, was reaching out to limit rights of investors under Section 10(b) by sending these claims to a then questionable arbitration forum. The SEC, feeling the deregulatory pressure that characterized Washington in those years, was shifting its position on arbitration. Confidence in deregulation and liberalized markets was still strong, and the market for corporate control was in full

61. *Id.* at 259-60.

62. 482 U.S. at 238.

63. *Id.* at 262-64 (Blackmun, J., dissenting).

64. *Id.* at 265.

swing.⁶⁵ However, as Justice Blackmun pointed out, abuses were beginning to surface in the securities markets at this end of the "go-go" 1980s, abuses that raised the question whether the SEC and SROs were adequately policing the markets.⁶⁶

Given the majority's activism, Justice Blackmun made a few activist statements of his own. He gave a prominent position to information cited by respondents: that the House Subcommittee on Oversight and Investigations was conducting an investigation into the adequacy of arbitration procedures at a time of increasing securities law violations and that the Chairman of the Subcommittee was surprised by the SEC's new position on arbitration.⁶⁷ This statement might encourage Congress to take up a matter that belonged in its domain. Justice Blackmun also urged lower courts to take seriously their limited power to review arbitration decisions. Finally, in what we shall see was a perceptive remark, Justice Blackmun observed that the decision might in fact increase court litigation, as investor-plaintiffs, upset by being forced into arbitration, would find new reasons to bring arbitration decisions to the courts for review: "It is thus ironic that the Court's decision, no doubt animated by its desire to rid the federal courts of these suits, actually may *increase* litigation about arbitration."⁶⁸

IV. THE EFFECTS OF THE *McMAHON* DISSENT

It may be somewhat odd to spend much time on a Justice's dissent in which, as in the *McMahon* case, he takes a position that will likely never prevail. Several years after the Court announced the *McMahon* decision, it went the further, expected step of explicitly reversing *Wilko* in *Rodriguez de Quijas v. Shearson/American Express, Inc.*⁶⁹ A

65. Change, and the 1987 market crash, were just around the corner. For example, in the same term, the Court, per Justice Powell, issued its opinion in *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987). There, the Court upheld an Indiana anti-takeover statute against federal pre-emption and Commerce Clause challenges, a decision that gave management an additional weapon in resisting takeovers. *Id.* at 94. Justice Blackmun, with Justices White and Stevens, were in dissent. *Id.* at 97. How could Justice Blackmun reconcile his vote in this case with the dissent in *McMahon*? Justice Blackmun was not opposed to a free market; he simply wanted a market that was not skewed in favor of certain participants. The state anti-takeover acts, such as Indiana's, could hurt small investors by preventing them from tendering their shares in profitable change-of-control transactions.

66. 482 U.S. at 265-66 (Blackmun, J., dissenting).

67. *Id.* at 266-67.

68. *Id.* at 268.

69. 490 U.S. 477, 484 (1989). It is interesting that Justice Blackmun did not even bother to write separately in this case, only joining Justice Stevens' brief dissent. In fact, there was little more to say, given his earlier dissent, which Justice Stevens cited approvingly. *See id.* at 487 n.3 (Stevens, J., dissenting). What little there was to say was well stated by Justice Stevens:

In the final analysis, a Justice's vote in a case like this depends more on his or her views about the respective law-making responsibilities of Congress and this Court than on

similarly constituted majority (with Justice Kennedy replacing Justice Powell) now considered that claims under the Securities Act of 1933 could be referred to arbitration.⁷⁰ Moreover, Justice Blackmun's dissent in *McMahon* is unlikely to have the social resonance of others dealing with highly charged, emotional subjects.⁷¹

However, it was interesting for me to consider what had become of securities arbitration after *McMahon*. Although my securities law practice had little to do with arbitration, I had heard about *Rodriguez* and noted occasional references to securities arbitration in the financial press. The question arose whether, from the perspective of individual investors, securities arbitration had improved. Any improvements, I thought, could perhaps owe something to Justice Blackmun's dissent. Because the *McMahon* majority appeared to assume that arbitration, as it then stood in 1986, was adequate, the substance of that majority opinion could hardly have been a catalyst for arbitral change.⁷²

To my surprise, I found that arbitration had changed significantly following *McMahon* and that these changes answered many of Justice Blackmun's criticisms. Although causation in the law, and history, is complex, the *least* that could be said was that his *McMahon* dissent had contributed in some way to this transformation of arbitration. Because I am not an expert on securities arbitration and because many excellent articles have been published on that subject both before and since *McMahon*,⁷³ what follows is not a comprehensive analysis or survey. Rather, I (i) highlight the history of arbitration reform following *McMahon* and (ii) refer to a few changes in arbitration that addressed Justice Blackmun's criticism.

conflicting policy interests. Judges who have confidence in their own ability to fashion public policy are less hesitant to change the law than those of us who are inclined to give wide latitude to the views of the voters' representatives on non-constitutional matters.

Id. at 487.

70. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989).

71. One thinks, for example, of his oft-cited dissent in *Bowers v. Hardwick*, 478 U.S. 186 (1986).

72. See *McMahon*, 482 U.S. at 233 ("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."). I would thus qualify the remark of my colleague, Professor Norman Poser, who in a brief but very useful comment on securities arbitration, observed that "[l]argely in response to *McMahon*, arbitration has changed dramatically, adapting to its new role as the normal method of resolving disputes between the securities industry and its customers." Norman S. Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration*, 59 BROOK. L. REV. 1095, 1097 (1993). The *McMahon* majority left investors with no choice but arbitration. The process improved, but only because the securities industry felt the need to improve its arbitration procedures and the SEC and Congress kept the pressure on it to do so. I suggest that Justice Blackmun's dissent was also a factor in this improvement.

73. See LOSS & SELIGMAN, *supra* note 56, at 4552 n.218 (providing a useful bibliography on securities arbitration).

A. LEGISLATIVE AND REGULATORY REACTION

The *McMahon* decision came down on June 8, 1987. As noted above, already the then powerful Representative Dingell was suggesting that Congressional action might be needed to protect investors from an inadequate forum in which to litigate securities law claims. Then followed the significant October 1987 stock market crash, which not only undermined the confidence of investors in the markets but also increased the number of arbitrations.⁷⁴ In the first half of 1988, the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce held a series of hearings on arbitration reform.⁷⁵ Participants in the hearings frequently cited Justice Blackmun's dissent as a particularly good statement of the problems of arbitration.⁷⁶ One of the purposes of the hearings was to provide legislative history for a bill designed to reform arbitration.⁷⁷

As it happened, the arbitration bill died in Committee.⁷⁸ However, the threat of Congressional action placed pressure upon the securities industry and the SEC. In both 1987 and 1988, the SEC sent letters to

74. See *Arbitration Reform: Hearings Before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce*, 100th Cong., 2d Sess. 265, 266 (1988) [hereinafter *Arbitration Reform Hearings*] (statement of James C. Meyer, Pres. N. Am. Sec. Adm'r's Ass'n) ("Use of securities arbitration increased dramatically in 1987 as a result of two key events: the U.S. Supreme Court's June 8, 1987 decision in *Shearson/American Express, Inc. v. McMahon* ("*Shearson*"), which upheld the enforceability of mandatory predispute arbitration agreements, and the stock market crash of October."), cited in Perry E. Wallace, Jr., *Securities Arbitration After McMahon, Rodriguez, and the New Rules: Can Investors' Rights Really Be Protected?*, 43 VAND. L. REV. 1199, 1200 n.6 (1990). Professor Wallace's article summarizes well the history of legislative and regulatory efforts to respond to *McMahon*.

75. See *Arbitration Reform Hearings*, *supra* note 74. In those hearings, which were held on March 31, June 9 and July 12, 1988, Congress obtained the testimony of numerous experts and interested parties in the field of securities arbitration. *Id.* Experts included counsel who argued *McMahon* before the Court, Theodore A. Krebsbach of Shearson and Theodore G. Eppenstein who represented the *McMahons*, as well as Professor Poser. *Id.*

76. Not surprisingly, it was particularly cited by those, such as Mr. Eppenstein, who were in favor of legislation reforming securities arbitration. See, e.g., *Arbitration Reform Hearings*, *supra* note 74, at 63 (statement of Mr. Eppenstein) ("It is our belief, as confirmed by the dissenting opinion of Justice Harry A. Blackmun in *McMahon*, 107 S. Ct. at 2359, that it is now up to Congress to restore rationality to this once settled area of law."); *id.* at 19 ("The chairman mentioned something that Justice Blackmun stated in his dissenting opinion and that was that there must be something to the fact that the Plaintiffs bar for the big securities fraud case wants to go to court and the securities industry wants to . . . send it to arbitration."). But see *id.* at 313, 331 (statement of Edward O'Brien, President, Securities Industry Association) (disputing several of Justice Blackmun's conclusions).

77. See *Arbitration Reform Hearings*, *supra* note 74, at 463 (statement of Representative Boucher, June 30, 1988) (introducing on behalf of himself and Representatives Markey and Dingell, the text of H.R. 4960 which, among other things, prohibited brokers from refusing to deal with customers who declined to sign a pre-dispute arbitration agreement, required the arbitration clause to be prominently displayed and its consequences discussed, and provided for fair arbitration procedures).

78. See Wallace, *supra* note 74, at 1225 n.144 (providing a summary of the legislative history of the Arbitration Reform Hearings).

the Securities Industry Conference on Arbitration, which was responsible for developing and refining the Uniform Code of Arbitration,⁷⁹ and to the SROs, requesting them to address arbitration issues.⁸⁰ Various meetings between these organizations occurred with the result that the Uniform Code of Arbitration was further amended and the SROs proposed rule changes to their own arbitration codes to make them compatible with the Uniform Code's amendments. The SEC approved these changes in 1989. Still not convinced that arbitration was adequately serving small investors, Representatives Dingell and Markey requested the GAO to examine SRO arbitration.⁸¹ In 1992, the GAO delivered its report, some of the results of which I shall briefly discuss below.⁸²

B. A FEW CHANGES IN ARBITRATION

In his *McMahon* dissent, Justice Blackmun was concerned that numerous federal securities law claims would end up in arbitration because of the majority's decision to permit enforcement of pre-dispute agreements to arbitrate. He feared that, because of certain features of securities arbitration identified by the *Wilko* Court, it would be difficult for courts or the SEC to monitor arbitration proceedings and arbitrator misbehavior. An essential condition of judicial review is a record of proceedings. As Justice Blackmun emphasized in his dissenting opinion, however, most 1987 securities arbitrations, just like those in 1953, did not require production of a record unless the arbitrators or parties requested it.⁸³

79. The history of the Securities Industry Conference on Arbitration and the Uniform Code of Arbitration it produced are described by one of the conference's original members. See Constantine N. Katsoris, *Punitive Damages in Securities Arbitration: The Tower of Babel Revisited*, 18 *FORDHAM URB. L.J.* 573, 579-81 (1991).

80. See Securities Exchange Act Release No. 26,805, [1989] Fed. Sec. L. Rep. (CCH) ¶ 84,414 (May 10, 1989), at 80,100 (describing the history of the SEC and SRO correspondence) [hereinafter Release].

81. See Wallace, *supra* note 74, at 1225 n.144.

82. See UNITED STATES GENERAL ACCOUNTING OFFICE, *SECURITIES ARBITRATION: HOW INVESTORS FARE* (May 1992) (GAO/GGD-94-74), reprinted in 1 *SECURITIES ARBITRATION 1992*, at 21-133 (PLI Corp. Law Practice Course Handbook Series No. 781, 1992) [hereinafter GAO REPORT].

83. See *McMahon*, 482 U.S. at 259 (footnote omitted) ("As at the time of *Wilko*, preparation of a record of arbitration proceedings is not invariably required today.").

Related to his concern about the general absence of a record was his observation that arbitrators were not required to justify, and were even discouraged from justifying, their decisions.⁸⁴ Justice Blackmun understood that this criticism went to the heart of arbitration, which was designed to be a speedy process that did not necessarily have lawyer-judges using legal reasoning. Opinion writing could delay the arbitration process and even hamper the historical prerogative of arbitrators to decide a case on the basis of their sense of justice.⁸⁵

With respect to a record and opinions, the situation is now different from that of *Wilko* and *McMahon*. Following *McMahon*, the SEC urged the SROs to require that a record be made with respect to each arbitration.⁸⁶ The Uniform Code was accordingly amended, as were the corresponding SRO rules, to make possible this essential feature for judicial review.⁸⁷ Because opinions characterize the judicial process, arbitration rules do not yet mandate them. At the SEC's urging,⁸⁸ the Uniform Code and SRO rules were modified to require arbitrators to provide limited information on arbitration awards, and this information had to be made public.⁸⁹ Although declining in 1989 to enforce an

84. See 482 U.S. at 259 (citations omitted) ("Moreover, arbitrators are not bound by precedent and are actually discouraged by their associations from giving reasons for a decision.").

85. *Id.*. Some arbitration experts argue that the practice of writing opinions in arbitration is generally not useful except in cases involving complex issues, large amounts of money, and even class actions, precisely because it hinders arbitrators from making what they feel to be a "just" award. See, e.g., Wallace, *supra* note 74, at 1248.

86. See Release, *supra* note 80, at ¶ 80.108 (explaining that "[i]n its September 10, 1987 letter, the Commission requested that SRO arbitration departments amend their rules to assure that records of arbitration proceedings are made and preserved. These records are necessary for courts to use in conjunction with any review of the proceedings they may make.").

87. See, e.g., CODE OF ARBITRATION SEC. 37 (1993), reprinted in 1 SECURITIES ARBITRATION 1994, 218 (PLI Corp. Law Practice Course Handbook Series No. B-851, 1994) ("A verbatim record by stenographic reporter or tape recording of all arbitration hearings shall be kept."); New York Stock Exchange Arbitration Rule 623, reprinted in 1 SECURITIES ARBITRATION 1994, at 256 (PLI Corp. Law Practice Course Handbook Series No. B-851, 1994) ("A verbatim record of all arbitration hearings shall be kept by stenographic reporter or tape recording."). Professor Wallace sees this rule change as a direct reaction to Justice Blackmun's criticisms of arbitration. See Wallace, *supra* note 74, at 1247.

88. See Release, *supra* note 80, at ¶ 80.109. The proposed H.R. 4960 would also have required the SROs to have a rule requiring arbitrators to give "a brief written statement of (i) the reasons for the decision, and (ii) the elements of the award" *Arbitration Reform Hearings*, *supra* note 74, at 466.

89. See Uniform Code Section 41(f), reprinted in 1 SECURITIES ARBITRATION 1994, *supra* note 87, at 220; New York Stock Exchange Arbitration Rule 627(e), reprinted in 1 SECURITIES ARBITRATION 1994, *supra* note 87, at 257-58. For example, Rule 627(e) provides that:

The award shall contain the names of the parties, the name(s) of counsel, if any, a summary of the issues, including the type(s) of any security or product, in controversy, the damages and/or other relief requested, the damages and/or other relief awarded, a statement of any other issues resolved, the names of arbitrators, the date the claim was filed and the award rendered, the number and dates of hearing sessions, the location of the hearing, and the signatures of the arbitrators concurring in the award.

opinion requirement on the SROs, the SEC thought that securities arbitrators themselves might develop a practice of writing opinions.⁹⁰ According to Professor Poser, this practice is gradually coming into existence.⁹¹

In *McMahon*, Justice Blackmun was concerned about investors' rights not only because arbitration's structural defects made judicial review difficult, but also because, as the *Wilko* Court had observed, the grounds for this review were limited.⁹² At the end of his dissent, he urged lower courts to use their review power,⁹³ but I do not think that he was particularly sanguine that such review offered much hope to investors unhappy with arbitration. However, there is some evidence that as arbitration has become the dominant forum for disputes between

New York Stock Exchange Arbitration Rule 627(e), reprinted in 1 *SECURITIES ARBITRATION* 1994, *supra* note 87, at 257-58.

90. See Release, *supra* note 80, at ¶ 80,109. "In the labor area, arbitrators have voluntarily developed a practice of writing opinions in order to help themselves understand developments in the labor arena. The opinions were not mandated and were not developed to enable courts to review arbitral decisions." *Id.* (footnotes omitted). The SEC observed that the changes to arbitration rules approved by its order were already significant and that the verbatim record was adequate for the purposes of court review. See *id.* at n.45.

91. See Poser, *supra* note 72, at 1107.

Although arbitrators still do not usually state the reasons for their decisions, there is an increasing tendency to write opinions. Unlike judicial opinions, arbitrators' opinions do not have precedential effect, but some of them are summarized in the financial press, and they are likely to influence arbitrators in subsequent cases. Furthermore, a monthly subscription service is available that summarizes awards and makes opinions available to subscribers.

Id.

92. Under Section 10 of the Federal Arbitration Act, an award may be vacated for the following reasons:

- (1) Where the award was procured by corruption, fraud, or undue means.
- (2) Where there was evident partiality or corruption in the arbitrators, or either of them.
- (3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
- (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10 (a)(1992). A court may also vacate an arbitration award if the arbitrators "manifest[ly] disregard" the law. *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

93. *McMahon*, 482 U.S. 220, 267 (1987) (Blackmun, J., dissenting).

brokers and individual investors, courts have expanded their grounds for review.⁹⁴ Moreover, it is particularly ironic that some members of the securities industry, who were so content with arbitration in *McMahon* and *Rodriguez*, now urge enhanced judicial review when the results of arbitration do not turn out to their liking.⁹⁵

Even more than judicial review, what concerned Justice Blackmun was that securities arbitration in the SROs constituted an industry forum and that investors believed it to be unfair to them. Given his belief that securities laws were designed to equalize the bargaining position of the individual investor in his or her dealings with the securities industry, it seemed inappropriate to him to send investor-broker disputes to a forum operated by that industry.⁹⁶ At the time of *McMahon*, there was some evidence that despite improvements, securities arbitration was partial to the securities industry.⁹⁷ Justice Blackmun also recognized that even if this forum was neutral, individual investors thought that it was biased. Justice Blackmun's concern with something so "soft" as perception or confidence does not mark him as a less than rigorous thinker in the financial law area. The "intangibles," such as investors' feelings about and confidence in markets and market participants, could be the greatest source of concern to market regulators like the SEC.⁹⁸

94. See, e.g., C. Evan Stewart, *Securities Arbitration Appeal: Oxymoron No Longer?*, 79 Ky. L.J. 347, 353-54 (1990-91).

First, more courts now embrace [the manifest disregard of the law standard] and openly look for ways in which to review arbitration awards that appear to be clearly contrary to law. Indeed, in the courts of the Southern District of New York, which have jurisdiction over the nation's busiest commercial center, such review is becoming relatively routine. Second, courts are beginning to acknowledge other non-statutory bases for reviewing arbitration awards on the grounds of irrationality, public policy, ambiguity or indefiniteness, arbitrariness or capriciousness, and lack of factual support.

Id. (footnotes omitted).

95. Mr. Stewart, who is general counsel for a securities house, argues for expansion of judicial review to protect complex substantive rights, absolute defenses to suits, and to deal with punitive damages. See *id.* at 367-68. Of course, all of these concerns are those of the brokerage community, not of individual investors. See also *infra* note 105 (discussing observations of Poser regarding the effectiveness of arbitration in the securities industry). Professor Poser has aptly characterized such complaints as "whining." See Poser, *supra* note 72, at 1111. However, Mr. Stewart may have a valid substantive point: if arbitration comes to resemble closely the litigation system it was designed to replace, a strong argument can be made that enhanced judicial scrutiny should accompany this transformation in arbitration.

96. See 482 U.S. at 260 (Blackmun, J., dissenting) ("Furthermore, there remains the danger that, at worst, compelling an investor to arbitrate securities claims puts him in a forum controlled by the securities industry.") (emphasis added).

97. Justice Blackmun cited the lack of preciseness in the industry definitions of "public" as opposed to "industry" arbitrators. *Id.* at 261. These definitions were important because, under the Uniform Code and SRO rules, a majority of an arbitration panel had to be composed of nonindustry arbitrators.

98. Of course, the issue of confidence has been a significant concern in the banking industry and banking law. Without such confidence there looms the ever-present possibility of bank panics and runs. See MACEY & MILLER, *supra* note 24, at 47.

The actual or perceived partiality of securities arbitration was a consistent subject of reform after *McMahon*. The SEC worked with the SROs to redefine the definitions of "industry" and "public" arbitrators, particularly eliminating from the latter category professionals, such as lawyers, a large part of whose work was devoted to industry clients.⁹⁹ Moreover, arbitration rules were amended to enhance disclosure of conflicts of interest by arbitrators to parties.¹⁰⁰

However, the SEC and the SROs have not completely solved this problem of arbitrator partiality. The GAO Report commissioned by Congress highlighted the need for the SROs to spend more time and effort in selecting and training their arbitrators. In the GAO's view, improved selection and training would help dispel the impression by individual investors that arbitration remains biased in favor of the securities industry.¹⁰¹ Moreover, the SROs have generally resisted the use of non-securities industry arbitration fora for investor-broker disputes, although this use would clearly enhance the perception of "fairness" of the process.¹⁰²

Perhaps the most disturbing feature of a bank run is its odd juxtaposition of mass irrationality with individual rationality. A bank run is in no one's best interest. Even if the bank has become insolvent, everyone would be better off if closure occurred through an orderly process in which the bank could maximize the value of its assets rather than selling them at "fire sale" prices in order to satisfy depositor demands. Nevertheless, once a bank run begins it is in everyone's individual interest to participate in the run. If they sit on the sidelines they are sure to lose their savings, but if they join the run they at least have a chance of recovery.

Id.

99. See Release, *supra* note 80, at ¶¶ 80,101-02.

100. See *id.* at ¶¶ 80,103-04.

101. See GAO REPORT, *supra* note 82, at 27.

The fairness of arbitration cases, regardless of the forum, depends largely on the impartiality and competence of individual arbitrators. The primary ways that industry-sponsored forums can ensure that their arbitration process is as fair as possible are to select arbitrators with appropriate backgrounds and experience and ensure that they are trained to know and understand the arbitration process.

Id.

102. See Wallace, *supra* note 74, at 1235-39 (describing the efforts by some investors to use arbitration with the American Arbitration Association, a non-securities industry arbitration forum, and the expertise of this forum in securities law disputes). The GAO REPORT noted that some of the SROs have encouraged their members to use non-industry arbitration fora. See GAO REPORT, *supra* note 82, at 34-35.

This perception by investors of industry bias may be changing. A recent survey of arbitration participants by the National Association of Securities Dealers reported that three-quarters of such participants are satisfied with the process. See *Most Arbitration Participants Satisfied with Process*, NASD Says, BNA SEC. L. DLY. (Jan. 20, 1995).

The basis for judicial review and the alleged bias of arbitration against investors, therefore, particularly concerned Justice Blackmun, as they had the *Wilko* Court. He did not dwell on the procedural differences between arbitration and standard litigation. He acknowledged these differences and realized that many court procedures would undermine the speediness of arbitration. Justice Blackmun simply observed in a footnote that in arbitration, investors lose certain advantages such as a "wide choice of venue and the extensive discovery" accompanying court actions.¹⁰³ His approach was compatible with his belief that in the federal securities laws Congress intended investors to benefit from significant procedural advantages available in court so as to improve their position in any disputes with the securities industry. In short, he thought that investors should have the judicial alternative to pursue their claims; he did not expect arbitration to become like a trial.

Although I have not spoken to Justice Blackmun about the subject, he would likely be surprised at what securities arbitration has become today.¹⁰⁴ It is uniformly the view of arbitration experts, and apparent from a cursory glance at the subject, that arbitration, particularly dealing with complex cases, increasingly resembles standard litigation.¹⁰⁵

103. 482 U.S. at 259-60 n.18 (Blackmun, J., dissenting).

104. The best example of this transformation is the book, *SECURITIES ARBITRATION 1994*, see *supra* note 87, which, as part of the Practicing Law Institute's continuing education program, includes contributions by leading arbitration practitioners and experts. Many of the articles treat subjects that one would expect to be major issues for typical litigation: e.g., discovery, legal briefs, motion practice, use of expert witnesses and cross-examination. On discovery, see George H. Friedman, *Discovery in Arbitration*, in 1 *SECURITIES ARBITRATION 1994*, *supra* note 87, at 389-90; H. Thomas Fehn et al., *In a New Age of Discovery: Recovery from Discovery*, in 1 *SECURITIES ARBITRATION 1994*, *supra* note 87, at 589-604. The authors of these articles explain that discovery in arbitration is limited, but that its use seems to be growing. See *id.* at 604 ("Arbitration discovery has begun to take on a life of its own. To the extent that this phenomenon is inimical to the goals of arbitration, it must be controlled."). See also Theodore A. Krebsbach, *Openings, Summations and Legal Briefs*, in 1 *SECURITIES ARBITRATION 1994*, *supra* note 87, at 531, 549 ("Briefs should be as short as possible, and only cover the most important issues."); Shirli Fabbri Weiss & Marvin Greene, *Motion Practice and Securities Arbitration*, in 1 *SECURITIES ARBITRATION 1994*, *supra* note 87, at 553; Edward B. Horwitz, *The Use and Abuse of Expert Witnesses*, in 2 *SECURITIES ARBITRATION 1994*, *supra* note 87, at 349; H. Thomas Fehn et al., *Cross-Examination, Summations and Reasoned Awards*, in 1 *SECURITIES ARBITRATION 1994*, *supra* note 87, at 607. Although the authors are careful to distinguish arbitration procedure from standard litigation, that these issues matter in arbitration at all suggests the transformation of this process.

105. See, e.g., C. Edward Fletcher III, *Learning to Live with the Federal Arbitration Act—Securities Litigation in a Post-McMahon World*, 37 *EMORY L.J.* 99, 137 (1988).

This is the danger of creeping legalization of securities arbitration. Arbitration runs the risk of becoming more and more formalized and stylized, of coming more and more under the intensive scrutiny of legal institutions such as the federal courts and the SEC. In time, the risk is that the benefits attendant to arbitration—savings in time and money—will be lost.

Id. (footnote omitted); Poser, *supra* note 72, at 1105-06.

Since customer-broker arbitration became mandatory, the self-regulatory organizations,

This increasing procedural complexity of arbitration cannot be laid upon Justice Blackmun's shoulders. It owes much to complex cultural factors that transform alternatives to legal systems into the very systems that they were designed to replace.¹⁰⁶ Justice Blackmun might find this new complexity, as well as the securities industry's calls for increased judicial oversight of arbitration, somewhat amusing, although he would not like a joke to be at individual investors' expense. He could now make the following statement to the *McMahon* majority: Since your decision, arbitration has probably not hurt small investors with small cases,¹⁰⁷ but the perception of its "partiality" to the securities industry remains.¹⁰⁸ It appears that the only way to dispel this perception is to transform arbitration into a system similar to standard litigation. Moreover, despite your efforts, securities arbitration continues to produce cases for federal courts,¹⁰⁹ and this litigation will likely increase if the securities industry gets its way and courts review more appeals from arbitration. Doesn't the above suggest that, in 1987, you should have resisted your judicial activism and left the subject of arbitration of securities disputes to Congress, which, at the very least, would have had more resources than you to explore how such arbitration should develop?

V. CONCLUSION

In this tribute to Justice Blackmun, I have looked at his dissent in *Shearson v. McMahon*, a case dealing with the enforcement of pre-dispute agreements to arbitrate investors' Exchange Act claims. Justice Blackmun's position there was characterized by his populist suspicion of large financial institutions and the securities markets and his concern that

at the urging of the SEC, have introduced certain protections comparable to those routinely provided in civil litigation in the federal courts The reforms, however, raise a question as to whether securities arbitration will continue to offer its special advantages of speed, economy, privacy and finality. What appears to be emerging is a compromise between these advantages and the protect[ion of] judicial procedures.

Id.; Stewart, *supra* note 94, at 349 (footnote omitted) ("With the arbitration process coming to be relied upon more and more, it is in fact becoming more like the civil litigation system it was designed to replace."). The increasing complexity of arbitration explains why this quick procedure is losing some of its speed. See GAO REPORT, *supra* note 82, at 62 ("The time it took investors to resolve securities disputes averaged over 1 year at SROs and slightly less than 1 year at [the American Arbitration Association].").

106. See Fletcher, *supra* note 105, at 133-37.

107. See GAO REPORT, *supra* note 82, at 25 ("GAO's analysis of statistical results of decisions in arbitration cases at both industry-sponsored and independent forums showed no indication of a pro-industry bias in decisions at industry-sponsored forums.").

108. See *id.* at 71 ("Individual investors generally described the current system as biased, self-serving, and not in the best interest of the individual investor.").

109. See Poser, *supra* note 72, at 1103.

they ignore the interests of small investors. Moreover, in the dissent Justice Blackmun showed his annoyance at a majority that, because it was hostile to private rights of action under Section 10(b) of the Exchange Act, failed to give appropriate weight to the policy of investor protection in interpreting both *Wilko* and the relationship between the Exchange Act and the Federal Arbitration Act. He also criticized the SEC, which had become suddenly enamored of the strengths of securities arbitration.

In writing the *McMahon* dissent, Justice Blackmun highlighted problems in arbitration that had not significantly changed since *Wilko*, but that the *McMahon* majority ignored. His dissent contributed to the process whereby the securities industry, Congress, and the SEC tried to make arbitration more hospitable, and a more trustworthy alternative to litigation, for individual investors. Many of the problems highlighted by Justice Blackmun—the preparation of a record and opinions, and enhancement of arbitrator qualifications, for example—became the main focus of arbitration reform. So much has arbitration changed, in fact, that in an ironic result for the *McMahon* majority, it came increasingly to resemble the litigation system it was supposed to replace.

The other irony is that arbitration has not kept disputes between investors and the securities industry out of the courts or the press. Reports of arbitration disputes continue to appear in the financial press.¹¹⁰ Moreover, a major case dealing with securities arbitration was heard this term by the Supreme Court, although a Court absent a recently retired Justice Blackmun. On Oct. 7, 1994, certiorari was granted in *Mastrobuono v. Lehman*.¹¹¹ The issue presented is of significant import to arbitration: whether a choice-of-law provision in a brokerage contract prohibits arbitrators from awarding investors punitive damages. In many typical arbitration contracts, the choice of law clause refers to the laws of the State of New York. New York law prohibits arbitrators from awarding punitive damages. However, arbitrators have awarded these damages in some cases, and courts have upheld them on

110. See, e.g., Michael Siconolfi, *Regulators Examine Smith Barney over Limits on Arbitration Claims*, WALL ST. J., at C1 (Dec. 1, 1994) (noting an investigation by SROs into alleged practice by brokers that bars investors from recovering punitive damages in arbitration and forces investors to go to court before arbitration for a determination on whether, for statute of limitations reasons, their claims can proceed); Michael Siconolfi, *Bear Stearns Client to Get Damages Award*, WALL ST. J., at C1 (Nov. 9, 1994) (reporting that the arbitration panel ruled that brokerage must pay damages to client because it sold a stock that its firm was recommending should be "held"); Dave Pettit, *Securities Arbitration Group to Develop Tight Ethics Restrictions on Nonlawyers*, WALL ST. J., at A9A (Oct. 17, 1994) (reporting that securities arbitration experts considered placing a ban upon representation of clients by nonlawyers in securities arbitration and highlighting the increasing "legalization" of arbitration).

111. 115 S. Ct. 305.

the basis that the Federal Arbitration Act preempts any state law restrictions on arbitrators' awards and that the agreement to apply New York law is limited to New York substantive, not arbitration, law.

The issue is an important one.¹¹² If nothing else, it again exemplifies the phenomenon noted by Professor Poser: the securities industry is content with the "flexibility" of arbitration only when the results of the process favor the industry. Surely, individual investors, now relegated to arbitration by the *McMahon* and *Rodriguez* majorities, are likely not to want their primary forum to be one of limited relief. It is unclear, and hazardous, to predict how the Court will decide *Mastrobuono*, but the signs are not good. Justice O'Connor, the author of *McMahon* and an advocate of states' rights, no doubt had much to do with the Court's granting certiorari in this case.¹¹³

However, things seem to have come full circle. The SEC has filed a brief in support of the *Mastrobuonos* because of its concerns about the rights of individual investors in arbitration.¹¹⁴ It will be interesting to see

112. Professor Katsoris, a specialist on arbitration, argues that in complex arbitration cases, punitive damages should be allowed, although a complete record of the proceedings should be made for judicial review purposes. Otherwise, he thinks, investors will feel that they have been relegated to an inferior forum. See Katsoris, *supra* note 79, at 602-03.

113. See *Alexander Securities v. Mendez*, No. 93-1338, 1994 U.S. LEXIS 4272 (June 6, 1994) (O'Connor, J., dissent from a denial of certiorari). In this dissent in a case similar to *Mastrobuono*, Justice O'Connor was joined by the Chief Justice. Although Justice O'Connor simply argued for a grant of certiorari on the basis of a conflict among state and federal courts on the issue (which conflict is described in her dissent), one suspects where her sympathies lie. She appears to cite with favor the lower court decision in *Mastrobuono*, 20 F.3d 713 (1994), which reversed the award of punitive damages on the basis that federal law simply sends a case to arbitration but does not otherwise replace the substantive state law that arbitrators must apply. Such a position might well accord with Justice O'Connor's position as a strong defender of States' rights.

Perhaps investors may fare well in this case, however. Although it is always difficult to predict outcomes from oral argument, the reports of the argument in *Mastrobuono*, held on January 10, 1995, suggest that Justices Kennedy, Souter, Ginsburg, and Breyer are favorable to the investors' position. See *High Court Hears Debate on Award of Punitive Damages in Arbitration*, SEC. L. DLY. (BNA Jan. 11, 1995).

114. See *SEC Sides with Investor in a Big Securities Case*, WALL ST. J., at B2 (Nov. 21, 1994).

The SEC action comes in what is widely considered the most important securities-arbitration case heard before the Supreme Court since 1987, when a landmark case required most investors to go to arbitration, rather than court, to settle disputes on Wall Street. The SEC's stance appears to reflect the agency's increasing concern with the rights of individual investors, as opposed to an earlier thrust on market regulation, analysts say.

Id. The Solicitor General has also been granted leave to participate in oral argument. See *Mastrobuono v. Shearson Lehman Hutton*, 115 S. Ct. 633, 633 (1994).

In its brief filed in support of the *Mastrobuonos*, see Brief for the United States and the Securities and Exchange Commission as Amici Curiae in Support of Petitioners, *Mastrobuono v. Lehman*, No. 94-84, 115 S. Ct. 305 (Nov. 16, 1994), the SEC first argues that NASD Rule 21(f)(4) prohibits brokers from including a provision in a contract that limits the ability of arbitrators to award relief. This Rule, which has the force of federal law because it has been approved by the SEC, preempts any contrary state law. Because the *Mastrobuonos*' contract was formed prior to the effective date of this Rule, the Rule does not apply in this case. However, the Court should recognize the limited effect of its decision.

how a majority (if it is formed to deny investors punitive damage relief) will be able to ignore *now* the SEC's views when it relied so much upon the SEC's position *then* in *McMahon* to send investors to arbitration in the first place. It is a case whose ironies Justice Blackmun would well have appreciated, and, I think, would have spelled out, were he still on the Court and were he, as in *McMahon*, in dissent.¹¹⁵

The other SEC arguments go more to the facts of this case: (i) that the courts overstepped their reviewing authority in this case in holding that the arbitrator had misconstrued the contract (they should not review a decision for legal error); (ii) that the arbitral award of punitive damages was in fact a reasonable reading of the parties' agreement, given that the contract referred both to New York law and the NASD Rules and especially given the anti-arbitration implication of the New York law prohibiting arbitrators from awarding punitive damages.

The SEC reconciles its position in this case with that in *McMahon* by observing that *McMahon* will be undermined if arbitration is made more complex and time-consuming by the courts' second-guessing arbitrator decisions. Moreover, the SEC also suggests that investors' confidence in arbitration will be shaken if they find that they receive less relief in arbitration than they would in court.

115. As it turned out, Justice Blackmun would not have had to be in dissent in *Mastrobuono* (which demonstrates once again the hazards of predicting the outcome of a case before the Court). While this article was in the editing process, an 8-1 decision written by Justice Stevens, the Court ruled in favor of the *Mastrobuonos*. See *Mastrobuono v. Lehman*, 115 S. Ct. 1212 (1995). In offering a classic demonstration of contract interpretation, the Court read the arbitration agreement at issue both to incorporate New York substantive law and not to limit an arbitrator's authority to award punitive damages. It remains to be seen whether brokerage houses will modify arbitration agreements explicitly to exclude punitive damages relief, an effort that, if attempted, would likely be opposed by the SEC. See *supra* note 114.