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McMAHON: THE NEXT TEN YEARS*

Therese Maynard†

INTRODUCTION

I thank Professor Norman Poser for his invitation to participate in today's Symposium on securities arbitration, a very timely and important topic. I have found all of the presentations made by today's distinguished speakers to be quite interesting and thought provoking.

In his presentation, Judge Selya suggested that, generally speaking, academics come to a symposium—such as this one on the topic of Securities Arbitration—with a fixed perspective on the topic at hand, a perspective that is often dictated by the views these academics have already expressed on the topic. As the last speaker of this Symposium, I am confident in suggesting that I am the only academic to stand at this lectern today who comes to our topic with no agenda. Although knowledgeable in the area of federal securities law, I was not particularly familiar with the law of securities arbitration prior to receiving Professor Poser's invitation to comment on the paper presented by Professor Marc Steinberg. Consequently, there is no agenda or established perspective that I bring to the podium today as a commentator on Professor Steinberg's presentation.

In his paper, Professor Steinberg maintains that today modern securities arbitration offers a more favorable forum than does litigation in federal court for the resolution of investors' claims in broker-customer disputes.¹ He reaches this

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† Professor of Law, Loyola Law School, Los Angeles, California. B.A., University of California, Irvine, 1978; J.D., UCLA, 1981. An earlier draft of this Comment was read by several of my colleagues, and I thank Janet Kerr, Norman Poser, Kay Tate, Steve Callaway and Rochelle Lindsay for their thoughtful comments and suggestions, as well as for our many discussions of the issues posed in this securities arbitration Symposium. Anastasia Liakas, Loyola Law School, class of 1997, cheerfully provided excellent research assistance, for which I am grateful.

¹ This piece was prepared as a Comment on Marc Steinberg, *Securities Arbi-*

conclusion by emphasizing that over the last two decades federal courts have substantially narrowed the availability of relief under the federal securities laws primarily because the Supreme Court, and increasingly the lower federal courts as well, have interpreted federal remedies in a very restrictive fashion.² In the process of reaching this conclusion, Professor Steinberg's paper also debunks the popular myth that arbitration is a forum that favors the securities industry.

I agree with Professor Steinberg that all the "evidence" currently available supports his conclusion that arbitrating investor claims may well be preferable to litigating these claims in federal court. Having said that, however, I do not believe that Professor Poser brought me all the way from California to chime in with a Commentary that is in the nature of a litigator's "Me, too!" brief. So, I thought that today I would assume the role of devil's advocate and share some of the thoughts that I have been reflecting on as I contemplated the implications of Professor Steinberg's conclusion for the future of securities arbitration over the *next* ten years.³

tration: Better for Investors Than The Courts?, 62 BROOK. L. REV. 1503 (1996). Professor Steinberg's article, and consequently my Commentary as well, focus on arbitration between brokerage firms and their public customers, including unsophisticated individual investors. This Commentary, therefore, does *not* address arbitration of industry claims (broker vs. broker disputes), nor does it address employment claims (employee/registered representative vs. employer/broker-dealer firm), because each of these types of claims involves public policy considerations that are quite distinct from the disputes that arise between brokers and their customers.

² In addition to these case law developments, Congress weighed in by enacting reform legislation in December 1995, the effect of which is to further restrict the scope of relief available to investors under the federal securities laws. See Private Securities Litigation Reform Act of 1995, Pub. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.). For commentary describing the impact of this major piece of legislation which reformed litigation practices under the federal securities laws, see, e.g., *Glen Shu, Take a Second Look: Central Bank After Private Securities Reform Act of 1995*, 33 HOUS. L. REV. 539, 542 (1996) ("[J]ust as the *Central Bank* Court limited a plaintiff's ability to bring suit against certain defendants, Congress passed the Private Securities Litigation Reform Act of 1995 (Reform Act), which places even greater restrictions on plaintiff's chances of recovery.") (footnotes omitted); *Symposium on the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 1219 (1996).

³ Indeed, let me emphasize that the observations and inquiries that I pose in this Commentary were provoked by the excellent paper that Professor Steinberg has written.

We have come together today to reflect on the developments in the law of securities arbitration that have occurred in the almost ten years since the Supreme Court's landmark decision in *Shearson/American Express, Inc. v. McMahon*.⁴ And, if Professor Steinberg is right—as I think he is—we have witnessed during the course of the last ten years the evolution of securities arbitration into a much more investor friendly forum. However, in thinking about Professor Steinberg's description of the developments in this area of securities law over the last decade, I kept finding myself wondering: What will the next ten years bring? Will securities arbitration continue to be as investor friendly? Will securities arbitration prove to be a viable, cost-effective, user friendly *alternative* forum for the resolution of broker-customer disputes?

These are the questions that I will raise in this Commentary. First, I will examine the future of securities arbitration over the next ten years from a micro perspective—by which I mean to examine the future of securities arbitration from the perspective of the parties themselves to the process. Whether the current state of securities arbitration, as described by Professor Steinberg and the other speakers today, offers the promise of providing cost-effective resolution of individual disputes on a case-by-case basis in the future will be addressed. Second, I will examine the future of securities arbitration over the next ten years from a macro perspective—by which I mean to ask, from a more general public policy perspective, whether arbitration will offer a socially desirable alternative forum in the future for the resolution of disputes between investors and their brokers. This Section will raise some important public policy considerations that society will be forced to grapple with over the next ten years. It is on these issues where Professor Steinberg and I might be seen as parting company in our thinking.⁵

⁴ 482 U.S. 220, *reh'g denied*, 483 U.S. 1056 (1987).

⁵ See *infra* notes 39-45 and accompanying text.

I. THE ARBITRATION PROCESS FROM THE INDIVIDUAL PARTIES' PERSPECTIVE

Even before the Supreme Court's decision in *McMahon*, we heard a cacophony of voices charging that the industry sponsored securities arbitration process was unfair. In the immediate aftermath of the *McMahon* decision, investors claimed that the industry sponsored arbitration process was stacked in favor of the securities industry defendants.⁶ Investors' charges of unfairness yielded a set of procedural reforms that were intended to ameliorate those concerns regarding the process used in arbitrating investors' claims against their brokers.

However, these reform efforts now seem to have increased the general level of dissatisfaction with the arbitration process, particularly among the members of the securities industry itself.⁷ Indeed, now we hear complaints that the modern arbitration process no longer offers its original advantages. In other words, the procedural reforms that have been implemented piecemeal over the last ten years are now seen as undermining the goals of the arbitration process, which was originally intended to offer speedy and final resolution of the parties' disputes in a cost-effective fashion. Ironically enough, I have even overheard some defense lawyers wax nostalgic about the "good old days"—back when they used to try cases in front of decisive federal judges who were willing to apply the rule of law to "throw the case out of court!"⁸

⁶ See, e.g., Robert Gregory, *Arbitration: It's Mandatory But It Ain't Fair*, 19 SEC. REG. L.J. 181 (1991) (stating that arbitration, as presently conducted by the NASD, NYSE or AMEX is not fair); Neal M. Brown et al., *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 32-36 (1987) (recommending a set of reforms to be made to the existing arbitration system, without which "the policy of investor protection embodied in the federal securities laws will be at risk; and courts will be plagued with cases involving adhesion contracts, unfairness in the arbitration process, and awards where arbitrators fail to follow statutory law").

⁷ DAVID E. ROBBINS ED., *SECURITIES ARBITRATION 1996 passim* (PLI Corp. Law & Practice Course Handbook Series No. B-949, 1996); Practising Law Institute, Taped Proceedings of Panel Presentation, Securities Arbitration 1996 Program (July-Aug. 1996); Norman Poser, Foreword: *Securities Arbitration: A Decade After McMahon*, 62 BROOK. L. REV. 1329, 1331 (1996).

⁸ Generally speaking, federal district judges today are perceived as more willing than securities arbitrators to dismiss customers' claims altogether on such grounds as failure to plead claims adequately, or failure to bring claims in a timely manner, thereby resolving the case early on in the litigation process. Indeed,

The ultimate irony of the last ten years may very well be that brokers and their counsel—among the strongest proponents for enforcing the pre-dispute arbitration clauses routinely included by brokers in their new account agreements with customers—are now generally seen as disillusioned and dissatisfied with the arbitration process. Not coincidentally, this shift towards disillusionment in the brokers' perception of arbitration mirrors the positive shift that Professor Steinberg describes in his article concerning investor perception of securities arbitration over the last ten years since the *McMahon* decision.⁹

II. THE GOALS OF ARBITRATION AS AN ALTERNATIVE FORUM FOR DISPUTE RESOLUTION

In thinking about the basis for the parties' shifting positions as to the "fairness" of securities arbitration, my analysis starts by reflecting on the general *goals* to be served by creating this alternative dispute resolution forum known as securities arbitration. Arbitration of broker-customer disputes was originally conceived and intended to serve certain specific, well-defined goals.¹⁰ First, arbitration was to yield speedy resolution of the parties' disagreements. The process of arbitration, as compared to litigation, was supposed to minimize delay and thereby facilitate early resolution of the parties' claims. Second, arbitration of investor claims was to provide a more economical forum for resolving the parties' disputes because of the less costly, more streamlined procedures typically used in arbitrating the parties' claims. Lastly, the arbitration process was to promote finality of the outcome. The arbitration forum promised to reduce vastly, if not virtually eliminate, appeals by allowing appeals from arbitration panel awards to be taken to

there has even been some suggestion made among members of the securities industry that a return to litigation may prove quite attractive. Poser, *supra* note 7, at 1331.

⁹ Steinberg, *supra* note 1, at 1506-09.

¹⁰ See, e.g., ANTHONY W. DJINIS & JOSEPH A. POST, *SECURITIES ARBITRATION: PRACTICE AND FORMS* § 4.04 (1991); C. EDWARD FLETCHER, *ARBITRATING SECURITIES DISPUTES*, 104-06, 111-15 (1990); PHILIP HOBLIN, *SECURITIES ARBITRATION: PROCEDURES, STRATEGIES, CASES* 2-4 to 2-5 (2d ed. 1992); DAVID ROBBINS, *SECURITIES ARBITRATION PROCEDURE MANUAL* § 1.01-1.13 (2d ed. 1995); James Beckley, *Equity and Arbitration*, in *SECURITIES ARBITRATION* 1996, *supra* note 7, at 44-52.

the courts only on the most narrow of grounds. As compared to litigation in federal courts, arbitration therefore was to promote certainty as to the resolution of the parties' claims against one another and thereby promote finality of the arbitrators' decision.¹¹ For all these reasons, arbitration was originally created in order to offer a simpler, more cost-effective *alternative* to litigation. In other words, arbitration was to be a forum that was a truly *meaningful* alternative to judicial resolution of the parties' claims.

By contrast, the primary goal of civil litigation has always been to promote the accuracy of the court's decision.¹² The

¹¹ Some commentators have suggested that arbitration was intended to serve a fourth goal, that of privacy, although I believe this privacy interest is rather hard to characterize as a *primary* goal to be attained through the arbitration process. See, e.g., Norman S. Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration*, 59 BROOK. L. REV. 1095 (1993) (protection of privacy interests may be viewed as a goal to be served by resorting to arbitration rather than litigation). Instead, protection of the parties' privacy interests seems to be more in the nature of an "inevitable by-product" of relying on arbitration as an alternative to litigating the parties' claims. Unlike the public proceedings of litigation, the confidentiality of arbitration tends to be preserved by the rules of procedure used in arbitration, and therefore these arbitral rules may be viewed as protecting the parties' privacy interests. However, many of the arbitral rules that result in protecting privacy interests were in fact implemented in order to promote the *other three primary* goals of the arbitration process. As an example, confidentiality of the arbitration proceedings is maintained, at least in part, by the lack of any written record of the arbitration hearing itself. However, the absence of any written transcript is in large part intended to promote the finality of the arbitrators' decision on the assumption that the existence of a written record might otherwise encourage the disappointed party to appeal the arbitrators' ruling or award. See FLETCHER, *supra* note 10, § 4.3; Beckley, *supra* note 10, at 31, 51-52 ("Courts have protected the right of an arbitrator to issue a binding decision without a written statement explaining their reasons for issuing an award. Courts, in protecting the right of an arbitrator, are protecting an individual's right to contract for an inexpensive and expedient means of dispute resolution.").

¹² See, e.g., Stephen Bundy, *Valuing Accuracy—Filling Out the Framework: Comment on Kaplow* (2), 23 J. LEGAL STUD. 411 (1994) (questioning "whether American adjudication spends too much time and treasure in pursuit of factual truth"); Louis Kaplow, *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 J. LEGAL STUD. 307 (1994) ("Concerns for the accuracy of adjudication permeate analyses of procedural rules . . . Yet the value of more accurate adjudication is largely taken for granted."); Daniel Ortiz, *Neoaetuarialism: Comment on Kaplow* (1), 23 J. LEGAL STUD. 403 (1994) ("Accuracy is a central, if not the central, value of adjudication."). On the other hand, any set of rules used to administer a system of criminal justice will reflect the very different goals to be served by a system of criminal justice. This Commentary, however, focuses only on resolution of civil disputes between citizens of our society, and even more specifically focuses only on disputes arising between securities brokers and their customers. As such,

goal of accuracy in the context of civil litigation encompasses two equally important aspects, both of which bear directly on the rules of procedure used to administer the modern process of civil litigation. The first aspect involves accuracy in framing and applying the rule of law to be applied by the decisionmaker. The second aspect involves accuracy in ascertaining all of the relevant facts surrounding the parties' dispute.¹³

In light of this brief statement of the goals of litigation and arbitration, I turn now to examine the procedural rules used in each of these systems for dispute resolution. The purpose of this examination is to determine how the procedural rules used in each of these systems promote the stated objectives of each system. So, in the case of litigation, we should see that the procedural rules used to administer this system foster accuracy, the dominant goal of litigation. Furthermore, in the case of securities arbitration, we should likewise expect that the procedural rules used will foster the stated goals of this system, which is to provide a forum for cheap, quick and final resolution of the parties' claims against each other. Each will be discussed in turn below.

III. POTENTIAL GOALS OF PROCEDURAL RULES FOR DISPUTE RESOLUTION

The body of scholarship spawned by the *McMahon* decision reflects a tension—and a resulting confusion—regarding securities arbitration. Indeed, as I will explain below, the literature on securities arbitration reflects that the rules of procedure used in today's process of securities arbitration have lost sight of the goals to be served by preferring arbitration over litigation. This tension grows directly out of the changes made in the arbitration process over the ten years since the *McMahon*

this Commentary considers *only* the rules of procedure used in civil litigation in federal court and the procedural rules used in the private sector, industry sponsored system of securities arbitration.

¹³ The development this century of the legal rules for discovery reflects our judicial system's primary concern that adjudication produce accurate results. See generally Robert Cooter & Daniel Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435 (1994) (the authors include a comprehensive bibliography of the literature examining the American legal institution of discovery).

ruling upholding the validity of pre-dispute arbitration clauses. Professor Steinberg and other Symposium participants have described in detail various procedural reforms that have been implemented in the aftermath of the Court's decision in *McMahon*.¹⁴ A rather significant consequence of these piecemeal reform efforts is that the rules of procedure used in arbitration have not developed in a consistent fashion to promote the stated goals and objectives of securities arbitration. As a result, there is today a substantial divergence between, on the one hand, the rules that govern the procedures used in securities arbitration and, on the other hand, the objectives to be served by preferring arbitration over litigation to resolve these securities law claims. This divergence is more difficult to recognize because the proponents of securities arbitration continue to portray industry sponsored arbitration as offering a truly meaningful alternative to litigation. In order to make clear the ever widening gap between the arbitral rules of procedure as they have evolved since the *McMahon* decision and the original goals of the arbitration process itself, let me first briefly identify the general goals that may be served by any set of procedural rules used to administer a system for dispute resolution.

One of the most important goals to be served by any set of procedural rules is accuracy. Indeed, the dominant goal of the Federal Rules of Civil Procedure can be summarized in that one word—accuracy.¹⁵ The various provisions of the Federal Rules of Civil Procedure therefore are deliberately crafted so as to promote accuracy in ascertaining all the facts surrounding the parties' dispute;¹⁶ in addition, the Federal Rules of Civil

¹⁴ See Bruce M. Selya, *Arbitration Unbound?: The Legacy of McMahon*, 62 BROOK. L. REV. 1433, 1445-46, 1449-51 (1996); Steinberg, *supra* note 1, at 1511-17.

¹⁵ This is not surprising, however, in light of the stated goal of our judicial process: to ascertain *truth* in order to reach a fair result in light of all the relevant facts and circumstances. Consequently, in our judicial system accuracy of the decision obtained is of paramount importance, and not surprisingly the rules of procedure used to administer the judicial process are designed to implement this goal. See *supra* notes 12-13 and accompanying text.

¹⁶ See *infra* note 41 and accompanying text (explaining why accurate ascertainment of *both* the facts and the law is of paramount importance from a micro-perspective, that is, from the perspective of the parties themselves, especially the investor who does not voluntarily bargain to compromise on accuracy goals by preferring arbitration over litigation).

Procedure are intended to ensure accuracy in the precise statement, as well as in the application, of the rule of law to the facts of the pending dispute.¹⁷

Indeed, our civil litigation process has made accuracy the primary goal, even if it means that the procedural rules used to administer this process may trump other legitimate goals that could be served by a set of procedural rules for a system of dispute resolution. Among the most important of these other goals that rules of procedure could be designed to emphasize are the following: (1) Cost—procedural rules should not impose unreasonable costs on either party or the dispute resolution system;¹⁸ (2) Bias—procedural rules should not favor or disfavor either party to the dispute;¹⁹ and (3) Participation—procedural rules should allow reasonable opportunities for participation, that is, participation by the parties themselves, as well as by other persons who are not parties to the dispute. Allowing the parties the opportunity to participate in the process is generally done by giving them the chance to have “their story heard,” all of which serves important psychological values from the perspective of the individual parties.²⁰ Likewise, the participation of third parties serves the

¹⁷ Accurate ascertainment of the law carries with it important public policy concerns from a macro-perspective as well. See *infra* notes 41-45 and accompanying text.

¹⁸ There is mounting evidence that cost is increasingly a pivotal consideration in evaluating proposals for reform of procedural rules. See, e.g., Bundy, *supra* note 12.

¹⁹ Indeed, among the earliest measures implemented to reform industry sponsored securities arbitration following the *McMahon* decision was modification of the definition of “public arbitrator.” See Steinberg, *supra* note 1, at 1511-12. In addition, more recent reform measures have been proposed to further change the process of qualifying and selecting persons to serve on the arbitration panel. See, e.g., Report of the Arbitration Policy Task Force to the Board of Governors, National Association of Securities Dealers, Inc., [1995-1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,735, at 87,470-87,476 (Jan. 1996) [hereinafter Ruder Report].

²⁰ See JERRY MASHAW, *DUE PROCESS IN THE ADMINISTRATIVE STATE* 158-253 (1985) (arguing that a claimant's direct participation in the proceedings has intrinsic value in promoting individual dignity); LAURENCE TRIBE, *AMERICAN CONSTITUTIONAL LAW* 666 (2d ed. 1988) (“The due process right grants to the individuals or groups against whom government decisions operate the chance to participate in the processes by which those decisions are made an opportunity to express their dignity as persons.”).

important function of monitoring the decisionmaking process, thereby assuring the continued legitimacy of, and public support for, the dispute resolution forum.²¹

In summary, a set of procedural rules can be designed to promote any of the following goals: (1) ensure the accuracy of the result obtained through the dispute resolution process; (2) minimize the costs of administering the system for dispute resolution; (3) eliminate bias in favor of either party to the dispute by eliminating even the appearance of bias in the decisionmaker, as well as by eliminating bias in the rules used to administer the system for dispute resolution; and, finally, (4) afford a right of participation to the parties themselves, as well as to outsiders.

It is in light of this general background regarding the goals to be served by a set of procedural rules that one should assess how the rules of procedure used in the two established systems for securities dispute resolution—litigation in the federal court and industry sponsored securities arbitration—promote the goals of each of these very different dispute resolution systems. The next Section examines whether the procedural reforms of the arbitration process, as implemented over the last ten years since the *McMahon* decision, still promote the stated goals for arbitrating investor claims rather than litigating them in federal court.²²

IV. DO THE PROCEDURAL RULES PROMOTE THE STATED GOALS OF SECURITIES ARBITRATION?

As just described, the rules of procedure used in federal court litigation assume that the overriding goal of this system of dispute resolution is to ensure the accuracy of the decision obtained through the judicial process.²³ Nevertheless, the Federal Rules of Civil Procedure often do reflect some of the other

²¹ See generally Owen Fiss, *The Supreme Court 1978 Term: Foreword: The Forms of Justice*, 93 HARV. L. REV. 1 (1979); Robert Pine, *Rethinking the "Day in Courts" Ideal and Nonparty Preclusion*, 67 N.Y.U. L. REV. 193 (1992).

²² Even more importantly, this general background, regarding the different goals that could be served by any set of procedural rules, will offer important insights in considering the "fairness" of the modern securities arbitration process.

²³ See *supra* notes 12-13 and accompanying text.

possible goals for procedural rules such as cost, bias, or participation, so long as they do not substantially interfere with the overriding goal of ensuring the accuracy of the outcome.²⁴

As for the procedural rules used in securities arbitration, the starting point lies in examining the important procedural reform measures that Professor Steinberg described in his article, which have been implemented since the *McMahon* decision.²⁵ All of these piecemeal procedural reforms share one very important common denominator, however. As Judge Selya has persuasively demonstrated in his article, all of these reform measures are based on the procedural rules used in the context of our modern civil litigation system.²⁶ As such, these piecemeal efforts to reform the procedural rules of arbitration have resulted in reworking the modern arbitration system into the image and likeness of the litigation system. Consequently, the current securities arbitration system looks less and less like a meaningful, alternative form of dispute resolution.

Nevertheless, proponents of arbitration continue to claim that the goals of arbitration (cost, speed and finality) are being served, and, therefore, arbitration is preferable to litigation of investor claims against the securities industry.²⁷ By trumpeting the goals of arbitration as offering these important advantages, the parties expect that they will obtain a speedy, final and cost-effective resolution of their disputes continue to be reinforced.

²⁴ See, e.g., Cooter & Rubinfeld, *supra* note 13; Edward Cooper, *Discovery Cost Allocation: Comment on Cooter and Rubinfeld*, 23 J. LEGAL STUD. 465 (1994); Bruce Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481 (1994); Laurens Walker, *Avoiding Surprise from Federal Civil Rule Making: The Role of Economic Analysis*, 23 J. LEGAL STUD. 569 (1994).

²⁵ See Steinberg, *supra* note 1, at 1511-17.

²⁶ Selya, *supra* note 14, at 1436. This common denominator even carries forward to the recommendations contained in the report of the Ruder Commission released earlier this year. Ruder Report, *supra* note 19, at 87,463-87,468 (describing the Commission's recommendations for reform of discovery process, which included a proposal for early automatic production of essential documents, a proposal not unlike the recent amendment to Federal Rule of Civil Procedure 26 providing for "self-executing discovery").

²⁷ These advantages of arbitration as an alternative forum for dispute resolution were originally touted in *Shearson/American Express v. McMahon*, 482 U.S. 220, 229-32 (1987), and continue to be repeated. See, e.g., Deborah Masucci, *Securities Arbitration—A Success Story: What Does the Future Hold?*, 31 WAKE FOREST L. REV. 183, 188-98 (1996).

The tension that results from these conflicting claims is obvious: There is an inherent contradiction in claiming that the modern system of securities arbitration offers a cheaper and faster alternative to litigation while at the same time implementing procedural reform measures for arbitration which borrow from the procedural rules used in litigation. This inherent inconsistency becomes rather obvious in light of the fact that the procedural rules of litigation were designed to implement the primary goal of ensuring the accuracy of the judicial decision, whereas arbitration was created in order to serve very different goals.

Despite this inherent inconsistency, it is nonetheless entirely understandable that the procedural rules for arbitration of investor claims would be reformed so that they more closely resemble the procedural rules used in federal court litigation. The dominant public perception of fairness in the procedures used to resolve disputes in our society is based in large part on their general familiarity with the procedural rules used to administer our judicial system.²⁸ Therefore, in order to eliminate any lingering investor concerns about the fairness of industry sponsored arbitration,²⁹ it is understandable that any

²⁸ Certainly the lawyer's perception of "procedural fairness" has been shaped in large part over the course of this century by the rules used to administer our judicial system. Likewise, the expectations of the parties themselves as to the "fairness" of procedural rules have been shaped in substantial measure by their perception of the procedures used in civil litigation. The public's general perception of fair procedures for dispute resolution can be based on their personal experience with our court system or on portrayals of our court system (whether fictionalized or not) contained in books, television programs, magazines, etc.

²⁹ In considering criticisms as to the "fairness" of the arbitration process, whether made by claimant-investors or by defendant-brokers, the obvious question arises as to whether it is the parties themselves or their lawyers who are *actually* doing the complaining about "fairness." This is an important inquiry for me because I am less inclined to respond to "fairness" complaints that originate with lawyers because such complaints may not reflect at all on what I see as the primary area of public policy concern: whether the legitimacy of securities arbitration is subject to substantial erosion because the *participants themselves* perceive this dispute resolution forum as fundamentally unfair. To the extent that these "fairness" criticisms trace back to the parties' counsel, and not to the parties themselves, it may be fair to say that such complaints do not present the same kind of threat to the legitimacy of this social institution, or at least do not demand the same kind of response. For example, in lieu of reforming securities arbitration to respond to lawyers' complaints of unfairness in the process, we could decide instead to retrain the legal profession and expand basic legal training beyond the accuracy model of civil litigation by including training in other skills that are

proposal to reform the procedures used in arbitration would borrow directly from the more familiar and more well-established procedural rules used in civil litigation, such as the Federal Rules of Civil Procedure. However, the cumulative result of these piecemeal procedural reforms has been to increase the level of dissatisfaction with the modern securities arbitration process, especially among members of the securities industry.³⁰ Brokers now complain that modern arbitration no longer offers the original advantages of speedy and cost-effective dispute resolution. This is contrary to the industry's expectations of the effect of pre-dispute arbitration clauses included in the brokers' new account agreements with their customers.

In light of this shifting focus in the complaints over the last decade as to the "fairness" of securities arbitration, it is imperative to explore the reasons why the procedures for arbitration were reformed in such a way as to bear a strong family resemblance to the procedural rules used in litigation. The explanation for this comes directly out of the Supreme Court's decision in *McMahon*, which is discussed below.

V. *McMAHON'S* IMPACT ON REFORM OF PROCEDURAL RULES FOR SECURITIES ARBITRATION

In upholding the validity of pre-dispute arbitration clauses, the Supreme Court chose to prefer arbitration over litigation for resolution of broker-customer disputes.³¹ Since *McMahon*, the securities industry has routinely required customers who open new accounts to agree to arbitrate any future dispute between the parties and thereby forego the opportunity to litigate these claims in federal court.³² The *McMahon* deci-

more suited to lawyering within the framework of other dispute resolution models, such as mediation, arbitration or even the "early neutral evaluation" process that has been recommended by the Ruder Report. See Ruder Report, *supra* note 19, at 87,450-87,458.

³⁰ See, e.g., Ruder Report, *supra* note 19, at 87,464-87,465; Masucci, *supra* note 27, at 183-84; Poser, *supra* note 7, at 1331.

³¹ See *McMahon*, 482 U.S. at 226-27.

³² I purposefully use the word "require" because securities arbitration in fact has been made virtually mandatory following the Court's opinion in *McMahon*. See, e.g., Richard E. Speidel, *Contract Theory and Securities Arbitration: Whither Consent?*, 62 BROOK. L. REV. 1335, 1349-56 (1996). I am persuaded by Professor Speidel's conclusion that any appearance of consent on the customer's part is illu-

sion, therefore, has had the practical effect of forcing the vast majority of customer complaints into arbitration, and, therefore, today's investors face virtually mandatory arbitration of their claims against their brokers. However, what the *McMahon* Court failed to address adequately, when it decided to prefer arbitration over litigation, is that this decision would force investor claims to be brought in a forum that uses a set of procedural rules that the customers did *not* knowingly and intelligently bargain for when they agreed to the terms of the securities industry's pre-dispute arbitration clause. The investor's lack of meaningful choice as to the forum for resolution of a claim against his or her broker is of significant importance in explaining the imperative to reform securities arbitration procedures by borrowing from the procedural rules used in federal court.

By contrast, where the parties have expressly bargained for mandatory, binding arbitration, both sides to the agreement have voluntarily chosen to prefer arbitration over litigation. Those parties have themselves weighed the relative advantages and disadvantages of arbitration over litigation and on balance have voluntarily decided to prefer the advantages of arbitration over litigation. Thus, in voluntarily negotiating for and agreeing to mandatory arbitration of any future disputes between them, the parties have knowingly and deliberately made the decision to forego accuracy in order to promote fast and cheap resolution of their disputes. The parties to this bargain have decided for themselves, on the facts of their particular situation, that they are willing to accept the consequences of this informed choice. So, by agreeing to mandatory arbitration in advance of any disagreements between them, both parties have themselves decided that it is acceptable to forego the enhanced opportunity for reaching an accurate result through litigation in federal court of any claims they may have. Howev-

sory since the new account agreement is tantamount to a contract of adhesion. The brokerage industry routinely insists on including a pre-dispute arbitration clause in their new account agreements with customers. Although some observers may well claim that, at least in theory, customers are free to take their business elsewhere, Professor Speidel points out that as a practical matter, the customer today has no meaningful choice other than to accept the inclusion of this pre-dispute arbitration clause. So, in effect, arbitration has been made "mandatory," if only on a "de facto" basis.

er, *McMahon* has eliminated any semblance of this kind of meaningful "investor choice" in the case of investor claims against securities brokers.³³

Following the *McMahon* ruling, reform of the procedural rules of arbitration to more closely resemble the litigation process may be viewed as a form of investor "proxy." In other words, these procedural reforms were undertaken in lieu of any meaningful effort to obtain voluntary, informed consent from the investor to arbitration of any future claims against his or her broker. Seen from this perspective, reform of the procedural rules used in arbitration may be viewed as a form of proxy for the lack of the investor's informed consent to mandatory arbitration. Reforming the procedures used in arbitration removes some of the sting that inevitably arises when, at some future time, the investor brings a claim and only then fully appreciates the significance of the pre-dispute mandatory arbitration clause to which the investor "consented."³⁴ Improving the fairness of the arbitration process through procedural reforms that borrow from federal court litigation addresses the fact that the customer has not bargained voluntarily to accept the consequences that flow from the decision to arbitrate rather than litigate.

In sum, the procedural reforms that were adopted in the wake of *McMahon* have been implemented to compensate for the fact that the customer did not voluntarily negotiate and agree to subordinate accuracy, the goal of litigation, in favor of

³³ See Speidel, *supra* note 32, at 1356-57; see also Joel Seligman, *The Quiet Revolution: Securities Arbitration Confronts the Hard Questions*, 33 HOUS. L. REV. 327 (1996).

³⁴ In other words, these procedural reform initiatives were undertaken in the wake of *McMahon*, and in the face of investor charges that the arbitration process was stacked in favor of the industry, in order to enhance the accuracy of the decision reached by the panel of arbitrators. The procedural rules used in litigation became the dominant model for reform of arbitration procedures. I believe the reforming arbitral procedures to enhance the accuracy of the process became important for at least two reasons. First, the general perception of "fairness" in the decisionmaking process is dominated by the public's understanding and familiarity with the procedural rules used in civil litigation. See *supra* notes 28-29 and accompanying text. Second, accuracy is important to establishing the legitimacy of the decision, both as to the individual parties to the dispute as well as from a broader public policy perspective as to the public's perception of the legitimacy of arbitration as a forum for dispute resolution. See *infra* notes 39-45 and accompanying text.

pursuing a cheap, quick and final resolution of the parties' disagreement, which is the goal served by the process of securities arbitration and which were clearly the goals the industry intended. Because the industry failed to obtain the customer's informed consent to prefer the goals of arbitration over that of litigation, it was forced to address the procedural "fairness" concerns that investors inevitably raise at such later time when they are forced to arbitrate their claims. Moreover, these investor fairness concerns have been dealt with by reforming arbitration procedures so that the current process of securities arbitration has become practically a clone of litigation.

We, as a society, are now forced to deal with the consequences of arbitration having evolved into a clone of litigation. However, this ongoing public debate fails to appreciate that the piecemeal reform measures of the last ten years have caused the process of arbitration slowly but surely to drift away from its original, stated objectives: to offer a forum for inexpensive, quick and final resolution of parties' disputes. While the reform measures adopted over the last ten years were largely based on the procedural rules of litigation, the ongoing public dialogue has failed to appreciate that the procedural rules of litigation were designed primarily to promote a very different objective—accuracy of outcome. Once we fully acknowledge the inherent inconsistency that results from these piecemeal reforms, then I believe that we, as a society, will be forced to confront—candidly and directly—important public policy issues: Do we really intend to impose on investors a system of dispute resolution that emphasizes the stated goals of speed, cost and finality of result? Do we really intend to promote arbitration goals at the expense of accuracy for these parties, one of whom had no choice? Are we willing to sacrifice accurate ascertainment of the facts regarding the parties' disputes, as well as the accurate application of the rule of law to these facts, in order to impose on the parties a forum that provides for a cheap, quick and final resolution of their dispute?

In light of the reforms that have been made to the procedures used in securities arbitration over the last ten years, it is increasingly apparent that the Supreme Court's decision in *McMahon*, giving preference to arbitration over litigation, may not have adequately addressed the public policy implications of

this preference—at least not in situations where the parties have not voluntarily chosen to prefer the advantages of the arbitration process over the litigation forum. Furthermore, as we look ahead to the next ten years, we need to ask, from a larger, public policy perspective, whether the current, reformed arbitration process will provide an adequate system for resolving disputes between brokers and their customers.³⁵

VI. THE SECURITIES ARBITRATION PROCESS FROM A PUBLIC POLICY PERSPECTIVE

Turning to the macro-perspective, the Court's ruling in *McMahon* raises important public policy concerns regarding the future development of the rule of law. These concerns loom ever larger as it becomes increasingly evident that *McMahon* has resulted in arbitration becoming virtually the *exclusive* forum for resolution of customers' claims against their brokers. This Section sets forth the nature of these public policy concerns.

As was the case in the last Section in examining the fairness of arbitral rules of procedure from a micro-perspective, there is considerable evidence that there is dissatisfaction, on the part of both customers and brokers, with the arbitration process,³⁶ although the exact nature of the parties' complaints

³⁵ The Ruder Report does not reflect this type of probing examination of fundamental public policy concerns. The Ruder Commission undertook its review of securities arbitration on the assumption that arbitration is here to stay as the most appropriate forum for resolution of investors' claims against their brokers. See Ruder Report, *supra* note 19, at 87,438; Seligman, *supra* note 33, at 343-46; Speidel, *supra* note 32, at 1356-57. I am not persuaded of the legitimacy of this assumption, however, at least as to resolution of broker-customer disputes. Putting aside employment claims and intra-industry disputes, which are outside the focus of both Professor Steinberg's paper and of my Commentary, I believe that there are important public policy concerns that underlie the Commission's presumption favoring arbitration of customer claims that merit a more complete and thoroughgoing examination and public debate before industry sponsored arbitration becomes even more entrenched as the dominant, if not exclusive, forum for determining the merits of customers' claims against their brokers.

³⁶ All of which ultimately leaves me with a perverse curiosity as to exactly *who* perceives the arbitration process to be "unfair." I am curious both as to *who* complains about the fairness of the procedures that govern the arbitration process, as well as *who* is complaining about the terms of the arbitrators' awards. Is it the parties to the arbitration proceeding? Or, is it their lawyers? I think the answer to this question is important because it will determine whether to respond at all

varies considerably.³⁷ In his introduction this morning, Professor Poser gave several examples of the types of criticisms that have been made regarding the modern arbitration process.³⁸

As to the parties' perception of the "fairness" of the substantive outcome, their complaints about the arbitration award

to complaints as to fairness of the arbitration process. Moreover, if a response is determined to be appropriate, the answer to this question will help to determine how to respond—to decide what specific reform measures are appropriate. See *supra* note 29.

³⁷ Obviously, the "dissatisfaction" I am referring to here is something more than merely the natural disappointment of a party who expected the award to include a much larger recovery. I have little sympathy with what amounts to just another complaint that the arbitrators did not award enough in damages to the claimant; and I have a similar lack of sympathy with brokers who complain that they had to pay too much to the claimant. I believe that policymakers can generally ignore these inevitable grumblings unless the parties' complaints raise concerns as to the fundamental fairness of the procedures used in securities arbitration or unless these complaints reflect the impact that arbitration is having on the further development of the rule of law by impairing the future development of substantive legal standards to be used to decide the validity of future claims.

³⁸ Poser, *supra* note 7, at 1331-32. The various types of complaints include the following:

- 1) the "split the baby" nature of arbitrators' awards;
- 2) the arbitrators' failure to award attorneys fees;
- 3) the arbitrators' failure to award punitive damages;
- 4) the arbitrators' failure to explain basis of decision, which includes criticisms as to:
 - i) the failure to explain *either* the cause of action *or* the legal principles that were applied on by the arbitrators or the panel to decide the case; or
 - ii) the arbitrators' failure to describe in any factual detail the nature of the culpable conduct on the part of either or both of the parties.

See S. JAFFEE, *BROKER-DEALERS AND SECURITIES MARKETS: A GUIDE TO THE REGULATORY PROCESS* 19 (1977) (regarding the "split the baby" compromising nature of arbitration awards); James N. Benedict & Nancy A. Brown, *The Power of Arbitrators to Award Punitive Damages*, 25 REV. SEC. & COMMODITIES REG. 71, 79 (1992) (maintaining that punitive damages awards in arbitration "are violative of due process"); David A. Lipton, *The Standard on Which Arbitrators Base Their Decisions: The SROs Must Decide*, 16 SEC. REG. L.J. 3 (1988) (exploring the issues of "whether arbitrators will base their award on commercial equitable judgments or on a strict adherence to legal precedence"); Masucci, *supra* note 27, at 193-94 (regarding the award of attorneys' fees in arbitration proceedings); Margo E.K. Reder, *Punitive Damages Are a Necessary Remedy in Broker-Customer Securities Arbitration Cases*, 29 IND. L. REV. 105, 130 (1995) (maintaining that "[p]unitive damages must be available as a remedy in securities arbitration"); Perry E. Wallace, Jr., *Securities Arbitration After McMahon, Rodriguez, and the New Rules: Can Investors' Rights Really Be Protected?*, 43 VAND. L. REV. 1191, 1203-05 (1990) (raising concerns as "to the application of legal theories underlying [investor] claims brought to arbitration").

often focus on the substantive legal standard that was applied by the panel of arbitrators to reach their decision on the facts of a particular case. In other words, the parties' complaints generally focus on either the way the arbitrators framed the relevant rule of law, or alternatively, the way the arbitrators applied the relevant rule of law to the particular set of facts at issue.³⁹

The extent to which these complaints about the fairness of the results obtained in an arbitration proceeding merit a response depends on whether the arbitration process is having a deleterious impact on the further refinement and development of the rule of law. In particular, the decision in *McMahon* enforcing pre-dispute arbitration clauses of the type that are now standard fare throughout the securities industry has created the possibility for the further erosion—if not ultimately the virtual extinction—of the rule of law, at least in the area of customer disputes with their securities brokers. When viewed from this broader perspective, *McMahon* obviously raises important public policy concerns that transcend the specifics of any particular investor's dispute with his or her broker.

Here is where I disagree with what I see as certain assumptions that are implicit in the conclusions Professor Steinberg reaches in his article. In concluding that arbitration of investor claims may well be preferable today to litigating such claims in federal court, Professor Steinberg's argument seems to assume that the rule of law continues to play a decisive, perhaps even determinative, role in the arbitrators' decisionmaking process. This implicit premise is not easy to accept. I also take issue with Professor Steinberg to the extent his paper, at least implicitly, assumes that if we rely on arbitration as virtually the exclusive method for resolution of the parties' disputes in this area of securities law, there will be no negative impairment on the continued development of the rule of law.

³⁹ See Beckley, *supra* note 10; Karen Kupersmith, *A Perspective on the Role of the Arbitrator in Securities Arbitration*, 31 WAKE FOREST L. REV. 297 (1996); Steinberg, *supra* note 1, at 1514-19; John F.X. Peloso, *Whether Arbitrators Have a Duty to Apply the Law*, N.Y. L.J., Apr. 18, 1996, at 3.

In examining the impact *McMahon* has had, and will continue to have, on the development of the substantive law used by arbitrators to resolve customers' claims against their brokers, the starting point lies in identifying the rule of law that is most often at issue in resolving these disputes. Much as Stephen Friedman did as part of his Commentary this morning, I start from the general premise that the vast majority of investors' claims against their brokers are fundamentally grounded on some type of claim of breach of fiduciary duty. In this context, I have often heard the acronym "SCUM" used to refer to the causes of action that investors most often allege against their brokers. SCUM refers to the causes of action for Suitability, Churning, Unauthorized trading, and Misrepresentation. Notably, all of these claims fundamentally arise out of a broker's breach of fiduciary duty owed to a customer.⁴⁰

The rule of law that is fundamentally at issue in any of these SCUM disputes, therefore, is the general rule imposing a fiduciary duty on the broker because of the agency relationship that is usually established between securities brokers and their customers. This general fiduciary duty principle, however, requires further refinement in order to define the specific scope of the broker's obligations to the customer; in addition, the scope of the customer's responsibility, if any, for his or her own trading activity in the financial markets must be taken into account in determining the scope of the broker's obligations to this customer. In large part, the SCUM acronym reflects this further refinement of the broker's obligations because it highlights the application of the general fiduciary duty principle to certain kinds of recurring problems in the context of the broker-customer relationship. Although the SCUM acro-

⁴⁰ Many misrepresentation claims do not implicate a breach of fiduciary duty since these claims arise out of affirmative misrepresentations and therefore such claims amount to a tort action for fraud. See NORMAN S. POSER, *BROKER-DEALER LAW & REGULATION* 80-82 (1995). However, to the extent a customer's fraud claim is based on deceit—in other words, the failure to disclose material information as opposed to claims of affirmative misrepresentation—such omissions are generally actionable only where there is some independent source of a duty to disclose, such as the fiduciary relationship arising out of the broker-customer relationship. See *id.* at 83-84. Consequently, many investor claims that fall within the "misrepresentation" prong of the "SCUM" acronym *do* involve a breach of fiduciary duty claim to the extent the claim is based on a failure to disclose, rather than on a claim of misrepresentation of a material fact.

nym does not purport to be an exhaustive description of the scope of fiduciary obligations arising out of the broker-customer relationship, it nonetheless reflects specific applications of this fiduciary principle. In turn, these specific applications serve as a guide for determining the scope of the parties' obligations in the case of future dealings between brokers and their customers.

Seen from this perspective, the general rule of law imposing a fiduciary duty on the broker-customer relationship leads to the further development of more precisely defined standards of conduct that govern future dealings between brokers and their customers, primarily through decisional law and administrative regulation. Thus, the law of fiduciary duty serves the general function of regulating the standards of fair conduct in commercial practices within the securities brokerage industry, and continues to evolve to refine the standards of professional conduct required of members of the securities industry.

The importance of a well-developed body of legal standards that also has the capacity to continue to evolve, in order to accommodate future changes in the securities markets and the accompanying changes in commercial practices, cannot be overstated. The capacity for continuous development of standards of fair conduct assumes even greater significance when considering the question of what standard should be used by arbitrators to decide whether a breach of fiduciary duty has occurred on the facts of a particular investor's claim against his or her broker.

In considering how to define the applicable standard for a broker's breach of fiduciary duty, arbitrators have a wide range of alternative approaches. Arbitrators may choose to use a subjective approach that frames the standard for determining breach by ascertaining the expectations of the parties to this fiduciary relationship. Based on these expectations, the arbitrators then determine whether a breach has occurred by deciding either what standard the parties expressly bargained for, or more likely, what the parties would have bargained for had they anticipated this particular set of circumstances. Alternatively, arbitrators may choose to use a more objective approach that frames the standard for determining breach of fiduciary duty by applying the expectations of a reasonably prudent customer and a reasonably prudent broker acting

under a similar set of circumstances. As a final alternative, arbitrators may be allowed the freedom to decide whether a breach of fiduciary duty has occurred based on their own sense of what is the fair or equitable result in light of the facts of each particular case.⁴¹

The important public policy implications that *McMahon* created for the future development of the rule of law in this area are dramatically highlighted given this range of standards for determining whether a breach of fiduciary duty has occurred. Now that *McMahon* has substantially eliminated any judicial consideration of investor claims involving the broker's breach of fiduciary duty,⁴² the possibility for continued judicial development of standards for determining a broker's breach of fiduciary duty has been arrested. Virtually the only authoritative body of decisional law available today to guide the arbitrators is the case law developed prior to *McMahon*. Even this guidance eventually will be rendered inadequate to address fully these breach of fiduciary claims in light of the accelerating pace of change in the global financial markets.

Since the arbitrators are not required to explain the bases of their decision, either as to their findings of fact or as to their statement of the relevant rule of law, there is virtually no possibility that the decisions of arbitration panels can be relied on to fill this void created by the *McMahon* ruling. Therefore, the fundamental concern in the wake of the *McMahon* decision is whether there is some mechanism in place that will allow for the continued development of the rule of law on an incre-

⁴¹ Over the course of the last ten years, many participants in the securities markets have come to believe that the standard used by arbitrators to decide broker-customer disputes involved some personalized notion of the individual arbitrators trying to "do equity." See, e.g., Beckley, *supra* note 10; Peloso, *supra* note 39. This perception is often the product of a perceived inconsistency in the results obtained in different arbitration proceedings, all of which appear to involve fact patterns that arise out of substantially the same kind of alleged misconduct. This perception invites criticism, at least from the parties to the arbitration process, that arbitration is "unfair" as a result of these perceived inconsistencies in the decisions reached by the arbitrators. In light of these claims of unfairness, it becomes increasingly difficult to predict outcomes in future arbitration matters and to offer advice regarding the legitimacy of proposed changes in business practices. Thus, the modern process of securities arbitration further erodes future development of the rule of law by undermining the objectives to be served by establishing a rule of law.

⁴² See *supra* notes 31-33 and accompanying text.

mental basis. I am not convinced that we have adequately considered the consequences of disrupting this common law tradition.

Moreover, now that arbitration has become virtually the exclusive forum for resolution of broker-customer disputes, an important check that Professor Steinberg seems to assume will be imposed on the arbitration process—namely, that the panel of arbitrators will apply the rule of law—is no longer available. The decisions of the arbitrators are not subject to the accuracy check that is imposed by the procedures used in civil litigation since there is no appellate review of the accuracy of the arbitrators' decision in either framing or applying the rule of law. Arbitrators are not required to explain the bases for any award they make. Moreover, the very limited statement of decision that the panel of arbitrators is required to produce today fails to explain how it applied the rule of law to the facts before the panel.⁴³ The panel also does not have to provide any analysis or explanation of their understanding or interpretation of the scope of fiduciary obligations arising out of the broker's relationship with his or her customer.⁴⁴ Although business practices, out of necessity, must evolve to accommo-

⁴³ See NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. ("NASD"), CODE OF ARBITRATION PROCEDURE Rule 41 (1996); Steinberg, *supra* note 1, at 1519 (Arbitrators "are reluctant to explain their rationale in a written opinion. The end product is one that reaches a defined result with no reasoning to support such a result.").

⁴⁴ The difficulties arising out of the absence of any published explanation for the arbitrators' ruling have become increasingly apparent over the last ten years since *McMahon* was decided, especially in light of the significant changes that have taken place in the capital markets. See, e.g., Beckley, *supra* note 10; David Lipton, *Generating Precedent in Securities Industry Arbitration*, 19 SEC. REG. L.J. 26 (1991); Lynn Katzler, Comment, *Should Mandatory Written Opinions Be Required in All Securities Arbitration?: The Practical and Legal Implications to the Securities Industry*, 45 AM. U. L. REV. 151 (1995).

Moreover, the absence of any requirement that the arbitrators publish a statement of the relevant legal standard they used to decide the case carries implications well beyond its impact on the parties to a particular dispute. The evolution of the rule of law is further stunted because the arbitrators' failure to publish a statement of the relevant rule of law deprives the participants in the securities markets of the information they need to ascertain the scope of their obligations; and, therefore, they lack crucial information necessary to modify their commercial practices in order to avoid liability in the future. As a further consequence of this failure to publish any definitive statement of the panel's reasoning, insufficient information exists on which lawyers can capably counsel clients as to how to conduct their business affairs and modify their commercial practices so as to avoid liability in the future.

date changes made in the world's modern financial markets, such evolution is now occurring largely without the fine-tuning and guidance offered by decisional law—the traditional, authoritative source of interpretive law.

Moreover, by eliminating decisional law as an authoritative source for further refining the rule of law, greater burdens presumably will be imposed on other possible sources for defining the rule of law, such as statutes and administrative rules and regulations. In the area of securities regulation, this probably means increasing reliance will be placed on Securities and Exchange Commission ("SEC") enforcement efforts, as well as on self-regulatory organization ("SRO") rulemaking efforts, all of which are subject to oversight by the SEC.⁴⁵ At a minimum, however, increasing the influence of SRO rules as a result of the elimination of decisional law is certainly an important public policy issue that warrants more thoughtful and thorough consideration than has been undertaken by our policy makers to date, as well as a meaningful opportunity for public debate. Even more importantly, however, is the concern as to whether the SEC has adequate resources and expertise to perform in a responsible manner all the myriad tasks delegated to it.

⁴⁵ In the case of NASD reforms of its arbitration procedures, any such proposal would generally originate with the SRO but would be subject to SEC approval before it could be implemented. *See* § 19 of the Securities Exchange Act of 1934, 15 U.S.C. § 78 (1994). In the case of the recent set of recommendations for reform of the securities arbitration process that were proposed by the Ruder Commission, these reform recommendations also would require approval of the SEC before they could be implemented. Once again we see the SEC placed in the role of public policy maker, but now its expertise is stretched beyond the regulation of our nation's capital markets to include the fairness of rules of procedure used to resolve disputes between brokers and their customers. I question whether this is a wise use of the SEC's scarce resources. In addition, the substantial erosion of decisional law as a source of authoritative interpretation of the federal securities laws has placed a greater burden on SEC enforcement resources, raising again the question of whether this constitutes a wise, or even effective, use of the agency's scarce resources. *See, e.g.,* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 314-16 (1985); J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

CONCLUSION

In its decision in *McMahon*, the Supreme Court expressed its preference for arbitration over litigation of investor claims against the securities industry. By doing so, the Supreme Court has made industry sponsored securities arbitration virtually the exclusive forum for resolution of broker-customer disputes.⁴⁶ As investors and their brokers have come to appreciate the full significance of the *McMahon* decision, however, increasing pressure has been exerted to modify the procedures used to arbitrate investor claims. For the most part, these reforms have been modeled on the procedural rules used in our modern civil litigation process. Consequently, as we reach the tenth anniversary of the Supreme Court's decision in *McMahon*, the inescapable conclusion is that our modern system of securities arbitration has evolved into virtually a clone of our modern system of civil litigation.

From the individual participant's point of view, it is entirely understandable that these post-*McMahon* reform measures should result in the reworking of arbitral procedures to bear this strong family resemblance to the modern litigation process. Reform of the procedural rules for arbitration helps to validate the pre-dispute choice of arbitration over litigation as

⁴⁶ The practical effect of the Court's decision in *McMahon* has been to steer most, if not virtually all, customer disputes with their brokers into arbitration. Recently, Professor Poser observed that since the *McMahon* decision, "arbitration has indeed eclipsed litigation in this area . . . ," although Professor Poser did hasten to add that it has been "only a partial eclipse" since a "considerable number" of investor claims are still litigated. Poser, *supra* note 11, at 1095-96. However, other commentators have gone further, contending that *McMahon* has resulted in virtually a total eclipse of court litigation since most investor claims—if not virtually all claims made by individual investors—are by arbitration. See Constantine N. Katsoris, *Should McMahon Be Revisited?*, 59 BROOK. L. REV. 1113, 1114 (1993); Speidel, *supra* note 32, at 1356-57 (citing the Ruder Report). Although this may not have been the driving force that led the *McMahon* Court to prefer arbitration over litigation, nonetheless the decision has resulted in relieving congestion in federal court dockets by forcing investors to arbitrate their claims against brokers. See *supra* notes 31-35 and accompanying text. Removing these securities disputes from the federal court docket, thereby making available considerable judicial resources to hear other types of disputes, may in fact be a laudable and socially desirable goal. However, this preference for arbitrating rather than litigating investor claims certainly merits a more thoughtful and thorough examination of the important public policy concerns that underlie such a preference than was undertaken in the *McMahon* decision.

the forum for resolution of investors' claims against their brokers. Such validation becomes necessary since, generally speaking, this pre-dispute decision to arbitrate was not made freely and voluntarily by the investor. Accordingly, procedural reforms have been implemented in lieu of undertaking any meaningful effort to obtain the investor's voluntary, informed consent to arbitrate any future claims that may arise. As such, these procedural reform measures may be viewed as a form of "proxy" for the lack of informed consent by the investor to mandatory arbitration of their future claims in an industry sponsored forum.

However, these efforts to improve on the "fairness" of the arbitration process, by implementing procedural reforms that borrow heavily from the procedures used in our modern civil litigation system, overlook the fact that the dominant goal of litigation is accuracy, whereas the primary goal of arbitration is to provide speedy, final and cost-effective resolution of the parties' claims. In the process of borrowing procedures from our litigation system to address investor's concerns as to the fairness of arbitration we have substantially diluted, if not completely eliminated, the ability of arbitration to serve its goals by offering a meaningful alternative to litigation.

The *McMahon* decision also presents important implications from a larger, public policy perspective. By making arbitration virtually the exclusive forum for resolution of investor claims against their brokers, *McMahon* has undermined the ability of our judicial system to continue to evolve appropriate legal standards to regulate the standards of professional conduct required of members of the securities industry. In particular, now that *McMahon* has virtually eliminated any judicial consideration of investor claims, the possibility for continued judicial development of standards for determining whether brokers have violated the fiduciary duties they owe their customers has come to a grinding halt.

Left in the wake of *McMahon* is the fundamental public policy concern as to whether there is some mechanism in place that will allow for adequate continued development of the rule of law on an incremental basis, including, most importantly, further development of the scope of fiduciary duty imposed on the broker-customer relationship. Commercial necessity dictates that business practices must evolve to accommodate the

ever-accelerating pace of change in our modern global capital markets. However, we now face the very real prospect that such evolution will occur without the fine tuning and guidance offered by decisional law, which has long been the authoritative source of interpretive law for determining whether brokers have breached the fiduciary duty they owe to their customers.

At a minimum, these very real and important public policy implications, as well as the impact on individual investors that results from making arbitration virtually the exclusive forum for resolution of these broker-customer disputes, deserve more probing scrutiny than they received either in the *McMahon* decision or in the public debate that has occurred since *McMahon*.

