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The End of Mandatory Securities Arbitration?

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The End of Mandatory Securities Arbitration?

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I. Introduction

Mandatory arbitration is under attack in the United States. In recent years, academics, media commentators, and consumer advocates have lamented the alleged evils of pre-dispute arbitration clauses in adhesive consumer and employment agreements. They decry oppressive clauses such as class action waivers, inconvenient venue selection, cost-shifting provisions, and process limitations, all foisted upon those with inferior bargaining power.[1] While some judges have applied common law contract doctrines to strike down these clauses as unconscionable,[2]

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1. *See, e.g.*, Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237 (2001); Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 LAW & CONTEMP. PROBS. 133 (2004); Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449 (1996); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33 (1997); Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631 (2005); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L. Q. 637 (1996); Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931 (1999). *But see* Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 264 (2006) (arguing against legislation prohibiting enforcement of adhesive predispute arbitration agreements and stating that "the general enforcement of adhesive arbitration agreements benefits society as a whole by reducing process costs and, in particular, benefits most consumers, employees and other adhering parties").

2. *See, e.g.*, Homa v. Am. Express Co., 558 F.3d 225 (3d Cir. 2009) (holding that class-arbitration waiver in parties' consumer credit-card agreement was unconscionable); *In re* Am. Express Merch. Litig., 554 F.3d 300 (2d Cir. 2009) (reversing grant of motion to compel arbitration where arbitration agreement contained mandatory class action waiver clause).

illusory,[3] or violative of the contract's implied covenant of good faith and fear dealing,[4] courts typically enforce the clauses pursuant to section two of the Federal Arbitration Act ("FAA"), which declares irrevocable and enforceable written arbitration provisions in all maritime transactions and contracts "involving commerce."[5] Routine enforcement stems from the United States Supreme Court's mandate that courts ruling on arbitrability questions must apply a presumption of arbitrability.[6]

In the early 2000s, legislators attempted reform, introducing a variety of bills into Congress to ameliorate the impact of FAA section two on adhesive consumer arbitration agreements, but these bills did not emerge from the committee process to become law.[7] Most recently, both the Senate and the House introduced nearly identical bills to enact the Arbitration Fairness Act of 2009 ("AFA").[8] Section two of the AFA consists of "findings" that reflect, in their totality, Congress' disdain for today's consumer, employment, and franchise arbitration that results from arbitration clauses in adhesive contracts, which it views as oppressive of consumer, employee, and franchisee rights, respectively. In these proposed "findings," Congress declares that the FAA "was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power,"[9] but that a "series of United States Supreme Court decisions have changed the meaning of the [FAA] so that it now extends to disputes between parties of greatly disparate economic power."[10] The "findings" further state that "[m]ost consumers and employees have little or no meaningful option whether to submit their claims to arbitration,"[11] a process that "undermines the development of public law for civil rights and consumer rights because there is no meaningful judicial review of arbitrators' decisions,"[12] and is a "poor system for protecting [those] rights because it is not transparent."[13]

3. *See, e.g.*, Penn v. Ryan's Family Steak Houses, 269 F.3d 753 (7th Cir. 2001).

4. *See, e.g.*, Hooters of Am. v. Phillips, 173 F.3d 933 (4th Cir. 1999).

5. 9 U.S.C. § 2 (2006).

6. *See* Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983).

7. *See, e.g.*, Arbitration Fairness Act of 2007, S. 1782, 110th Cong. (2007); H.R. 3010, 110th Cong. (2007).

8. Arbitration Fairness Act of 2009, S. 931, 111th Cong. (2009); H.R. 1020, 111th Cong. (2009).

9. S. 931 § 2(1).

10. *Id.* § 2(2).

11. *Id.* § 2(3).

12. *Id.* § 2(5).

13. *Id.* § 2(6).

The AFA, if passed by Congress, would amend the FAA to invalidate pre-dispute arbitration agreements ("PDAAs") that require arbitration of an employment, consumer, franchise, or civil rights dispute.[14] Each of these disputes is defined quite broadly, so as to ensure maximum invalidation of mandatory arbitration. The AFA also provides that courts, not arbitrators, decide all questions as to the "validity and enforceability of an [arbitration] agreement . . . irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement."[15] This language reverses the Supreme Court's "separability" doctrine, which permits arbitrators to rule on a claim that a contract is not valid even though the allegedly invalid contract is the source of the arbitration clause.[16] It also codifies the Supreme Court holding that courts decide questions of arbitrability while simultaneously strengthening it by apparently eliminating the exception that arbitrators can decide if the parties "clearly and unmistakably" intended the arbitrators to decide arbitrability.[17]

Academic reaction to the AFA has been mixed.[18] Some deem the 2009 AFA an overreaching legislative solution to the problem of mandatory consumer and employment arbitration.[19] Others laud it as welcomed reform.[20]

In this essay, I put aside the important debate over the AFA with respect to all forms of arbitration except one: securities arbitration.[21]

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14. *Id.* § 402(a).

15. *Id.* § 402(b)(1).

16. *Id.* The "separability" doctrine stems from *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), in which the Supreme Court held that arbitrators can decide a claim of fraudulent inducement of a contract containing an arbitration clause because the allegation of fraud was directed at the contract itself and not at the arbitration clause.

17. *See* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995).

18. This academic reaction may also be moot, as the legislation does not appear headed for passage, at least as of the summer of 2010.

19. *See, e.g.*, Thomas E. Carbonneau, *Arguments in Favor of the Triumph of Arbitration*, 10 CARDOZO J. CONFLICT RESOL. 395 (2009); Peter B. Rutledge, *The Case Against the Arbitration Fairness Act*, 16 DISP. RESOL. MAG., Fall 2009, at 4. *See also* Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J. L. PUB. POL'Y 549 (2008).

20. *See, e.g.*, Richard M. Alderman, *Why We Really Need the Arbitration Fairness Act*, 12 J. CONSUMER & COM. L. 151 (2009) (arguing the Act is needed to correct the separation of powers violations by adhesive arbitration); Jean R. Sternlight, *Fixing the Mandatory Arbitration Problem: We Need the Arbitration Fairness Act of 2009*, 16 DISP. RESOL. MAG., Fall 2009, at 5.

21. My focus on securities arbitration stems from my long-standing scholarly and clinical interest in the process. Since 1999, I have been a Director of the Investor Rights

"Securities arbitration" broadly refers to arbitration of disputes between investors (customers) and their individual brokers and broker-dealer firms, employment disputes between individual brokers and their employer firms, and intra-industry disputes among securities industry parties. Today, these disputes are arbitrated at FINRA Dispute Resolution.[22]

In the early 2000s, due, in part, to the intensifying scrutiny of adhesive consumer and employment arbitration, investors raised anew their contentions, largely silenced since the late 1980s by the Supreme Court,[23] that mandatory arbitration of customer disputes—the first category of securities arbitration mentioned above—was unfair. In response, the Senate version of the 2009 AFA expressly extended its coverage to securities industry disputes through its definition of "consumer dispute." Thus, the proposed Act defines "consumer dispute" as:

Clinic (f/k/a Securities Arbitration Clinic) at Pace Law School, in which law students, under faculty supervision, represent individual investors of modest means in their arbitrable securities disputes. My scholarship has focused on assessing the fairness of securities arbitration. I have been a Financial Industry Regulatory Authority ("FINRA") arbitrator for almost ten years, and just completed four years of service as a public member of the National Arbitration and Mediation Committee of FINRA.

22. Until mid-2007, the National Association of Securities Dealers, Inc. ("NASD") and the New York Stock Exchange ("NYSE") ran separate arbitration forums that handled a combined 99% of all securities arbitrations in the country. On July 30, 2007, NASD and NYSE Regulation, including their respective arbitration forums, consolidated and formed FINRA. *See* Press Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority (July 30, 2007), *available at* http://www.finra.org/Newsroom/NewsReleases/2007/P036329. FINRA now operates the largest dispute resolution forum in the securities industry. *See* FINRA, What is Dispute Resolution?, http://www.finra.org/ArbitrationMediation/AboutFINRADR/Overview/ (last visited July 25, 2010).

23. In the late 1980s, the U.S. Supreme Court overruled prior law, *Wilko v. Swan*, 346 U.S. 427 (1953), and held that brokerage firms could enforce PDAAs in brokerage account customer agreements as to federal securities law claims. *See* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 485 (1989) (holding that claims arising under the Securities Act of 1933 are arbitrable); Shearson/Am. Express v. McMahon, 482 U.S. 220, 242 (1987) (holding that claims arising under the Securities Exchange Act of 1934 are arbitrable). Several subsequent landmark arbitration law opinions issued by the Supreme Court arose from NASD/FINRA arbitrations. *See, e.g.*, Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79 (2002) (holding that NASD arbitrators, not courts, decide the application of NASD forum's eligibility rule); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995) (holding that NASD arbitrators have power to award punitive damages); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991) (holding broker's claim arising under the Age Discrimination in Employment Act is arbitrable before NASD).

> a dispute between a person other than an organization who seeks or acquires real or personal property, services (including services relating to securities and other investments), money, or credit for personal, family, or household purposes and the seller or provider of such property, services, money or credit.[24]

However, Congress' 2010 legislative agenda placed the AFA on the backburner as it focused on financial services regulatory reform, among other legislative priorities. Instead, the politically-charged clamor for stronger regulation of the financial services industry culminated in the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[25] As part of that massive reform bill, a provision in Dodd-Frank empowers the Securities and Exchange Commission ("SEC") to prohibit PDAAs in customer agreements. Should it?

This essay argues that, because securities arbitration is markedly different from other forms of consumer arbitration, the SEC should not exercise its new power to ban PDAAs in securities customer account agreements, nor should Congress, if it passes the AFA, extend it to encompass arbitration of securities customer disputes. The first part of this essay briefly chronicles the current debate over the fairness of securities arbitration. Next, I argue that FINRA arbitration—whose fairness is regulated with substantial oversight by the SEC[26]—does not suffer from the same features and flaws that critics of arbitration in other forums have excoriated as oppressively unfair. In this part, I also argue that eliminating mandatory securities arbitration would have significant adverse consequences for investors and for the vitality of the dispute resolution mechanism. The essay concludes by asserting that regulators should not enact arbitration reform that needlessly and without foundation brands securities arbitration as the evil twin of adhesive

24. S. 931, 111th Cong. § 401(2) (1st Sess. 2009). The House version defines "consumer dispute" as "a dispute between a person other than an organization who seeks or acquires real or personal property, services, money, or credit for personal, family, or household purposes and the seller or provider of such property, services, money, or credit." H.R. 1020, 111th Cong. § 3(6)(4) (1st Sess. 2009). If Congress takes further action on the AFA, the House is expected to conform its version with the Senate's extension during the committee process.

25. Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2d Sess. 2010).

26. For a detailed discussion of the nature and statutory authority for this oversight, see Jill I. Gross, *McMahon Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 493, 512-17 (2008).

consumer arbitration.

II. The Recent Debate over the Fairness of Securities Arbitration

For more than twenty years, arbitration in forums sponsored by the securities industry has been the primary mechanism[27] for the resolution of disputes among investors, brokerage firms and brokers. Brokerage customers who allege, for example, that their broker recommended unsuitable investments or strategies, placed unauthorized trades or committed fraud[28] must, because of the arbitration clause in their customer agreements, arbitrate those claims in the FINRA arbitration forum. Moreover, even if the customer agreement does not contain a pre-dispute arbitration clause, FINRA Code of Arbitration Procedure for Customer Disputes Rule 12200 requires broker-dealers and their associated persons to submit to arbitration upon the demand of a customer.

As a result of the virtually mandatory and ubiquitous nature of the process to resolve disputes between investors and their brokers,[29] participants have debated its fairness despite numerous improvements over the years. Many investor advocates argue that securities arbitration is unfair, inefficient, expensive, and biased towards the securities industry.[30] The securities industry, on the other hand, contends that the arbitration process works well, is faster and less expensive than litigation, and is fair to all the parties involved.[31] Since 2007, the Securities Industry and Financial Markets Association ("SIFMA"), the trade association for the securities industry, has engaged in substantial

27. Mediation is also utilized if all parties consent. *See* Jill I. Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, 21 OHIO ST. J. ON DISP. RESOL. 329, 359 (2006).

28. For a description of the most common claims brought by customers against their brokers, see Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1008-12 (2002).

29. N. AM. SEC. ADM'RS ASS'N ("NASAA"), MANDATORY BINDING ARBITRATION: IS IT FAIR AND VOLUNTARY? 1 (2009).

30. *See The Arbitration Fairness Act of 2007: Hearing on S. 1782 Before the Subcomm. on the Constitution*, 110th Cong. (2007) [hereinafter *Senate Subcommittee Hearing*] (statement of the Public Investors Arbitration Bar Association ("PIABA") in Connection With the Subcommittee's Review of the arbitration system); Mark A. Tepper, *Survey Says—SRO Arbitration Unfair*, 12 PIABA BAR J. 11 (2005).

31. *See* FIN. SERVS. INST., THE EFFICACY OF SECURITIES ARBITRATION AND PROPOSALS FOR CHANGE (2010) (concluding that FINRA arbitrations are more cost-effective and resolve more quickly than litigation). The Financial Services Institute is an advocacy organization for Independent Broker-Dealers.

lobbying efforts to persuade Congress not to extend the AFA to the securities industry, including the release of a White Paper arguing that securities arbitration is fair to investors.[32] As with mandatory consumer arbitration, scholars are divided.[33]

The U.S. Congress also has examined securities arbitration in recent years. In March 2005, a subcommittee of the House of Representatives Financial Services Committee held a hearing to better understand how the securities arbitration process was working and whether reforms were needed.[34] At that hearing, witnesses with expertise in securities arbitration testified about, and disagreed on the ramifications of, many aspects of the process, including: (1) its mandatory nature,[35] (2) the inclusion of one industry arbitrator on every three-arbitrator panel,[36] and

32. SEC. INDUS. & FIN. MKTS. ASS'N, WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY (2007), *available at* http://www.sifma.org/regulatory/pdf/arbitration-white-paper.pdf [hereinafter SIFMA WHITE PAPER]. SIFMA "brings together the shared interests of hundreds of securities firms, banks and asset managers." SIFMA, The SIFMA Organization, http://www.sifma.org/about/about.html (last visited Mar. 7, 2010).

33. *Compare* Barbara Black, *Is Securities Arbitration Fair to Investors?*, 25 PACE L. REV. 1 (2004) (concluding that the process is fair), *with* Edward Brunet & Jennifer J. Johnson, *Substantive Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 459 (2008) (arguing that securities arbitration is not fair). *See also* Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123 (2005).

34. *See The Securities Arbitration System: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 109th Cong. 13-14 (2005) [hereinafter *2005 Hearing*].

35. *Id.* To open an account with virtually any broker-dealer, investors must sign an agreement that contains a clause requiring them to settle any disputes in arbitration. This clause is regulated, both in form and content, by FINRA Rules. *See* NASD CONDUCT R. 3110(f), *available at* http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/ConductRules.

36. At FINRA, if the claim is more than $100,000, the arbitration panel generally consists of three arbitrators. FINRA CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES R. 12401(c) (2009), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4096 [hereinafter CUSTOMER CODE]. A three-person arbitration panel consists of one non-public arbitrator, customarily referred to as an industry arbitrator, and two public arbitrators, or arbitrators who are not associated with the securities or commodities industry. CUSTOMER CODE R. 12402(b). Industry arbitrators include individuals who have been associated within the past five years with, or who are retired from, the securities or commodities industry, as well as professionals who have devoted at least twenty percent of their professional work in the past two years to clients in the securities and commodities industry. CUSTOMER CODE R. 12100(p). Investor advocates contend that "the industry arbitrator presents an appearance of bias and impropriety to the investing public," *2005 Hearing*, *supra* note 34, at 105 (statement of PIABA), while the securities industry asserts that industry arbitrators provide valuable expertise. SIFMA WHITE PAPER, *supra* note 32, at 36.

(3) a lack of transparency in arbitrators' decisions.[37] In 2007, Senators Russell D. Feingold and Patrick Leahy urged SEC Chairman Christopher Cox to enact a rule banning mandatory arbitration clauses from broker-dealers' customer agreements.[38] Shortly afterwards, Senate and House subcommittees held hearings on the proposed AFA of 2007[39]—with an identical bill introduced in each chamber—and a critic of the current securities arbitration process testified at each of them.[40] Senator Feingold, sponsor of the Senate bill, expressly stated that the Act would apply to PDAAs in securities brokerage customer account agreements.[41] The 2007 AFA never emerged from committee, and so, early during the 2009-10 Congressional session, each chamber of Congress introduced the 2009 version of the AFA.

In the fall of 2009, the AFA stalled in Congress due to more pressing legislative priorities, including bail-outs of automakers, banks, and insurance companies. But policy-makers were still concerned about the fairness of securities arbitration. With pressure mounting for regulatory reform of the financial services industry, the Treasury Department released a blueprint for this reform.[42] Buried near the end of more than eighty pages of policy positions and proposals to avoid a repeat of the systemic failures that caused the 2008 credit crisis was the recommendation that "[t]he SEC should study the use of mandatory arbitration clauses in investor contracts."[43] The body of the

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37. FINRA publishes all arbitration awards on its website and, during the arbitrator-selection process, provides information on an arbitrator's past awards. However, FINRA does not require its arbitrators to explain awards or their reasoning, unless all parties jointly request an explained award. *See* CUSTOMER CODE R. 12904.

38. Letter from Russell D. Feingold, Senator, & Patrick Leahy, Chairman, Committee on the Judiciary, U.S. Senate, to Christopher Cox, Chairman, SEC (May 4, 2007) (on file with author). *See also* Gretchen Morgenson, *Dear S.E.C., Reconsider Arbitration*, N.Y. TIMES, May 6, 2007, § 3, at 1.

39. *See Senate Subcommittee Hearing*, *supra* note 30; *Hearing on "H.R. 3010, The Arbitration Fairness Act of 2007" before the H. Subcomm. on Commercial and Administrative Law*, 110th Cong. (2007) [hereinafter *House Subcommittee Hearing*].

40. *See Senate Subcommittee Hearing*, *supra* note 30, at 13 (statement of Tanya Solov, representing NASAA); *House Subcommittee Hearing*, *supra* note 39, at 113 (statement of Theodore G. Eppenstein, Testimony in Support of Prohibiting Mandatory Arbitration in Securities Cases).

41. *Senate Subcommittee Hearing*, *supra* note 30 (opening statement of Sen. Feingold). "First, [the Act] is intended to cover disputes between investors and securities brokers. I believe that such disputes are covered by the definition of consumer disputes, but to clear up any uncertainty, we will make the intent even clearer when we mark up the bill in committee." *Id.*

42. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (2009).

43. *Id.* at 72.

recommendation stated:

> Broker-dealers generally require their customers to contract at account opening to arbitrate all disputes. Although arbitration may be a reasonable option for many consumers to accept after a dispute arises, mandating a particular venue and up-front method of adjudicating disputes—and eliminating access to courts—may unjustifiably undermine investor interests. *We recommend legislation that would give the SEC clear authority to prohibit mandatory arbitration clauses in broker-dealer and investment advisory accounts with retail customers*. The legislation should also provide that, before using such authority, the SEC would need to conduct a study on the use of mandatory arbitration clauses in these contracts. The study shall consider whether investors are harmed by being unable to obtain effective redress of legitimate grievances, as well as whether changes to arbitration are appropriate.[44]

This proposal—to empower the SEC to prohibit mandatory PDAAs in customer agreements, if, after studying the impact of mandatory securities arbitration on investors, it concludes it would serve the interests of investor protection—appeared in Dodd-Frank, the financial services regulatory reform bill that President Obama signed into law on July 21, 2010. Thus, section 921 of Dodd-Frank, provides:

> The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.[45]

44. *Id.* (emphasis added).

45. Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 921(a) (2d Sess. 2010). The original House of Representatives version of the Act, in section 7202, would also have required the Comptroller General of the United States to:

Unlike the Senate version of the AFA, which, if enacted, would represent an exercise of Congressional power for the express purpose of banning mandatory securities arbitration,[46] Dodd-Frank delegates to the SEC the task of deciding whether the "the public interest" and "the protection of investors" requires it to ban arbitration clauses in customer agreements, and expressly authorizes the SEC to enact such a rule change. Thus, Dodd-Frank appears to obviate the need for the AFA to encompass securities arbitration.[47] Rather, Congress has chosen the route of delegating power to an administrative agency to regulate securities arbitration.[48]

Why did Congress choose to delegate the power to ban PDAAs to the SEC rather than ban them outright? It could just be a politically palatable compromise: legislators answered the investors' lobby call for reform but did not run afoul of Wall Street's strong desire to preserve arbitration as the primary dispute resolution mechanism for customer disputes. Congress simply punted to the SEC to address the issue.

Another, more likely answer is that, in 1975, Congress amended the federal securities laws to empower the SEC to oversee self-regulatory

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> conduct a study to review—(1) the costs to parties of an arbitration proceeding using the arbitration system operated by the Financial Industry Regulatory Authority and overseen by the Securities and Exchange Commission as compared to litigation; (2) the percentage of recovery of the total amount of a claim in an arbitration proceeding using the arbitration system operated by the Financial Industry Regulatory Authority and overseen by the Securities and Exchange Commission; and (3) other additional issues as may be raised during the course of the study conducted under this subsection.

This provision mandating a Comptroller General study did not survive the conference committee mark-ups.

46. *See supra* notes 8-17 and accompanying text.

47. Dodd-Frank may obviate the need for the AFA altogether, at least with respect to consumer disputes, as the new law creates a Bureau of Consumer Financial Protection empowered to, among other things, prohibit pre-dispute arbitration clauses in consumer financial products and services contracts. H.R. 4173 §§ 1011, 1028.

48. This delegation also might explain why section 921 of Dodd-Frank, by its terms, applies only to arbitration of federal securities law claims, and not state law claims as well. If the SEC ultimately exercises its new power to ban PDAAs in customer agreements, it could exclude PDAAs with respect to state law claims, returning the industry to the pre-*McMahon* bifurcation of federal and state claims. *See* Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985) (holding that, when a complaint raises both federal securities law and pendent state law claims, district court must compel arbitration of state law claims and retain jurisdiction over federal statutory claims).

organization ("SRO") rule-making, including SRO arbitration.[49] As a result, the SEC has been in the business of examining the fairness of securities arbitration for the past thirty-five years. Congress might not have wanted to usurp a function for which the SEC has far more experience and expertise.

Yet, even under this view, a legislative enactment was necessary, because the SEC has taken the position that it did not have the power to ban PDAAs in customer agreements before this express legislative authorization. This position stems from the Supreme Court's seminal decisions in *Shearson/American Express v. McMahon*[50] and *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[51] which held that claims arising under the Securities Exchange Act of 1934 and the Securities Act of 1933, respectively, are arbitrable. Those decisions also reiterated the Court's previous holding that FAA § 2's declaration that PDAAs are irrevocable and enforceable could only be trumped by clear evidence that Congress did not intend those statutory rights to be arbitrable.[52] The Court concluded that provisions in those Acts that declare void "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Act]" did not constitute clear Congressional intent to ban arbitration of claims arising under these Acts.[53] Since Congress has not amended the federal securities laws to add any other clear evidence since those decisions, the SEC reasons, any regulation it adopted banning PDAAs in customer agreements would exceed its statutory authority. In other words, unless Congress tells the SEC it has the explicit authority to ban PDAAs in customer agreements, the SEC will not ban them, even if it concludes that doing so would further its investor protection mission.

While SEC studies of the FINRA arbitration process and any resulting rule-making will take time, it is not inconceivable that the mandatory securities arbitration regime as we know it today will cease to exist in the not-too-distant future. In the next section of this essay, I

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49. The SEC has oversight authority over SRO securities arbitration pursuant to section 19(b) of the Securities and Exchange Act of 1934 (the '34 Act), 15 U.S.C. § 78s(b) (2006), which requires SEC approval of any changes to the SRO securities arbitration rules. The SEC is required to find that any proposed change is "consistent with the requirements of [the '34 Act] and the rules and regulations thereunder," including the requirement that the rule protect investors and be in the public interest. *Id.* § 78s(b)(2).

50. 482 U.S. 220 (1987).

51. 490 U.S. 477 (1989).

52. *See id.* at 483; *McMahon*, 482 U.S. at 226-27.

53. *See Rodriguez*, 490 U.S. at 482-83; *McMahon*, 482 U.S. at 227-28.

examine whether the SEC should tinker with this regime.

III. The SEC Should Not Ban Mandatory Securities Arbitration

Although Congress has now provided the requisite authority to the SEC to ban mandatory arbitration (or, as some legislators think, Congress has that authority directly), I do not believe the SEC or Congress should exercise that authority. In 2008, I argued that securities arbitration, which takes place primarily in FINRA's dispute resolution forum, is fair to investors, when measured against hallmarks of procedural fairness.[54] I based my assessment on an analysis of the rules and practices of the forum and my own experiences with the process, not only as an arbitrator, but also as a lawyer who has represented both claimants and respondents in customer and intra-industry disputes.

On the other hand, empirical research shows that investors *perceive* that securities arbitration is unfair.[55] In 2006-08, Professor Barbara Black of the University of Cincinnati College of Law and I conducted a mailed survey of participants' perceptions of fairness in recent securities arbitrations.[56] Our survey results demonstrated that: "(1) investors have a far more negative perception of securities arbitration than all other participants, (2) investors have a strong negative perception of the bias of arbitrators in the securities arbitration forum, and (3) investors lack knowledge of the securities arbitration process."[57] While we contended that, at least in part, factors other than the substantive fairness of the forum are responsible for investors' negative perceptions of FINRA arbitration,[58] we acknowledged that the survey's results clearly called for some type of reform.[59] I do not, however, believe that a blanket ban on

54. *See* Gross, *supra* note 26, at 518.

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

56. *Id.*

57. *Id.* at 354.

58. *Id.* at 391-99.

59. In fact, in direct response to the survey results, FINRA enacted several reforms of its arbitration procedures, including requiring arbitrators to write an "explained decision" if all parties request it, *see* Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure To Require Arbitrators To Provide an Explained Decision Upon the Joint Request of the Parties, 74 Fed. Reg. 6928-29 (Feb. 11, 2009) (citing survey results as one catalyst for the revised rule change proposal), and introducing the Public Arbitrator Pilot Program to give customers the option of having their dispute decided by an all-public panel. *See* FINRA Dispute Resolution, Public

mandatory arbitration is the answer. As Professor Black and I wrote:

> As longtime observers of securities arbitration, we continue to believe that it is a better alternative to litigation. Nevertheless, the survey's findings are troublesome. Despite FINRA's commendable efforts to improve the process, these efforts will likely prove unsuccessful in winning customers' confidence so long as they are required to accept both an industry arbitrator and an unexplained award. . . . [I]n light of these findings of customers' dissatisfaction and perceptions of unfairness, the indisputable reality is that it is incumbent upon regulators, the forum, and the industry to work toward further improvements in the system. We believe that these suggested reforms [eliminating the industry arbitrator and requiring explained awards upon any party's request] may help to improve investors' perceptions and obviate the need for Congressional action.[60]

Because I believe that any flaws in the system can be reformed from within, I believe the SEC should not prohibit pre-dispute arbitration clauses in customer agreements with their securities brokerage firms nor should the AFA, if ever enacted, cover securities disputes. Securities arbitration is vastly different from the consumer arbitration that the AFA is designed to remedy for many important reasons. First, the SEC robustly exercises its extensive authority to oversee the primary securities SRO, FINRA, including its dispute resolution arm.[61] This SEC oversight is designed to ensure that FINRA's rules, including its Code of Arbitration Procedure, are fair and protect investors. By contrast, no administrative agency reviews the rules, procedures or protocols of consumer or non-securities employment arbitration forums. In that context, no oversight agency exists to mandate reform if party participants perceive substantive injustices or procedural deficiencies.

Arbitrator Pilot Program Frequently Asked Questions, http://www.finra.org/ArbitrationMediation/Parties/ArbitrationProcess/NoticesToParties/P116995 (last visited March 13, 2010).

60. Gross & Black, *supra* note 55, at 400-01.

61. *See supra* note 49 and accompanying text. *See also* Gross, *supra* note 26, at 512-17.

Second, FINRA Conduct Rule 3110(f) prescribes language that member firms must include in their customer agreements, if they include a PDAA, which discloses to customers that the agreement contains an arbitration clause and that they are relinquishing rights by signing the agreement. The Rule also precludes brokerage firms from including unfair provisions, or provisions that limit a customer's rights and remedies, in investor PDAAs, thus promoting fairness for the investor-claimant.[62] Thus, for example, unlike adhesive class action waivers that appear routinely in consumer arbitration clauses, FINRA bars brokerage firms from imposing class action waivers in their PDAAs, and FINRA Dispute Resolution does not permit class arbitrations, thus freeing investors to pursue class action claims in court.[63]

Third, FINRA's Code of Arbitration Procedure for Customer Disputes ("Customer Code") contains provisions that expressly contradict the types of unfair consumer arbitration provisions that the AFA targets, including required notice of the claim,[64] an opportunity to be heard,[65] a right to be represented,[66] a hearing location convenient for the customer,[67] and decision by neutral arbitrator(s).[68] The Customer Code permits extensive document discovery while discouraging time-consuming and costly depositions.[69] It also explicitly empowers arbitrators to impose sanctions on any party for discovery intransigence.[70] The Code also stringently limits costly and potentially forum-prohibitive dispositive motions.[71]

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62. NASD CONDUCT R. 3110(f)(4) provides:

> No predispute arbitration agreement shall include any condition that:
> (A) limits or contradicts the rules of any self-regulatory organization;
> (B) limits the ability of a party to file any claim in arbitration;
> (C) limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement;
> (D) limits the ability of arbitrators to make any award.

63. CUSTOMER CODE R. 12204.
64. CUSTOMER CODE R. 12300, 12301.
65. CUSTOMER CODE R. 12600.
66. CUSTOMER CODE R. 12208.
67. CUSTOMER CODE R. 12213.
68. CUSTOMER CODE R. 12400, 12408, 12414.
69. CUSTOMER CODE R. 12505-12513.
70. CUSTOMER CODE R. 12511.
71. CUSTOMER CODE R. 12504.

Fourth, FINRA Dispute Resolution facilitates forum access to investors. FINRA subsidizes forum fees by charging securities industry parties a greater percentage of its costs than investors, rendering investors' costs to pursue securities arbitration substantially lower relative to consumer arbitration.[72] The Customer Code provides for the waiver of filing fees upon ample demonstration of financial hardship.[73] It provides liberal rules for representation by attorneys and non-attorneys.[74] It assists *pro se* investors with their filings and supports law school clinics to fill gaps in representation.[75] It designates a convenient hearing location based on the customer's residence, not on the brokerage firm's place of business.[76] It permits direct communication between parties and arbitrators to reduce costs and increase efficiencies.[77] Finally, it provides a special, expedited procedure for default proceedings against a member firm whose membership privileges have been terminated, suspended, canceled, or otherwise defunct, or against an associated person whose registration is terminated, revoked or suspended.[78]

Fifth, FINRA Dispute Resolution actively promotes transparency of the arbitration process. Its user-friendly website is replete with guides, resources and links to materials that are helpful to users of the forum—both parties and their representatives.[79] To enhance arbitrator accountability, it recently amended its rules to require arbitrators to write an explained decision, if all parties jointly request one.[80] It regularly tracks and publishes statistics regarding the speed of resolution and the

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72. *See* Rick Ketchum, Chairman & CEO, FINRA, Testimony Before the Committee on Financial Services, 111th Cong. (Oct. 6, 2009) (transcript available at http://www.finra.org/Newsroom/Speeches/Ketchum/P120108) (stating that "FINRA-registered firms pay for most arbitration costs and FINRA waives fees for individuals experiencing financial hardship."). *See also* CUSTOMER CODE R. 12901.

73. *See* Ketchum, *supra* note 72. *See also* CUSTOMER CODE R. 12901, 12900(a)(1).

74. CUSTOMER CODE R. 12208.

75. In particular, the forum lists resources for unrepresented parties to help them find a lawyer able to represent them. *See* FINRA, Arbitration and Mediation, How to Find an Attorney (2010), http://www.finra.org/ArbitrationMediation/Parties/Overview/HowToFindAnAttorney (last visited Mar. 13, 2010).

76. CUSTOMER CODE R. 12213.

77. CUSTOMER CODE R. 12211.

78. CUSTOMER CODE R. 12801.

79. *See* FINRA, Arbitration and Mediation, Resources for Parties, http://www.finra.org/ArbitrationMediation/Parties/ (last visited July 26, 2010).

80. CUSTOMER CODE R. 12904(g). For a discussion of the pros and cons of explained awards in arbitration, see Barbara Black & Jill I. Gross, *The Explained Award of Damocles: Protection or Peril in Securities Arbitration*, 34 SEC. REG. L.J. 17 (2006).

outcomes of customer cases.

Sixth, FINRA ensures that, if an arbitration panel awards damages, the investor will collect those damages promptly as long as the losing party or parties have assets. The Customer Code mandates that "[a]ll monetary awards shall be paid within 30 days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction."[81] This power sharply deters any industry-related party from stalling or resisting payment of an award. Statistics show that customers win an award of damages in roughly forty percent of cases that proceed to a hearing.[82] Collection agencies are rarely needed for investors to obtain their awards, in part because FINRA retains the power to suspend or revoke the license of any broker-dealer that does not pay an award within thirty days.[83] In sum, the features of FINRA Dispute Resolution's arbitration process distinguish it from many of the forums that regularly hear consumer disputes and render it more fair.

Supporters of the ban on mandatory securities arbitration contend that these many distinguishing characteristics still do not justify depriving investors of choice. Under the regime these advocates seek, if investors want arbitration, they can choose it post-dispute under Customer Code 12200, which permits customers to demand that a FINRA member firm and/or associated person of that firm arbitrate disputes arising "in connection with the business activities of the member or the associated person."[84] If investors do not want to arbitrate a particular dispute, a member firm or associated person could not compel it. As an investor advocate, I have difficulty arguing against enhanced investor choice.

Yet numerous factors persuade me that this legislated regime would ultimately not benefit investors. First, investors' claims would face a far more hostile environment in court, as the rule of law, particularly in federal court, is far more anti-investor than the equitable principles that

81. CUSTOMER CODE R. 12904(j).

82. *See* FINRA, Summary Arbitration Statistics January 2010, *available at* http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm (including historical data for results of customer claimant arbitration award from 2005 through January 2010).

83. *See* FINRA BY-LAWS, ARTICLE VI, SECTION 3(b), SUSPENSION OR CANCELLATION (2007), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4625. *See also* CUSTOMER CODE R. 12904; NASD NOTICE TO MEMBERS 00-55, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003993.pdf.

84. CUSTOMER CODE R. 12200.

an arbitration panel can employ to deliver justice.[85] Instead of recovering some amount of damages in more than forty percent of their claims,[86] investors would face significant procedural hurdles to even survive the pleading stage of a lawsuit, which can drag on for several years. They would also have to bear the costs of extensive discovery, primarily depositions, which are not permitted in FINRA arbitration. By contrast, mandatory securities arbitration results in substantially lower barriers to entry for the average investor to have a dispute decided.

Second, eliminating mandatory securities arbitration would result in higher transaction costs for investors.[87] Resolution of customer disputes would occur in a bifurcated fashion, as customers could pursue claims in both FINRA arbitration and in court.[88] Broker-dealers would have to alter their business models to account for the higher costs to litigate, rather than arbitrate, most customer disputes. The firms, in turn, would pass on those higher dispute resolution costs to investors in the form of higher account fees and/or commissions.

Third, individual investors, if given the choice of submitting disputes to arbitration or court, might not choose rationally. Recent studies demonstrate that individuals faced with choices do not often choose in their best interests.[89] In fact, there is ample empirical evidence that investors do not even make rational investment decisions when given choices.[90] Rather, they elect the path requiring the least amount of movement or thought (i.e., inertia).[91] Scholars also have argued that

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85. *See* Black & Gross, *supra* note 28, at 1035-40.

86. *See* FINRA, Summary Arbitration Statistics January 2010, *supra* note 82.

87. *See* Yin Wilczek, *Panelist Warns Investor Committee About Dropping Arbitration Agreements*, SEC. LAW DAILY, May 18, 2010 (quoting Professor Barbara Black as stating that "eliminating [PDAAs] would be costly for broker-dealers" and date "'[t]he incentives to support arbitration changes when the system becomes voluntary'"). Professor Ware makes the same argument regarding adhesive arbitration agreements generally, although he does not focus on any particular industry. *See* Ware, *supra* note 1, at 254-57.

88. *See supra* note 48 and accompanying text. *See also* Wilczek, *supra* note 87 (reporting that an in-house counsel for a brokerage firm warned that "eliminating pre-dispute mandatory arbitration agreements would cause a 'dual track'" whereby investors could pursue claims in both an arbitration forum and in court).

89. *See generally* Alina Tugend, *Too Many Choices: A Problem That Can Paralyze*, N.Y. TIMES, Feb. 27, 2010, at B5 (describing numerous research studies on individuals' choice failures).

90. Susan Stabile, *Freedom to Choose Unwisely: Congress' Misguided Decision to Leave 401(K) Plan Participants to Their Own Devices*, 11 CORNELL J. L. & PUB. POL'Y 361, 391-94 (2002) (identifying heuristics and cognitive biases that impede investors' rational decision-making in their 401(k) plans).

91. *Id.* at 376 n.76 (2002) (citing Brigitte C. Madrian & Dennis F. Shea, *The Power*

numerous cognitive and psychological barriers block disputants from choosing the most efficient or suitable dispute resolution mechanism.[92] Instead, they choose the "default" mechanism, which, in this case, would be litigation.[93]

Recent process choices posed to customers who have filed arbitration demonstrate the validity of this research. For example, FINRA's Public Arbitrator Pilot Program gives investors in eligible cases the right to opt into the pilot in order to gain the option to strike all non-public arbitrators, and thus avoid the appointment of an industry-affiliated arbitrator in customer cases. Theoretically, strategic and rational investors should opt into the program whenever eligible, as it only enhances their choices as to the composition of their arbitration panels in three-arbitrator cases. Yet, through December 31, 2009, barely half of investors (fifty-four percent) opted into the program.[94] And, in those cases, less than half (forty-nine percent) struck all proposed non-public arbitrators.[95] Thus, giving investors the choice of dispute resolution mechanisms under the proposed regime might not lead to rational decision-making and might not maximize investors' interests.

Fourth, eliminating mandatory securities arbitration could backfire and lead to the repeal of FINRA Customer Code 12200. If broker-dealers can no longer present their customers with adhesive arbitration agreements, will broker-dealers then seek to overturn SRO rules imposing on broker-dealers a duty to arbitrate?[96] While the Chief Executive Officer of FINRA, Richard Ketchum, publicly states that FINRA will not seek to repeal Rule 12200,[97] the issue is far from

of Suggestion: Inertia in 401(k) Participation and Savings Behavior, 116 Q. J. ECON. 1149 (2001)) (finding that the vast majority of employee-participants in open 401(k) plan enrollment do not alter the default investment participation selected by the employer).

92. Maurits Barendrecht & Berend R. de Vries, *Fitting the Forum to the Fuss with Sticky Defaults: Failure in the Market for Dispute Resolution Services?*, 7 CARDOZO J. CONFLICT RESOL. 83, 93-111 (2005) (theorizing that psychological and cognitive biases result in disputants selecting litigation as the "default" dispute resolution mechanism).

93. *Id.*

94. 1 FINRA, THE NEUTRAL CORNER 7 (2010).

95. *Id.*

96. In a 2008 article, Professor Stephen Ware asked the related question of "whether fewer broker-dealers would present their customers with adhesive arbitration agreements if SRO rules stopped imposing on broker-dealers a duty to arbitrate?" *See* Stephen J. Ware, *What Makes Securities Arbitration Different from Other Consumer and Employment Arbitration?*, 76 U. CIN. L. REV. 447, 452 (2008).

97. *Seminar Highlights: Revisiting Mandatory Arbitration*, 2009 SEC. ARBITRATION COMMENTATOR, no. 3 (Sec. Arbitration Commentator, Inc., Maplewood, N.J.), Apr. 2010, at 5 (reporting that Mr. Ketchum has "made it clear that FINRA's rule mandating BD arbitration at the demand of customers will stay, regardless of the PDAA's fate").

resolved, as SIFMA has publicly contended that this potentially one-sided arbitration system would be patently unfair to the securities industry.[98]

If the SEC were to permit the repeal of Rule 12200, customers and industry parties would likely not submit to post-dispute arbitration for the same cases. Once a dispute has arisen, and the parties must select the forum for a dispute whose details, including its strengths and weaknesses, are known, then customers would likely select arbitration in cases where the equities are on their side, and brokerage firms would prefer arbitration in cases where the equities are on their side. Since the equities usually favor one side or the other in a particular case, then the two sides would rarely agree to arbitrate the same case, even if generally they are receptive to the possibility of arbitration.[99]

Moreover, industry players would have good reason to decline a customer's post-dispute request for arbitration, especially for smaller cases. Because litigation costs would be prohibitive for low dollar-value disputes, and willing practitioners would be scarce, customers would likely decide not to pursue the claims. The time delays and costs of proceeding in court would likely discourage many customers from seeking relief.

As a result, most customer disputes, particularly larger dollar value disputes, presumably will end up in court, and the number of customer arbitrations would decline precipitously.[100] With a diminished case

98. *See* Yin Wilczek, *Crisis Caused Spike, Different Trends in Arbitration Cases, FINRA Official Says*, THE BUREAU OF NAT'L AFFAIRS (Jan. 11, 2010), http://corplawcenter.bna.com/pic2/clb.nsf/id/BNAP-7ZHVEN?OpenDocument (noting SIFMA associate general counsel's argument that "'[i]t is unacceptable' that the choice to arbitrate is at the sole election of investors" and quoting him as saying that "[t]he choice should be given to both parties"). Professor Ware agrees, noting that securities arbitration is different from employment and consumer arbitration, and contending that it is bad policy to have securities laws require brokerage firms to submit to arbitration upon demand of a customer or employee. He points out that enforcing PDAAs in brokerage firm customer agreements is a preferred method of mandating arbitration because it preserves contractual freedom. *See* Ware, *supra* note 96, at 457.

99. Ware, *supra* note 1, at 263. *See also* Seth Lipner, *Should Securities Arbitration Be Mandatory?*, FORBES.COM, June 29, 2009, http://www.forbes.com/2009/06/29/lipner-mandatory-arbitration-intelligent-investing-consumer-choice.html.

100. One recent study found that, when FINRA changed its arbitration code to permit employees of FINRA member firms to opt out of their mandatory employment arbitration agreements with respect to statutory discrimination claims, the case volume of employment discrimination claims plummeted at FINRA. *See* David B. Lipsky, Ronald L. Seeber & J. Ryan Lamare, *The Arbitration of Employment Disputes in the Securities Industry: A Study of FINRA Awards, 1986-2008*, DISP. RESOL. J., Feb.-Apr. 2010, at 12, 59.

volume, FINRA would likely not have the same financial capacity to maintain an efficient, subsidized, and investor-friendly forum.[101]

Finally, if arbitration in FINRA were optional, not mandatory, there would be far less political pressure on FINRA to ensure the fairness of the forum, as the contention that investors were dragged into the forum against their will would no longer be true. This political pressure has been responsible for several procedural reforms over the past decade, including the advent of the Neutral List Selection System, the explained award,[102] the public arbitrator pilot program, and a stricter definition of what constitutes a "public arbitrator."[103] Another impetus for FINRA's investor-friendly practices and procedures would be squandered.

IV. Conclusion

While Congress is unlikely to enact the AFA or any other regulation of securities arbitration due to other legislative priorities in 2010, mandatory securities arbitration may not survive if the SEC exercises its recent and explicitly-granted power to ban it. It seems to be a fundamental and politically appealing policy to provide disputants,

101. Wilczek, *supra* note 87 (reporting that Linda Fienberg, President of FINRA Dispute Resolution, "expressed concern with the 'economics of running the forum' if FINRA only heard small cases").

102. *See supra* note 88 and accompanying text.

103. Recent FINRA rule changes, among other things: (1) expanded the definition of a "non-public arbitrator" to include those who had been associated with a registered broker-dealer or commodities firm during the previous five years (as opposed to three years); (2) clarified that a non-public arbitrator—which already included those who had "retired" from the securities industry—also included those who spent a substantial part of their careers in the securities industry; (3) excluded from the definition of "public arbitrator" (a) anyone who has been associated with the industry for at least twenty years, no matter how long ago that association had ended, and (b) attorneys, accountants and other professionals whose firms have received at least ten percent of their annual revenue, in the previous two years, from securities or commodities industry clients. The rule change also added to the definition of "immediate family member" (whose association with the securities industry is imputed to the arbitrator) parents, children, stepparents, and any member of the arbitrator's household. *See* Order Granting Approval to a Proposed Rule Change Relating to Arbitrator Classification and Disclosure in NASD Arbitrations, 69 Fed. Reg. 21,871 (Apr. 22, 2004). To further ensure the neutrality of arbitrators, in 2006 and 2008, the SEC approved additional rule changes amending the definition of public arbitrators to exclude from the public roster those with indirect ties to the securities industry. *See* Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments to the Classification of Arbitrators Pursuant to Rule 10308 of the NASD Code of Arbitration Procedure, 71 Fed. Reg. 62,026 (Oct. 20, 2006); Order Approving Proposed Rule Change to Amend the Definition of Public Arbitrator, 73 Fed. Reg. 15,025 (Mar. 20, 2008).

including investors, with unfettered access to courts to resolve their disputes. In the current political climate, permitting "repeat players" such as securities brokerage firms with far superior monetary resources and bargaining power to mandate the FINRA arbitration forum through adhesive customer agreements appears unpalatable.

Yet, if Congress or the SEC were to sweep securities arbitration into the wide net of public condemnation of consumer arbitration, it would unduly blemish a system of dispute resolution that, while far from perfect, does not suffer from the flaws of other types of consumer arbitration that the proposed AFA identifies and is designed to combat. Perhaps the system is a victim of "the grass is always greener" mentality, as reformists contend that court is a fairer means of resolution of customer disputes without seriously confronting and considering the drawbacks of securities litigation. Prohibiting PDAAs could endanger the vitality of the securities arbitration system that has developed over the past three decades under extensive SEC oversight.

Instead, as it has done for the past twenty-five years, the SEC should permit the specter of its regulatory oversight to gradually produce internal change. Investor advocates continue to identify areas ripe for change, and the SEC forces FINRA Dispute Resolution to respond. One thing is clear: Whether through internal reform or external policy, securities arbitration as we know it today will not survive much longer.