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Securities Mediation: Dispute Resolution for the Individual Investor

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Securities Mediation: Dispute Resolution for the Individual Investor

JILL I. GROSS*

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The individual investor must feel like a contestant on *Let's Make A Deal*.¹ First, to pursue claims for damages stemming from misconduct by their securities brokers, investors opened Door Number One—litigation,

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¹ *Let's Make A Deal* was a popular television game show that aired in the 1960s and 1970s on which contestants were "Traders" who would attempt to negotiate "trade ups" of household items to better prizes. At the end of the show, for the "Big Deal of the Day," Traders would have to choose among Door Number One, Door Number Two, or Door Number Three, to guess which Door revealed the most valuable prize. See *Let's Make A Deal Show Info*, <http://www.letsmakeadeal.com/showinfo.htm> (last visited Nov. 3, 2005).

along with its advantages of the jury trial and access to punitive damages. In response, courts imposed great responsibilities on investors before they could recover damages.² Courts also rebuffed investors' attempts to expand the liability of securities industry participants for treating them unfairly.³

Despite this seemingly unmatched advantage, the securities industry fought hard to transfer resolution of customer disputes from the courts to the arbitration venue.⁴ This fight led to the Supreme Court's holding in the late 1980s that federal securities law claims were arbitrable and thus pre-dispute arbitration agreements in customers' brokerage account agreements were enforceable.⁵ Courts closed Door Number One.

Investors then opened Door Number Two—arbitration—to pursue claims against their brokers and their firms. Regulatory oversight of the securities arbitration forums to support the goal of investor protection lent an air of fairness to the process.⁶ At the same time, however, reforms designed to alleviate investors' concerns transformed a formerly quick and informal process into a system resembling litigation.⁷ Parties quickly discovered that securities arbitration was more expensive and slower than the industry thought it would be, and required a mastery of many rules and procedures. Moreover, the securities industry, in a classic case of "be careful what you wish for," started doubting the wisdom of its preference for binding

² 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, 1037 (2002) (reporting that courts today expect investors to possess a certain level of sophistication to comprehend investing in modern investment products in order to be deemed "reasonable").

³ See Barbara Black & Jill I. Gross, *Economic Suicide: The Collision of Ethics and Risk In Securities Law*, 64 U. PITT. L. REV. 483, 499–507 (2003) (arguing that there is scant judicial support for imposition of liability on brokers for failing to warn against, monitor, or stop their customers' risky investment choices).

⁴ See *New York Stock Exchange, Inc., Symposium on Arbitration in the Securities Industry*, 63 FORDHAM L. REV. 1495, 1511–12, 1517–18 (1995) [hereinafter *NYSE Symposium*] (discussing securities industry's support for enforceability of predispute arbitration clauses in brokerage account agreements).

⁵ *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989) (holding that claims arising under the Securities Act of 1933 are arbitrable); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (holding that claims arising under the Securities Exchange Act of 1934 are arbitrable). Because virtually all broker-dealers include a pre-dispute arbitration clause in their customer account agreements, this holding mandated the arbitration of almost every customer dispute.

⁶ See discussion *infra* Part II.A.1.

⁷ See Black & Gross, *supra* note 2, at 998–1005.

arbitration and sought judicial intervention to overturn arbitration awards.⁸ Door Number Two had its problems.

In 1989, the National Association of Securities Dealers (NASD)⁹ began offering mediation as an alternative to arbitration. Mediation is a process in which a third party neutral (the mediator) assists disputing parties in settling their dispute.¹⁰ NASD believed that mediation would give parties more control over the outcome of their disputes,¹¹ allow parties to resolve their disputes more quickly than arbitration, and trim parties' expenses.¹² Since 1989, securities mediation administered by NASD Dispute Resolution (NASD-DR)¹³ has exploded.¹⁴

⁸ See Barbara Black, *The Irony of Securities Arbitration Today: Why Do Brokerage Firms Need Judicial Protection?*, 72 U. CIN. L. REV. 415, 416 (2003).

⁹ NASD is the securities industry's largest self-regulatory organization (SRO), and is registered with the Securities and Exchange Commission as a national securities association pursuant to §15A of the Securities Exchange Act of 1934. 15 U.S.C. § 78o-3 (2004).

¹⁰ See NASD Dispute Resolution, *Mediation: An Alternate Path*, http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=530 (last visited Nov. 3, 2005) [hereinafter *Mediation: An Alternate Path*] (defining mediation as "non-binding negotiation facilitated by an experienced and independent neutral"); see also MARTIN DOMKE, DOMKE ON COMMERCIAL ARBITRATION (The Law and Practice of Commercial Arbitration) § 3.15 (3d ed. 2003) (defining mediation as a process in which "participants, together with the assistance of a neutral person or persons, systematically isolate disputed issues in order to develop options, consider the alternatives, and reach a consensual settlement that will accommodate their needs"); UNIF. MEDIATION ACT, § 2(1) (2001) (defining mediation as "a process in which a mediator facilitates communication and negotiation between parties to assist them in reaching a voluntary agreement regarding their dispute"). For a variety of other similar definitions, see KIMBERLEE KOVACH, MEDIATION: PRINCIPLES AND PRACTICE 27-28 (3d ed. 2004).

¹¹ Parties have more control because they are the decision-makers and the mediator fills an advisory rather than an adjudicatory function. While some mediators may make a settlement recommendation to the parties, that recommendation is only advisory. The parties, however, can choose to enter into a binding settlement agreement embodying that recommendation. See David S. Ruder, Chairman, SECURITIES ARBITRATION REFORM, REPORT OF THE ARBITRATION POLICY TASK FORCE TO THE BOARD OF GOVERNORS, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. 47 (1996) [hereinafter *Ruder Report*].

¹² See NASD Solicits Comment on New Mediation Program and Draft Mediation Rules, NASD Notice to Members 95-1, at 1 (Jan. 1995) [hereinafter NASD Notice to Members 95-1], available at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000407 (follow "1995" hyperlink; then follow "95-1" hyperlink).

¹³ In 2000, NASD spun off its arbitration and mediation department as a wholly-owned subsidiary, and re-named it NASD Dispute Resolution, Inc. See Press Release, NASD Dispute Resolution, Inc., NASD Launches New Dispute Resolution Subsidiary

How does the opening of Door Number Three—mediation—affect dispute resolution for the individual investor? First, the emergence of an alternative dispute resolution (ADR) device for customer-broker disputes inevitably raises the question of whether mediation is the “appropriate”¹⁵ mechanism to resolve these disputes.¹⁶ In other words, is mediation more suitable than other devices such as negotiation, arbitration or litigation?

Professors Sander and Goldberg’s seminal work in developing a “user-friendly guide” for parties to choose an appropriate dispute resolution procedure sets forth a presumption that mediation is preferred to other ADR devices absent *contrary indications*, because it has the greatest chance of “overcoming the impediment to settlement.”¹⁷ Sander and Goldberg also note, however, that in a context like customer-broker disputes where one party, the customer, seeks to maximize his or her monetary recovery and has no intention of doing business with the adverse party, the broker, again, *contrary indications* are generally present. In such a context, public adjudication (i.e., court) is more likely than mediation to achieve this singular goal.¹⁸ Yet, in the context of investors’ disputes, where the

(July 17, 2000), available at http://www.nasd.com/stellent/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_011399&ssSourceNodeId=557.

¹⁴ Current estimates by industry players indicate “some 2,000 disputes are being mediated in the securities arena each year.” *Seminar Highlights: SIA C&L Conference*, SEC. ARB. COMMENTATOR, Apr. 2004, at 9 (reporting on speeches at SIA Compliance and Legal Division’s Annual Conference). Mediation filings have increased steadily since 1989, peaking at 1,217 cases filed for mediation in 2004. *See NASD Stats, 2004*, SEC. ARB. ALERT 2005-02-01 (Jan. 12, 2005).

¹⁵ Carrie Menkel-Meadow has advanced the notion that the “A” in ADR should stand for “appropriate,” rather than “alternative.” *See* Carrie Menkel-Meadow, *Whose Dispute Is It Anyway?: A Philosophical And Democratic Defense of Settlement (In Some Cases)*, 83 GEO. L. J. 2663, 2689–90 (1995). Much of the current ADR literature has adopted this suggestion.

¹⁶ *See* Jean R. Sternlight, *ADR Is Here: Preliminary Reflections on Where It Fits In A System of Justice*, 3 NEV. L.J. 289, 296 (2003) (noting that “various forms of dispute resolution have different impacts on individual disputants and on society as a whole” and stating that “it is clear that societies must make self-conscious choices as to which dispute resolution methods should be preferred for particular disputes”).

¹⁷ Frank E.A. Sander & Stephen B. Goldberg, *Fitting the Forum to the Fuss: A User-Friendly Guide to Selecting An ADR Procedure*, 10 NEGOT. J. 49, 59–60 (1994) (explaining that selection of an appropriate dispute resolution process for a particular dispute should take into account multiple variables).

¹⁸ *Id.* at 53. Others have argued that settlement (whether direct or assisted) between two parties of vastly different resources (e.g., the small investor against the wealthy brokerage firm) can result in an unfair outcome for the disadvantaged party, and thus the disadvantaged party should prefer public adjudication of the dispute. One frequently cited

courtroom door is mainly closed due to the pre-dispute arbitration clause in the customer agreement, and arbitration has the identifiable downside of being overly litigious, their generalizations do not hold true. As a result, mediation should remain an “appropriate” dispute resolution option for those cases calling out for a compromised resolution.¹⁹

Second, since mediation is a form of assisted settlement, why can’t investors negotiate directly with firms and brokers? Why is it necessary to involve a third party neutral?²⁰ One simple answer is that one or more of the parties to the dispute (and their lawyers) have unreasonable expectations of the settlement value of the dispute, making settlement impossible without third party interference.²¹ In that circumstance, a mediator can alter those unreasonable expectations sufficiently to make settlement more possible.²²

article advocating this view is Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073 (1984). Fiss argues that many types of cases are not appropriate for settlement. *Id.* at 1076. *But see* Menkel-Meadow, *supra* note 15 (critiquing this view); Jeffrey Seul, *Settling Significant Cases*, 79 WASH. L. REV. 881 (2004) (critiquing Fiss’ argument that disputes about “moral-laden issues” are not appropriate for settlement).

¹⁹ Certain disputes that are “slam dunk” cases for one side or the other strike me as unsuitable for mediation. This article does not argue that investors and their advocates should utilize mediation in lieu of arbitration for those cases. Rather, this article largely concerns those cases that are not predictable “slam dunks.” For those disputes, investors should consider mediation.

²⁰ Bradley Kaufman, an experienced brokerage firm lawyer, posed this question at PLI’s Securities Arbitration 2004 Program, New York, N.Y. (Aug. 11, 2004) (author’s notes on file) (“Can it really be that lawyers are too lazy to engage in hardcore settlement discussions on their own now that securities mediation has grown into an accepted method of dispute resolution in the industry?”).

²¹ This explanation was offered by two panelists, Kaufman and Robbins, at PLI’s Securities Arbitration 2004 Program, New York, N.Y. (Aug. 11, 2004) (author’s notes on file); *see also* DAVID ROBBINS, SECURITIES ARBITRATION PROCEDURE MANUAL § 16-3 (5th ed. 2003) (explaining that mediation is indicated when “the parties’ contrasting perceptions of the problem prevent them from moving forward”).

²² The literature is rich with discussion and theory as to why direct negotiation between parties may not resolve disputes. Robert Mnookin first identified four categories of barriers to negotiation: (1) strategic barriers arising out of game theory and economic analysis; (2) principal-agent problems; (3) cognitive barriers; and (4) reactive devaluation (the tendency of people to discount the statements and proposals of those with whom they are in conflict). *See* Robert H. Mnookin, *Why Negotiations Fail: An Exploration of Barriers to the Resolution of Conflict*, 8 OHIO ST. J. ON DISP. RESOL. 235 (1993); *see also* Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 MICH. L. REV. 107, 109–10 (1994) (identifying similar barriers). A more recent Mnookin article described three tensions inherent in negotiation: (1) the tension between creating and distributing value; (2) the tension between empathy and assertiveness; and (3) the tension between principal and agents. *See* Robert H. Mnookin, *Strategic Barriers to Dispute Resolution: A Comparison of Bilateral and*

Another plausible explanation is that a mediator can facilitate lawyers' communications with their clients, thereby provoking a willingness of parties to resolve disputes amicably rather than preserve them through continued adversarial tactics.²³ Thus, for those parties that have not succeeded in resolving their dispute through direct negotiation, mediation provides an alternative to arbitration.²⁴

This leads to the third inevitable question that investors want answered before choosing mediation: Is mediation a "fair" alternative to arbitration?²⁵

Multilateral Negotiations, 8 HARV. NEGOT. L. REV. 1 (2003). Other theorists point to wide-ranging factors, such as the mood of the negotiators (see Clark Freshman, *The Lawyer-Negotiator as Mood Scientist: What We Know And Don't Know About How Mood Relates to Successful Negotiation*, 2002 J. DISP. RESOL. 1, 19), habit (see Scott R. Peppet, *Contract Formation in Imperfect Markets: Should We Use Mediators In Deals?*, 19 OHIO ST. J. ON DISP. RESOL. 283, 335 (2004)), and the lawyer's lack of creativity (see Carrie Menkel-Meadow, *The Lawyer as Problem Solver and Third-Party Neutral: Creativity and Non-Partisanship in Lawyering*, 72 TEMPLE L. REV. 785, 801-02 (1999); Jean R. Sternlight, *Lawyers' Representation of Clients in Mediation: Using Economics and Psychology to Structure Advocacy in a Nonadversarial Setting*, 14 OHIO ST. J. ON DISP. RESOL. 269, 366 (1999)).

²³ Other explanations—although less plausible in my view—are that the brokerage industry has an "under siege" mentality due to a recent spike in regulatory activity, and thus industry parties are less willing to settle arbitration cases, and/or that a certain segment of customers' lawyers are new to the field and do not understand settlement dynamics unique to securities arbitrations. Chuck Austin, current President of PIABA, offered these two reasons at PLI's Securities Arbitration 2004 Program, New York, N.Y. (August 11, 2004) (author's notes on file). Austin also questioned whether customer lawyers who had "postured" to prospective clients regarding the strength of their case to persuade the client to hire them then had difficulty switching gears and convincing the client that there were weaknesses in the case sufficient to justify a settlement. *Id.* NASD-DR statistics and its staff's anecdotal experience do not support these hypotheses. Interview with Kenneth Andrichik, Senior Vice President, Director of Mediation and Business Strategies, NASD Dispute Resolution, Inc., in N.Y., N.Y. (September 24, 2004).

²⁴ Some readers might wonder why it is even necessary to make a case for the appeal of mediation. Those readers might wonder why a disputing party would not be willing to try mediation. In my experience, however, many parties and/or counsel to securities disputes think mediation is a waste of time, are reluctant to try an unfamiliar process, fear the settlement pressures of a directive mediator, are not knowledgeable about the amount of party control, and/or believe that mediation is simply another tool of the adversary to extract an advantage for the inevitable arbitration. As a result, it remains necessary to make the case for mediation. See Philip S. Cottone, *Top Ten Specious Reasons Why Securities Lawyers Won't Mediate*, PIABA B.J., Fall 2004, at 73 (debunking reasons).

²⁵ One scholar recently wrote of the need to examine procedural and substantive justice in dispute resolution processes, as she claims most participants in the process concentrate primarily on resolution. Nancy A. Welsh, *Remembering the Role of Justice in*

Recent articles suggest that securities arbitration is better for the investor than litigation,²⁶ but virtually no literature analyzes the fairness of mediation of customer disputes. This paper will seek to fill that gap, exploring the development of securities mediation as a dispute resolution mechanism for investors.

Part I of this article will provide a brief history of ADR in the securities industry (primarily arbitration), and then will describe the emergence of mediation as an alternative to arbitration.

Part II will explore the state and federal statutory regulations that arguably govern the securities mediation process, and their impact on procedural and substantive justice.²⁷ In particular, this section will review the applicability to and impact on securities mediation of the Securities Exchange Act of 1934 (1934 Act),²⁸ the Federal Arbitration Act (FAA),²⁹ and state mediation statutes, including the Uniform Mediation Act.³⁰ In this section, I will argue that the 1934 Act imposes a sufficient level of oversight over mediation to increase its fairness without interfering with its flexibility. I will then demonstrate that the FAA does not apply to mediation. Courts that hold otherwise are imposing an unnecessary layer of regulation over the process, threatening to erode its advantages. I will also argue that state mediation laws are either harmonious with or preempted by forum rules.

Finally, Part III will analyze numerous dimensions of fairness as they apply to securities mediation, such as party choice, legal and procedural justice, substantive outcome, and achievement of non-legal goals. This part of the paper will identify mediation's advantages to the investor, including efficiency, lower cost, and procedural justice (advantages previously cited in connection with arbitration), as well as some of its disadvantages, including the lack of finality, the lack of discovery, and the potential need for compromise of what investors might be legally entitled to in other forums. In

Resolution: Insights from Procedural and Social Justice Theories, 54 J. LEGAL EDUC. 49, 49–50 (2004).

²⁶ Black & Gross, *supra* note 2; Marc I. Steinberg, *Securities Arbitration: Better for Investors Than The Courts?*, 62 BROOK. L. REV. 1503, 1505–06 (1996).

²⁷ Scholars have not reached a consensus on how to measure justice in mediation, or even how to define “justice” in this context. *See infra* notes 218–21 and accompanying text.

²⁸ The specific provisions at issue are those that provide the Securities and Exchange Commission with oversight authority over self-regulatory organizations. *See* 15 U.S.C. § 78s (2004).

²⁹ 9 U.S.C. § 1 *et seq.* (2004).

³⁰ The full text of the UMA is posted on the website of the National Conference of Commissioners on Uniform State Laws, <http://www.law.upenn.edu/bll/ulc/mediat/2003finaldraft.htm> (last visited Nov. 3, 2005).

this part, I conclude that, as measured by these dimensions, securities mediation is a fair method of dispute resolution for the individual investor, and is a viable alternative to arbitration.

I. A BRIEF HISTORY OF ADR IN THE SECURITIES INDUSTRY

A. Securities Arbitration: Fair Yet Litigious

Alternative dispute resolution in the securities industry dates back to the founding of the New York Stock Exchange (NYSE) in the late 1790s, when NYSE clerks ruled on disputes over mismatched trades.³¹ In 1817, the NYSE started using internal arbitration to resolve disputes between members,³² and in 1872 expanded its use to disputes between consenting customers and member firms.³³ In 1935, the newly created Securities and Exchange Commission (SEC) recommended to Congress that the NYSE offer an independent arbitral tribunal for customer cases.³⁴ However, from 1935 until

³¹ Known as "out-trades," these were trades in which, during the trade settlement process, a buy order did not match a sell order, either in price, number of shares, or accrued interest. See Henry C. Lucas, Jr. et al., *Information Technology and the New York Stock Exchange's Strategic Resources from 1982-1999*, #CIS-2002-08, CIS Working Papers Series (May 2002), available at <http://cisnet.baruch.cuny.edu/papers/cis200208.pdf>; see also James Beckley, *Embracing Irrationality: A Functional Test for Vacating Arbitration Awards*, in 2 SECURITIES ARBITRATION 1998, at 537, 539 (David E. Robbins, Chair, PLI 1998) ("Limited judicial review of arbitral awards is a hangover from the earlier simpler days under the Buttonwood Tree where members of the exchange ruled on out-trades.").

³² ROBBINS, *supra* note 21, § 3-10. The NYSE Constitution of 1817 provided that "All Questions of dispute in the purchase of stocks shall be decided by a majority of the Board." Edward W. Morris, Jr., Deborah Masucci & Robert S. Clemente, *Securities Arbitration at Self Regulatory Organizations: New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc., Administration and Procedure*, in 1 SECURITIES ARBITRATION 1992, at 141 (David E. Robbins, Chair, PLI 1992).

³³ *Id.* Subsequent amendments provided for the resolution of all member disputes in arbitration and in places other than New York City. *Id.*

³⁴ See Letter from Joseph P. Kennedy, Chairman, Securities and Exchange Commission, Securities and Exchange Commission letter to Richard Whitney, NYSE President, Exchange Act Release No. 34, 131, (1935 WL 29028, at *3) (Mar. 21, 1935). At first, the NYSE responded that the customer could elect to go to court in lieu of arbitration before the Exchange. The SEC replied that the NYSE could circumvent this election by "encourage[ing] its members to offer customers a standard arbitration agreement requiring that resort be had to arbitration at the election of either the customer or the member, and providing for arbitration before independent arbitral tribunals at the election of the customer." *Id.*

the 1960s, very few customer disputes ended up in litigation or arbitration.³⁵

In the 1960s, following a successful attempt by a firm to compel arbitration of a NYSE customer dispute,³⁶ brokerage firms started enforcing—against their customers' wishes—previously ignored pre-dispute arbitration agreements (PDAAs) in their customer contracts.³⁷ The NASD, a self-regulatory organization (SRO) that was growing in size and importance to the industry, adopted its first Code of Arbitration Procedure in 1968, providing an alternative to the NYSE for the arbitration of customer disputes.³⁸ To increase the use of arbitration, the securities SROs further developed their arbitration procedures through the 1970s and 1980s,³⁹ and the securities industry resisted challenges by customers to the enforceability of PDAAs.⁴⁰ In the late 1980s, the Supreme Court agreed with the industry, reversed long-standing precedent,⁴¹ and held that federal securities claims arising out of customer account agreements were arbitrable.⁴²

Following these Supreme Court decisions, most customer disputes with their broker-dealers have been resolved in an arbitration forum sponsored by a securities SRO—either NASD-DR or the NYSE Arbitration Department.⁴³ While securities arbitration is still touted as an inexpensive, efficient and fair dispute resolution mechanism for disputes between customers and brokers,⁴⁴

³⁵ ROBBINS, *supra* note 21, § 3-10.

³⁶ See *Colonial Realty Corp. v. Bache*, 358 F.2d 178 (2d Cir. 1966). The firm prevailed in the arbitration as well.

³⁷ Morris, Masucci & Clemente, *supra* note 32, at 141.

³⁸ See Deborah Masucci, *Securities Arbitration—A Success Story: What Does The Future Hold?*, 31 WAKE FOREST L. REV. 183, 185 (1996).

³⁹ See Constantine N. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 FORDHAM L. REV. 279, 283–84 (1984); Norman S. Poser, *Making Securities Arbitration Work*, 50 SMU L. REV. 277, 280–87 (1996); see also Black & Gross, *supra* note 2, at 998–1005 (discussing development of arbitration procedures).

⁴⁰ See *NYSE Symposium*, *supra* note 4, at 1511–12, 1517–18 (discussing securities industry's support for enforceability of pre-dispute arbitration clauses in brokerage account agreements); see also Norman S. Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration*, 59 BROOK. L. REV. 1095, 1097 (1993) (noting that the “securities industry fought persistently for mandatory arbitration”).

⁴¹ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁴² *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987). For a more in-depth discussion of the reasons behind the Supreme Court's overruling of *Wilko*, see Black & Gross, *supra* note 2, at 995–98.

⁴³ See Black & Gross, *supra* note 2, at 991–92. More than ninety percent of these arbitrations are conducted in the NASD-DR.

⁴⁴ See Masucci, *supra* note 38, at 190–200 (discussing benefits of securities arbitration); *Ruder Report*, *supra* note 11, at 1 (finding securities arbitration to be a

and despite the enactment of many reforms in recent years, criticisms abound.⁴⁵ These criticisms include: (1) NASD-DR, as a wholly-owned subsidiary of NASD, is not independent enough to offer so-called neutral arbitration services;⁴⁶ (2) the consensual nature of arbitration is meaningless since every brokerage firm in the country requires that customers enter into a PDAA to open a customer account and, therefore, have no choice but to submit to arbitration;⁴⁷ (3) brokerage firms, as repeat players in the arbitration forum, have a competitive advantage over investors;⁴⁸ and (4) the presence of arbitrators on panels affiliated with the securities industry in some capacity reduces the panels' neutrality.⁴⁹ Some scholars and forum

"relatively efficient, fair, and less costly forum for resolution of disputes involving public investors, member firms, and firm employees" but also stating "that many areas for improvement of the system exist"); Securities Industry Association, *Arbitration Is Fair, Fast and Economical for Investors* (Jan. 29, 2004), <http://www.sia.com/press/pdf/ArbitrationTalkingPoints2003.pdf>.

⁴⁵ See, e.g., Richard Karp, *Hardball*, BARRON'S, Oct. 20, 2003 (stating that "securities arbitration cases are surging—and turning nasty"); Gary Weiss, *Walled Off From Justice?*, BUSINESSWEEK, Mar. 22, 2004, at 90–92 (reporting on difficulties investors face in securing awards from arbitration panels); *Ruder Report*, *supra* note 11, at 7–11 (reporting that the "increasingly litigious nature of securities arbitration has gradually eroded the advantages of SRO arbitration" and recommending numerous reforms).

⁴⁶ See Rachel McTague, *Mass. Securities Director Critiques NASD, Says Industry Bias Seen in Arbitration Forum*, SEC. L. DAILY, July 21, 2004 (reporting that the Director of Massachusetts Securities Division urged that securities arbitrations be run by an independent entity).

⁴⁷ See, e.g., Russell D. Feingold, *Mandatory Arbitration: What Process is Due?*, 39 HARV. J. ON LEGIS. 281, 290 (2002) (arguing that mandatory arbitration is unfair); Richard E. Speidel, *Contract Theory and Securities Arbitration: Whither Consent?*, 62 BROOK. L. REV. 1335, 1339 (1996) (arguing for increased SEC oversight of securities arbitration due to the decline of consent by investors). It is beyond the scope of this paper to explore the significance of the lack of customer consent to the arbitration clause.

⁴⁸ See Carrie Menkel-Meadow, *Do the "Haves" Come Out Ahead in Alternative Judicial Systems? Repeat Players in ADR*, 15 OHIO ST. J. ON DISP. RES. 19, 50–52 (1999); Richard A. Voytas, Jr., *Empirical Evidence of Worsening Conditions for the Investor in Securities Arbitration*, 12 SECURITIES ARBITRATION COMMENTATOR 7 (2002).

⁴⁹ See Charles Gasparino, *Judging Wall Street*, NEWSWEEK, Sept. 6, 2004, at 56 (reporting that certain claimants' lawyers are criticizing the fairness of securities arbitration due to the presence of arbitrators on panels who also serve frequently as mediators, and are compensated by brokerage firms and thus face a conflict of interest); Michael A. Perino, Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations (Nov. 4, 2002), <http://www.sec.gov/pdf/arbconflict.pdf> [hereinafter *Perino Report*] (reporting that critics of securities arbitrations "consistently point to the presence of industry arbitrators on arbitration panels and the classification of arbitrators as public or

representatives disagree, arguing that securities arbitration is fair to investors.⁵⁰ These conflicting views came to a head at recent Congressional hearings on the subject of the fairness of securities arbitration.⁵¹ In the meantime, investors and industry alike continued the search for alternatives.⁵²

non-public as the primary sources of potential pro-industry bias”). *But see* U.S. GEN. ACCOUNTING OFFICE, REP. NO. GGD-92-74, SECURITIES ARBITRATION: HOW INVESTORS FARE 6-9 (1992) (finding no pro-industry bias in securities arbitration) [hereinafter GAO 1992 REPORT].

⁵⁰ See U.S. GEN. ACCOUNTING OFFICE, REP. NO. GGD-00-115, SECURITIES ARBITRATION: ACTIONS NEEDED TO ADDRESS PROBLEMS OF UNPAID AWARDS 4 (2000) (stating that there was no basis to make any conclusions about the fairness of SRO arbitration proceedings); Barbara Black, *The Eighth James D. Hopkins Lecture: Is Securities Arbitration Fair to Investors?*, 25 PACE L. REV. 1 (2004) (concluding that securities arbitration is a fair alternative to courts for investors, and examining procedural due process components and finding no inherent unfairness); Black & Gross, *supra* note 2, at 1035-47 (arguing that investors fare better in arbitration because the law is anti-investor); Robert S. Clemente & Karen Kupersmith, *Pillars of Civilization: Attorneys and Arbitration*, 4 FORDHAM FIN. SEC. & TAX L.F. 77, 92 (1999) (arguing that securities arbitration “has proven its worth and value”); George H. Friedman, *The Level Playing Field*, 11 SEC. ARB. COMMENTATOR 12 (2001); David S. Ruder, *Elements of a Fair and Efficient Securities Arbitration System*, 40 ARIZ. L. REV. 1101, 1108 (1998) (arguing that securities arbitration “provides clear and significant advantages over the civil litigation system”); Gary Tidwell et al., *Party Evaluation of Arbitrators: An Analysis of Data Collected From NASD Regulation Arbitrations*, Presented to National Meeting, Academy of Legal Studies in Business (Aug. 5, 1999), http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_009528.pdf (concluding that 93.49% of participants in securities arbitration felt their “cases had been handled fairly and without bias”).

⁵¹ See *A Review of the Securities Arbitration System: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Financial Servs. Comm.*, 109th Cong. (2005), available at <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=362&comm=1>. Speakers included representatives of the NASD and NYSE arbitration forums and the securities industry, investors’ advocates, and academics.

⁵² Following a recent recommendation to the SEC that the SROs sponsor independent research to “resolve any lingering concerns about pro-industry bias” in securities arbitration, the Securities Industry Conference on Arbitration is currently sponsoring an empirical study of perceptions of fairness of SRO arbitration. *Perino Report*, *supra* note 49, at 5

To date, available empirical evidence, particularly with respect to investor perceptions of the arbitration process, is fairly limited and only suggests that there are no substantial systemic problems in SRO arbitrations. As a result, this Report recommends that the SROs sponsor additional independent studies to further evaluate the impartiality of the SRO arbitration process.

B. *The Emergence of Mediation as a Dispute Resolution Process in the Securities Industry*⁵³

In 1989, the securities industry introduced mediation as a mechanism to resolve customer disputes.⁵⁴ At that time, the commercial and insurance industries were increasingly using mediation and its success stimulated interest for the securities industry.⁵⁵ Additionally, NASD's arbitration department was facing a rising caseload and a more formal and litigious arbitration process.⁵⁶ As a result, disputants expressed a "renewed interest in alternative forms of dispute resolution that would recapture the informal, low-cost, time-saving advantages that arbitration once provided."⁵⁷

At first, through two pilot programs, NASD⁵⁸ partnered with outside dispute resolution companies that already had been providing securities mediation services.⁵⁹ NASD found that participation in those experimental

⁵³ For a brief history of mediation use generally, see KOVACH, *supra* note 10, at 28–34. While mediation has been around since biblical times, modern mediation has been growing in popularity in the United States since 1976. *Id.* at 1, 31–34.

⁵⁴ Kenneth Andrichik has been the principal individual at NASD responsible for the development of mediation as a viable dispute resolution process other than arbitration offered by NASD to its members. In particular, he felt that there was a more constructive role for lawyers to represent parties in mediation as opposed to arbitration. Interview with Kenneth Andrichik, *supra* note 23.

⁵⁵ See NASD Notice to Members 95-1, *supra* note 12, at 1.

⁵⁶ *Id.*; SEC Approves New NASD Mediation Rules That Take Effect August 1, 1995, NASD Notice to Members 95-62, at 1 (July 1995) [hereinafter NASD Notice to Members 95-62] ("The NASD hopes that a mediation program will help to relieve the weight of this growing number of arbitration cases"); see also Black & Gross, *supra* note 2, at 998–1005 (describing the evolution of the increasingly litigious nature of securities arbitration through the 1990s).

⁵⁷ NASD Notice to Members 95-62, *supra* note 56, at 1.

⁵⁸ Other exchanges and SROs also experimented with mediation services at this time. The National Futures Association started providing some mediation services for its members in 1989. *Ruder Report*, *supra* note 11, at 48. The American Stock Exchange, before it merged its arbitration services with NASD, launched its own mediation pilot program in May 1991, using ENDISPUTE, Inc. as its mediation service provider. That program was also unsuccessful. See W. REECE BADER, *SECURITIES ARBITRATION: PRACTICE AND FORMS* § 12.02 (2003).

⁵⁹ See GAO 1992 REPORT, *supra* note 49, at Appendix II. NASD first partnered with the American Arbitration Association, which had been providing mediation services since 1983, and U.S. Arbitration and Mediation, Inc. In 1991, NASD added JUDICATE, the National Private Court System, as a third mediation service provider. See BADER, *supra* note 58, § 12.02. Those forums did not use any specialized procedures or rules for securities mediation; instead they just offered the same mediation services they offered to customers in other types of disputes. The only perk that these providers offered to

programs was not as high as it had hoped, and its settlement rate was somewhat lower than other industries had experienced.⁶⁰ These early pilot programs did, however, serve to increase awareness of mediation as a viable alternative to arbitration.⁶¹ And, while repeat players in securities arbitration resisted a new and different dispute resolution process, they did not reject the idea of mediation altogether.⁶² Instead, eligible participants expressed the view that NASD should develop its own in-house mediation program, so that disputants would not have to experience the awkward “hand-off” from NASD to an external company.⁶³

After analyzing the history and current market for mediation programs, NASD’s National Arbitration Committee (NAC)⁶⁴ recommended that NASD establish an internal mediation program to resolve securities disputes.⁶⁵ In early 1995, NASD solicited comments on its draft mediation procedures and the structure and provisions of the mediation program proposed by the NAC.⁶⁶ On June 6, 1995, after revising the proposal based on comments received during the comment period⁶⁷ and “further internal NASD review,” NASD filed a proposed rule change with the SEC to amend the NASD Code of Arbitration Procedure to add provisions to govern the administration of mediation and solicited public comment on the proposal.⁶⁸ The SEC received

securities industry participants was an advantageous pricing structure. Furthermore, NASD’s role was as a conduit, merely referring interested parties to these external mediation forums. Interview with Kenneth Andrichik, *supra* note 23.

⁶⁰ One report indicates that, of the 230 cases identified as appropriate for referral to mediation during the NASD pilot program, in only 55 did the parties consent to engage in mediation, only 16 cases ended up in a mediation session, and only six of those settled. BADER, *supra* note 58, § 12.02.

⁶¹ See *Ruder Report*, *supra* note 11, at 48 n.77 (characterizing “[e]arly experiences with the pilot” as “very positive”).

⁶² Interview with Kenneth Andrichik, *supra* note 23.

⁶³ BADER, *supra* note 58, § 12.02; Interview with Kenneth Andrichik, *supra* note 23.

⁶⁴ It is now known as the National Arbitration and Mediation Committee.

⁶⁵ NASD Notice to Members 95-1, *supra* note 12, at 1-2. NAC’s mediation subcommittee, made up of individuals experienced in commercial mediation as well as securities arbitration, developed original mediation rules, although they were based in part on the rules of other mediation service providers.

⁶⁶ *Id.*

⁶⁷ NASD received five comment letters, all of which generally favored the proposed rule, but suggested alterations in the proposed Mediation Rules. See Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to Mediation of Disputes, Exchange Act Release No. 34-35830, 60 Fed. Reg. 31,522, 31,526 (June 15, 1995).

⁶⁸ See *id.* at 31,524.

no public comments, and approved the proposed rule change on July 19, 1995 to take effect August 1, 1995.⁶⁹

As adopted, NASD's mediation rules:⁷⁰ (1) establish the general scope and authority of the mediation rules;⁷¹ (2) designate a Director of Mediation to administer the Rules;⁷² (3) preclude a mediator or the NASD from compelling a party to submit to mediation or to settle at mediation, confirming the voluntary nature of the process;⁷³ (4) provide that the filing of a mediation will not stay the arbitration of the same dispute already pending so as to "prevent the use of mediation as a delaying tactic;"⁷⁴ (5) provide for the appointment and selection of mediators;⁷⁵ (6) provide mediators with immunity;⁷⁶ (7) set forth "Ground Rules" for the mediation itself;⁷⁷ (8) set forth payment and fee schedules;⁷⁸ and (9) prohibit the maintenance of a verbatim record of a mediation session, so as to promote a free-flowing and confidential exchange of views, opinions, proposals and admissions.⁷⁹ Except for one modification to the postponement fee and a current proposed rule change to reorganize, renumber and simplify the language of the mediation code,⁸⁰ the NASD mediation rules have not changed in substance since they were enacted.⁸¹ These forum rules effectively guide the parties

⁶⁹ See Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Mediation of Disputes, Exchange Act Release No. 34-35990, 59 SEC Docket 2054 (July 19, 1995).

⁷⁰ National Association of Securities Dealers Manual, Code of Arbitration Procedure, Rule 10400 Series (2005) [hereinafter NASD Rules].

⁷¹ NASD Rules 10401(a), 10402 (2005).

⁷² NASD Rule 10401(b) (2005).

⁷³ NASD Rule 10401(c) (2005).

⁷⁴ NASD Rule 10403 (2005).

⁷⁵ NASD Rule 10404 (2005).

⁷⁶ NASD Rule 10405 (2005).

⁷⁷ NASD Rule 10406 (2005). See *infra* notes 275-81 and accompanying text for a more detailed description of these Ground Rules.

⁷⁸ NASD Rule 10407 (2005).

⁷⁹ NASD Rule 10326(b) (2005).

⁸⁰ See Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto to Amend NASD Arbitration Rules for Mediation Proceedings, SEC Release No. 34-51855, File No. SR-NASD-2004-013, 70 Fed. Reg. 36440 (proposed June 23, 2005). The filing does not propose any substantive changes to the mediation rules, but proposes separating the rules from the Code of Arbitration Procedure into its own Code of Mediation Procedure.

⁸¹ *Mediation: An Alternate Path*, *supra* note 10.

through the process and set some minimal parameters, without provoking a call for additional rules.

The use of mediation as a dispute resolution process in securities disputes steadily rose in the late 1990s.⁸² Currently NASD-DR handles the vast majority of these cases; NYSE,⁸³ AAA, JAMS, and private mediators each handle a small number of the remaining cases. In its first full year, 1996, NASD-DR mediated 512 cases. By 2003, this number had increased to 1,889 cases—with an average turnaround time of 118 days.⁸⁴ In the first quarter of 2004, NASD-DR reached the milestone of mediating case number 10,000 since it started in-house mediation in 1995. The cumulative settlement rate for those 10,000 cases is 80%.⁸⁵ NASD's efforts also increased the diversity of ADR methods available to the parties with their consent and thus reduced the criticisms leveled at the mandatory nature of PDAA arbitrations.

Party evaluations of the securities mediation procedures, as well as the mediator and the staff are extremely positive and overwhelmingly report on

⁸² The Ruder Report was a strong catalyst for the expansion of securities mediation. Reporting "very encouraging" results from the program in the short time period between August 1, 1995 and November 30, 1995, the Ruder Task Force recommended that NASD expand its mediation program by encouraging parties to participate in mediation, training additional mediators, and hiring additional mediation staff. *Ruder Report*, *supra* note 11, at 47, 50, 54–56. Although the Task Force considered a recommendation that NASD compel participation of parties in mediation, it ultimately declined to adopt that recommendation. *Id.* at 54–55.

⁸³ The NYSE started a subsidized, mandatory mediation program in 1998, but only for industry disputes over \$500,000. The scope of covered cases expanded in 2002 for claims over \$250,000, but this program effectively expired in 2003 when NYSE amended its mediation rules. After that, mediation at NYSE became entirely voluntary and requires the parties to bear their own expenses. See NYSE Information Memo 03-04, Arbitration: Administrative Conferences and Mediation (Feb. 25, 2003), [http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256A71006FB86385256C620065859E/\\$FILE/Microsoft%20Word%20-%20Document%20in%202003-4.pdf](http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256A71006FB86385256C620065859E/$FILE/Microsoft%20Word%20-%20Document%20in%202003-4.pdf). While NYSE, like NASD-DR, will provide requesting parties with a list of mediators, NYSE, unlike NASD-DR, offers no financial incentive to parties to postpone an arbitration hearing to attempt resolution through mediation.

⁸⁴ BADER, *supra* note 58, § 12.02.

⁸⁵ Interview with Kenneth Andrichik, *supra* note 23; see also Securities Arbitration Alert 2004-20 (May 19, 2004) (reporting that NASD-DR currently claims that more than 80% of disputes submitted to mediation result in a settlement agreement). Mr. Andrichik noted that mediation is most likely to be successful if the parties submit to mediation when the right type of case is ripe for the process and the parties carefully select an appropriate mediator.

the benefits of the process.⁸⁶ In January 2000, NASD-DR implemented a (non-scientific) survey of mediation participants to gauge their reaction to the mediation program. After gathering 635 completed and returned surveys, the NASD-DR staff wrote a summary report that reflected an extremely high level of satisfaction of participants with the process.⁸⁷

Attorneys representing parties in securities mediation also praise the process. David Robbins, a leading practitioner in the securities dispute resolution field, writes that “[m]ost practitioners who have participated in the mediation of a securities dispute are pleasantly surprised with the intelligence of the process, the pragmatism of the mediator and the reasonableness of the result. Speaking to them of the advantages of mediation is preaching to the converted.”⁸⁸ As he observes, “[m]ediation is to arbitration as arbitration is to litigation. That is, as arbitration—touted as the expeditious, cost-effective alternative to litigation—becomes more like litigation, an alternative to that alternative has emerged to itself become the expeditious, cost-effective alternative to arbitration.”⁸⁹

However, party evaluations collected on an informal basis combined with anecdotal reports of attorney satisfaction certainly do not establish that a dispute resolution mechanism is fair. The remainder of this paper will explore—in a more systematic fashion—the factors that impact on the fairness of securities mediation.

II. STATUTORY REGULATION OF SECURITIES MEDIATION

One way to assure some level of fairness in a dispute resolution process is to regulate it.⁹⁰ Modern securities mediation has the unique distinction of being regulated at the forum, federal, and state levels. First, the SRO mediation forums must be concerned with fairness, because one of their primary roles under their enabling legislation, the 1934 Act, is to protect

⁸⁶ NASD Dispute Resolution, Inc., Mediation Survey (2003) (on file with author).

⁸⁷ *Id.* For example, 93% of participants in mediations that ended in a settlement reported that they felt the mediator was fair and unbiased, and 84% of these participants were satisfied with the mediation process. For mediations that did not result in a settlement, 81% of participants classified as claimants and 89% of participants classified as respondents reported that the mediator was fair and unbiased. *Id.*

⁸⁸ ROBBINS, *supra* note 21, § 16-1. The entirety of chapter 16 of Robbins’ well-known treatise provides a detailed description of securities mediation.

⁸⁹ *Id.*

⁹⁰ SARAH R. COLE, CRAIG A. MCEWEN & NANCY H. ROGERS, *MEDIATION: LAW, POLICY & PRACTICE* § 2:1 (2d ed. 2003) (stating that “legal regulation of mediation aspires to achieve fairness, effectiveness, quality and access” but also noting that “goals for legal regulation of mediation often conflict”).

investors.⁹¹ Second, SEC oversight of these forums adds a federal layer of regulation.⁹² Third, state mediation statutes add a regulatory layer, although state mediation law tends to be consistent with—or else preempted by—federal law.⁹³

While regulation seems unavoidable, our legal system's choices as to the quantity and methods of regulation of a dispute resolution process will have an impact on its success.⁹⁴ For this reason, any additional regulation over and above the sources identified above would be extraneous and inhibiting. Yet, recent judicial trends suggest that courts could stretch the FAA to cover securities mediation—adding an unwarranted layer of federal law.⁹⁵ In this section, I explore these multiple layers of regulation of securities mediation that simultaneously attempt to insure the integrity and fairness of the process and threaten to inhibit its flexibility.

A. Federal Regulation

1. SEC Oversight

The 1934 Act⁹⁶ established a complex scheme to regulate and maintain capital markets as well as to protect the investing public. It also created the SEC to administer the Act and oversee its regulations.⁹⁷ Under the 1934 Act, “a major portion of the day-to-day regulation of broker-dealers and associated persons with them were left to SROs subject to SEC supervision.”⁹⁸ Since virtually all broker-dealers are members of NASD, “no broker-dealer can escape the self-regulatory system.”⁹⁹ In 1975, Congress amended the 1934 Act by authorizing the SEC to, *inter alia*, review all

⁹¹ See Poser, *supra* note 40, at 1097 (noting that the Exchange Act has the “explicit goal of protecting investors”).

⁹² See *infra* Part II.A.1.

⁹³ See *infra* Part II.B.

⁹⁴ See Sternlight, *supra* note 16, at 296 (recognizing that “[w]e must also make choices as to how to regulate these various forms of dispute resolution”).

⁹⁵ See *infra* Part II.A.2.

⁹⁶ Securities Exchange Act of 1934, 15 U.S.C. § 78a (2005).

⁹⁷ Securities Exchange Act of 1934, 15 U.S.C. § 78b (2005).

⁹⁸ NORMAN POSER, *BROKER-DEALER LAW AND REGULATION* § 13.01 (3d ed. 2004). The Maloney Act of 1938, 52 Stat. 1070, codified as Section 15A of the 1934 Act, amended the federal securities laws to permit qualified associations of broker-dealers to register with the SEC as national securities associations. Securities Exchange Act of 1934, 15 U.S.C. § 78o-3 (2005). The NASD is the only national securities association registered pursuant to this provision. *Id.*

⁹⁹ POSER, *supra* note 98, § 13.01.

proposed SRO rules.¹⁰⁰ Thus, SROs, NASD and NYSE must file with the SEC any change they propose in their own rules, including arbitration and mediation rules,¹⁰¹ and await SEC approval.¹⁰²

The Supreme Court has used this SEC oversight to justify the mandatory nature of arbitration with respect to customer disputes, at least those arising under the federal securities laws.¹⁰³ When the Court in *McMahon* first abrogated prior law by holding that investors' federal securities law claims were arbitrable,¹⁰⁴ it noted that the 1975 amendments to the 1934 Act gave the Commission new and "expansive power to ensure the adequacy of the arbitration procedures employed by the SROs."¹⁰⁵ This power includes the authority to "mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights."¹⁰⁶ The Court thus reasoned, that because SEC oversight of SRO arbitration adequately

¹⁰⁰ Prior legislation authorized the SEC to review or modify only a narrower set of SRO rules. *See id.*

¹⁰¹ Edward Brunet, *Toward Changing Models of Securities Arbitration*, 62 BROOK. L. REV. 1459, 1465 (1996) (stating that the "SEC has statutory authority to influence securities arbitration" under section 19 of the 1934 Act); David S. Ruder, *Securities Arbitration in the Public Interest: The Role of Punitive Damages*, 92 NW. U. L. REV. 69, 72 (1997) (noting that "the Commission has broad authority to oversee and to regulate the rules adopted by the SROs relating to customer disputes, including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights"). For examples of SEC review of NASD-DR procedural rule changes, see, e.g., NASD Dispute Resolution, Inc., 2005 NASD Dispute Resolution Rule Filings, http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=1186 (last visited Nov. 3, 2005).

¹⁰² Securities Exchange Act of 1934, 15 U.S.C. § 78s(b)(1) (2004) ("Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization . . . accompanied by a concise general statement of the basis and purpose of such proposed rule change."). The SEC then publishes the proposed rule change, gives "interested persons" an opportunity to comment on the proposal and, following the public comment period, approves the rule change if it finds that it "is consistent with the requirements of [the '34] Act and the rules and regulations thereunder," including the requirement that the rule protect investors and the public interest. See 15 U.S.C. §§ 78f(b)(5), 78o-3(b)(6) (2005), for a National Securities Exchange and a Registered Securities Association, respectively.

¹⁰³ *See Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 234-35 (1987).

¹⁰⁴ *Id.* at 233-34.

¹⁰⁵ *Id.* at 233.

¹⁰⁶ *Id.* at 234.

protects investors, arbitration would not deprive investors of the means to enforce their rights under the 1934 Act.¹⁰⁷

The 1975 Amendments to the 1934 Act added an indispensable layer of statutory regulation over SRO arbitration as well as mediation with the express statutory purpose of enhancing investor protection.¹⁰⁸ In theory, this “public interest” model of mediation¹⁰⁹ carries with it the constant threat of regulatory intervention. In reality, however, the threat of oversight has not translated into anything more than minimal intervention by the SEC.¹¹⁰ No public comments were received when the SEC published for comment NASD’s proposed mediation rules,¹¹¹ and the SEC approved them “as is.” Similarly, the SEC has approved easily (albeit sometimes quite slowly) the SROs’ proposed changes to their arbitration rules, especially if the rule appears to judicialize the procedure so as to ensure investor protection.¹¹² Moreover, since there have been no substantive mediation rule changes since the SROs’ internal programs began, the SEC has had little opportunity to review the mediation process. The SEC has neither published nor commissioned any studies of mediation and it has made no public pronouncements about mediation.

¹⁰⁷ *Id.* at 231–34.

¹⁰⁸ Ruder, *supra* note 101, at 74 (stating that the presence of “active SEC oversight of the SRO arbitration system provides a major distinguishing characteristic between securities arbitration and other arbitration systems” and that the “oversight is an essential ingredient in assuring a securities arbitration system in the public interest”); *see also* Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931, 1007 (1998) (arguing that “[o]ne could distinguish securities industry arbitration cases from other types of cases involving arbitration of statutory claims on the ground that under the Securities Acts, there is a possibility of SEC oversight of the SROs and their arbitration tribunals, a possibility that does not exist when violations of other statutory rights are alleged”).

¹⁰⁹ I derive this term from Professor Speidel’s naming of the “public interest model” of securities arbitration. He has called for this model due to “the power imbalances between investors and broker-dealers in a highly regulated industry and the common use of ‘adhesion’ contracts The reality is that private ordering will not work to neutralize the investor’s lack of choice, the risk of imbalance in the terms of the contract to arbitrate securities disputes, or the perception that the arbitration process is under industry control.” Richard E. Speidel, *Punitive Damages and the Public Interest Model of Securities Arbitration: A Response to Professor Stipanowich*, 92 NW. U. L. REV. 99, 105 (1997); *see also* Speidel, *supra* note 47, at 1362–63 (discussing public interest model).

¹¹⁰ Brunet, *supra* note 101, at 1464–66 (contending that “[t]he past and present degree of SEC public interest regulation of securities arbitration reveals an ongoing agency presence but little in the way of regulatory vigor”).

¹¹¹ *See supra* note 69 and accompanying text.

¹¹² Brunet, *supra* note 101, at 1466.

At the same time, the rule-making process has not had any adverse impact on NASD mediation. It seems that the need for SEC approval has allowed the SROs to maintain the status quo, because rule changes are an encumbered undertaking and the SROs do not pursue them readily. Additionally, the SEC has never rejected a mediation-related rule proposal and NASD has never declined to seek an amendment to its rules because of the possibility of SEC rejection.¹¹³ If anything, NASD-DR views the SEC oversight as a value-added feature to the mediation services it provides.¹¹⁴

Nevertheless, even a minimal amount of SEC review of SRO dispute resolution procedures ensures that "major developments in securities [mediation] receive some public airing."¹¹⁵ The SEC staff does, on a regular basis, visit NASD-DR for oversight examinations to review its procedures.¹¹⁶ This regulatory layer—which does not exist for most mediation service providers—should provide some comfort to investors that the SEC's oversight will ensure a fairer process and should enhance investors' perceptions that mediation is a fair alternative to arbitration.

2. *The Federal Arbitration Act?*

Another federal statutory scheme that arguably regulates the securities mediation process is the Federal Arbitration Act.¹¹⁷ The far-reaching implications of a recent federal decision applying the FAA to mediation¹¹⁸—enabling greatly enhanced judicial intervention in many phases of the process—warrant a detailed examination of this suspect holding.¹¹⁹

¹¹³ Interview with Kenneth Andrichik, *supra* note 23.

¹¹⁴ *Id.*

¹¹⁵ Brunet, *supra* note 101, at 1484.

¹¹⁶ Interview with Kenneth Andrichik, *supra* note 23.

¹¹⁷ 9 U.S.C. §§ 1 *et seq.* (2005). The Supreme Court has made it clear that the FAA applies to securities brokerage agreements containing a PDAA. *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002) (applying FAA to securities arbitration).

¹¹⁸ *Fisher v. GE Med. Sys.*, 276 F. Supp. 2d 891 (M.D. Tenn. 2003).

¹¹⁹ It has been suggested to me that a court could find that section two of the FAA applies to mediation proceedings, thus making agreements to mediate future disputes enforceable, but that the procedural devices specified in the other sections of the FAA do not apply to mediation. Under this scenario, the finding that section two covered mediation would not be nearly as troubling. I reject this suggestion as implausible. Besides the interpretive hoops one must jump through to justify a conclusion that "arbitration" has different meanings in different sections of the same Act, a primary legislative purpose of the procedures in sections 3–16 was to give the parties devices to enforce the substantive rights granted by section two. A conclusion that section two

The FAA, adopted by Congress in 1925,¹²⁰ regulates and enforces arbitration agreements that fall within its scope. For any dispute that is governed by the FAA, the parties gain access to certain procedural devices, including the right to move to stay litigation when the dispute is covered by an enforceable arbitration agreement,¹²¹ move to compel an adverse party to comply with an enforceable agreement to arbitrate,¹²² move to confirm an arbitration award and reduce it to an enforceable judgment,¹²³ move to vacate or modify an arbitration award under certain limited grounds,¹²⁴ and appeal from rulings under the FAA.¹²⁵ In addition, the FAA grants subpoena power to the arbitrators to secure attendance of witnesses or production of documents at the hearing.¹²⁶

But what types of written provisions are within the FAA's scope? The central substantive section of the FAA, section 2, reads:

[a] written provision in any maritime transaction or a contract evidencing a transaction involving commerce to *settle by arbitration* a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.¹²⁷ The Supreme Court has written, that as embodied in this section, the primary *purpose* of the FAA was to overcome the courts' common law refusal to enforce agreements to arbitrate.¹²⁸ The legislative history also suggests that at least one additional

deemed mediation agreements enforceable as a matter of substantive federal law but that the FAA provided no means to enforce this law seems illogical.

¹²⁰ United States Arbitration Act, P.L. 68-401, 43 Stat. 883 (1925).

¹²¹ 9 U.S.C. § 3.

¹²² 9 U.S.C. § 4.

¹²³ 9 U.S.C. § 9.

¹²⁴ 9 U.S.C. §§ 10-11.

¹²⁵ 9 U.S.C. § 16.

¹²⁶ 9 U.S.C. § 7.

¹²⁷ 9 U.S.C. § 2 (emphasis added).

¹²⁸ *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219 (1985); *see also* *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984). This conclusion is supported by both the House and Senate Reports supporting the bill. H.R. REP. NO. 68-96, at 1 (1924) (stating that "[t]he purpose of this bill is to make valid and enforceable [sic] agreements for arbitration contained in contracts involving interstate commerce"); S. REP. NO. 68-536, at 2 (1924) (stating that the purpose of the bill is "clearly set forth in section 2," the section making agreements to arbitrate irrevocable). The Senate report explained that courts refused to enforce agreements to arbitrate for three reasons: (1) fear that the arbitration tribunal lacked the means to give full or proper redress as well as a belief they lacked the authority to compel a party to submit his cause to arbitration thus denying his right to a

purpose of the bill was to expedite legal claims, lower their costs and place arbitration agreements on the same footing as other contracts.¹²⁹

Because the FAA does not define the term “arbitration,”¹³⁰ courts have grappled with its meaning.¹³¹ While the Supreme Court has never addressed whether the FAA applies to agreements for non-binding dispute resolution, many lower federal¹³² and state courts¹³³ have held that only dispute

court of justice; (2) fear courts would be ousted of much of their jurisdiction; and (3) established precedent. *Id.* at 2–3.

¹²⁹ The Supreme Court wrote:

This is not to say that Congress was blind to the potential benefit of the legislation for expedited resolution of disputes. Far from it, the House Report expressly observes:

“It is practically appropriate that the action should be taken at this time when there is so much agitation against the costliness and delays of litigation. These matters can be largely eliminated by agreements for arbitration, if arbitration agreements are made valid and enforceable.”

Byrd, 470 U.S. at 220; S. REP. NO. 68-536, at 3 (1924) (stating that Congress’ motivation in enacting the FAA was a “desire to avoid the delay and expense of litigation” and noting that the “settlement of disputes by arbitration appeals to big business and little business alike, to corporate interests as well as to individuals”).

¹³⁰ Section 1 of the FAA, 9 U.S.C. § 1, defines certain terms used in the Act but conspicuously omits the definition of “arbitration.” *Portland Gen. Elec. Co. v. U.S. Bank Trust Nat’l Assn.*, 218 F.3d 1085, 1089 (9th Cir. 2000) (“Curiously, the FAA does not define ‘arbitration.’”); *Fisher v. GE Med. Sys.*, 276 F. Supp. 2d 891, 893 (M.D. Tenn. 2003) (“The FAA does not precisely define what processes constitute ‘arbitration.’”). The analysis in this section applies equally to suspect applications of the Uniform Arbitration Act (UAA) and the Revised Uniform Arbitration Act (RUAA) to mediation, as those Acts were patterned after the FAA and contain the identical non-definition of “arbitration.” *See* RUAA § 6; UAA § 6.

¹³¹ *AMF Inc. v. Brunswick*, 621 F. Supp. 456, 459 (S.D.N.Y. 1985) (stating that “[a]rbitration is a term that eludes easy definition”).

¹³² *E.g.*, *Salt Lake Tribune Pub. Co., LLC v. Mgmt Planning, Inc.*, 390 F.3d 684 (10th Cir. 2004) (holding that appraisal process was not “arbitration” under the FAA); *Fit Tech, Inc. v. Bally Total Fitness Holding Corp.*, 374 F.3d 1 (1st Cir. 2004) (holding that accounting remedy was FAA arbitration because it was binding and final remedy); *Hartford Lloyd’s Ins. Co. v. Teachworth*, 898 F.2d 1058 (5th Cir. 1990) (holding that insurance appraisal process was not FAA arbitration because it was informal and determined only amount of loss, not liability of parties).

¹³³ *E.g.*, *Cheng-Canindin v. Renaissance Hotel Assocs.*, 57 Cal. Rptr. 2d 867, 872 (Cal. Ct. App. 1996) (defining arbitration as ADR process resulting in a binding decision by third party); *Urology Assocs., P.C. v. CIGNA Healthcare of Tenn., Inc.*, No. M2001-022521, 2002 WL 31302922, *7–8 (Tenn. Ct. App. Oct. 11, 2002) (holding that arbitration must be binding to be covered by federal and state arbitration acts); *see also*

resolution processes resulting in a *binding* and *final* determination qualify as “arbitration” within the meaning of the FAA.

With increasing frequency, however, some courts are concluding that the FAA applies to dispute resolution procedures other than binding arbitration.¹³⁴ First, focusing on the word “settle” in section 2 of the FAA rather than the word “arbitration,” some courts have held that non-binding arbitration is arbitration within the meaning of the Act if it has some potential to “settle” the controversy.¹³⁵ For example, in *AMF Inc. v. Brunswick*, 621 F. Supp. 456 (S.D.N.Y. 1985) two competing bowling equipment manufacturers had previously settled a lawsuit regarding alleged deceptive advertising practices. The settlement agreement provided that the parties would settle any future similar controversy through a non-binding advisory opinion process administered by the National Advertising Division (NAD).¹³⁶ When a subsequent advertising controversy arose, AMF invoked the advisory opinion process but Brunswick refused to comply.¹³⁷

AMF brought an action in federal district court to compel Brunswick’s compliance with the NAD provision of the settlement agreement under section four of the FAA. Brunswick argued that the FAA covers only binding arbitration, but not a process through which the end result would be a non-

Schaefer v. Allstate Ins. Co., 590 N.E.2d 1242 (Ohio 1992) (ruling that arbitration must be binding to be “arbitration” under state law); Ohio Council 8, Am. Fed’n of State, County and Mun. Employees v. Ohio Dep’t of Mental Retardation and Developmental Disabilities, 459 N.E.2d 220, 222–23 (Ohio 1984) (declining to confirm mediators’ recommendations pursuant to Ohio arbitration rules and concluding that “mediation and arbitration represent separate and distinct means of attempting to resolve grievances”); Godfrey v. Hartford Cas. Ins. Co., 16 P.3d 617 (Wash. 2001) (refusing to enforce, pursuant to Washington’s arbitration statute, an agreement calling for non-binding arbitration).

¹³⁴ See *AMF*, 621 F. Supp. at 459–61; *Shelby v. Gen. Elec. Co.*, No. 03-F-106-N, 2003 U.S. Dist. LEXIS 26472 (M.D. Ala. Nov. 6, 2003) (compelling non-binding arbitration under FAA); *Allied Sanitation, Inc. v. Waste Mgmt. Holdings, Inc.*, 97 F. Supp. 2d 320, 327 (E.D.N.Y. 2000) (stating that “[t]he concept of arbitration plausibly embraces all contractual dispute resolution mechanisms, consistent with Congress’s design to foster alternative means to resolving litigation”).

¹³⁵ See *AMF*, 621 F. Supp. at 461; see also *Mortimer v. First Mount Vernon Indus. Loan Ass’n*, No. AMD 03-1051, 2003 U.S. Dist. LEXIS 24698, *6 (D. Md. 2003) (enforcing a contract requiring parties to resort to mediation before arbitration or litigation under the Maryland Uniform Arbitration Act because it is an “alternative method to settle controversies”).

¹³⁶ *AMF*, 621 F. Supp. at 457. The parties agreed that NAD—a division of the Council of Better Business Bureaus—would determine whether there was “experimental support” for the superiority claim. Compliance with an NAD advisory decision was voluntary but, previously, compliance by advertisers had been 100%. *Id.* at 458.

¹³⁷ *Id.*

binding, advisory opinion.¹³⁸ Instead, Brunswick argued that the FAA applied only to arbitration processes that provided a true alternative to litigation in that they resulted in a final settlement of the dispute.¹³⁹

The district court disagreed. Noting, that in the labor arbitration field, some commentators had written that arbitration had become “synonymous with ‘mediation’ and ‘conciliation.’” Chief Judge Weinstein concluded that “[n]o magic words such as ‘arbitrate’ or ‘binding arbitration’ or ‘final dispute resolution’ are needed to obtain the benefits of the [FAA].”¹⁴⁰ Instead he found that, because submission of the parties’ dispute to NAD would “settle” the advertising controversy between the parties, the non-binding arbitration process constituted “arbitration” within the meaning of the FAA.¹⁴¹

AMF and other courts also have found non-binding arbitration to be FAA-governed arbitration on the grounds that the parties had agreed to submit their disputes for resolution to a process other than litigation or made non-binding arbitration a condition precedent to litigation.¹⁴² For these

¹³⁸ *Id.* at 459.

¹³⁹ *Id.*

¹⁴⁰ *Id.* Judge Weinstein rested his conclusion on *dictum* from a 1910 Supreme Court case, *City of Omaha v. Omaha Water Co*, 218 U.S. 180, 194 (1910), that stated “a plain case of the submission of a dispute or difference which had to be adjusted . . . was in fact an arbitration, though the arbitrators were called appraisers.” *AMF*, 621 F. Supp. at 459–60 (quoting from *City of Omaha*, 218 U.S. at 194). Of course, however, *City of Omaha* preceded the passage of the FAA, so the Court could not have been defining “arbitration” within the meaning of the FAA.

¹⁴¹ *AMF*, 621 F. Supp. at 460–61. Judge Weinstein also rejected the notion that arbitration necessarily had to include certain hallmarks such as an “adversary proceeding, submission of evidence, witnesses and cross-examination.” *Id.* at 460.

¹⁴² See *Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205, 1208–09 (9th Cir. 1998) (ruling that non-binding arbitration process was FAA arbitration because parties agreed to submit dispute to a third party for resolution and agreed not to pursue litigation until that process was completed); *AMF*, 621 F. Supp. at 461; *Homes of Legend v. McCollough*, 776 So.2d 741, 748 (Ala. 2000) (stating that “[t]he FAA . . . does not require that an arbitration agreement provide for binding arbitration” and finding that the court could compel non-binding arbitration under the FAA); *Kelly v. Benchmark Homes*, 550 N.W.2d 640, 645 (Neb. 1996) (ruling that FAA applied to contract arising out of interstate commerce that contained a pre-dispute clause requiring non-binding arbitration as a condition precedent to litigation); *Webb v. Am. Employers Group*, 684 N.W.2d 33, 41 (Neb. 2004); see also *Dluhos v. Strasberg*, 321 F.3d 365, 371–72 (3d Cir. 2003) (concluding that dispute resolution program under Internet Corporation for Assigned Names and Numbers’ was not FAA arbitration because it was not meant to replace litigation); *Brennan v. King*, 139 F.3d 258, 266 (1st Cir. 1998) (concluding that tenure grievance procedure giving tenure candidate the right but not obligation to pursue a form of arbitration was not FAA arbitration because parties could not have a reasonable expectation that the procedure would resolve the dispute); *Harrison v. Nissan Motor*

courts, the non-binding nature of the procedure was not fatal to the classification of the procedure as FAA arbitration. For example, the *AMF* court indicated that the fact that the NAD process “may not end all controversy between the parties for all times is no reason not to enforce the agreement.”¹⁴³ Rather, because the NAD process provided an alternative to litigation, it qualified as arbitration under the FAA.¹⁴⁴ As a result, the court compelled the parties to submit to the NAD process pursuant to section four of the FAA.¹⁴⁵

Since *AMF*, several courts have considered the applicability of the FAA to mediation. In *C.B. Richard Ellis, Inc. v. American Environmental Waste Management*,¹⁴⁶ the court applied the FAA to a mediation clause, but there, the parties had already agreed that the FAA applied.¹⁴⁷ In *Cecala v. Moore*,¹⁴⁸ the court ruled that the FAA did not apply to a contract containing a mediation clause on the grounds that there was no interstate commerce.¹⁴⁹

Corp., 111 F.3d 343, 349–52 (3d Cir. 1997) (finding that parties’ agreement to submit controversies to an informal dispute resolution procedure was not covered by the FAA because the procedure did not provide for completion of the process as a prerequisite for litigation); *Parisi v. Netlearning, Inc.*, 139 F. Supp. 2d 745, 751–52 (E.D. Va. 2001) (concluding that dispute resolution program under Internet Corporation for Assigned Names and Numbers’ was not FAA arbitration because it was not meant to replace litigation). In New York, where arbitration laws were a model for the FAA, courts also have ruled that non-binding arbitration constitutes “arbitration” under the state arbitration statute. See *Citibank N.A. v. Bankers Trust Co.*, 633 N.Y.S.2d 314 (N.Y. App. Div. 1995) (enforcing agreement to resolve disputes through only partially binding ADR procedure and staying litigation until after procedure was completed); *Bd. of Educ. v. Cracovia*, 321 N.Y.S.2d 496 (N.Y. App. Div. 1971) (holding that New York’s arbitration act covered collective bargaining agreement’s provision for non-binding arbitration).

¹⁴³ *AMF*, 621 F. Supp. at 461.

¹⁴⁴ *Id.*

¹⁴⁵ In any event, the court noted that the dispute resolution provision was enforceable under New York law, and the court invoked its equitable powers under state law to compel the parties to submit to the NAD process. *Id.* As Professor Schmitz has argued, the court potentially could have avoided application of the FAA by ordering the parties to participate in the NAD process under doctrines of contract law. Amy S. Schmitz, *Refreshing Contractual Analysis of ADR Agreements By Curing Bipolar Avoidance of Modern Common Law*, 9 HARV. NEGOT. L. REV. 1, 16–17 (2004). The ambiguous law in place at the time in New York regarding specific enforcement of private ADR agreements may explain the court’s circumvention of contract law and stretch to apply the FAA. *Id.*

¹⁴⁶ No. 98-CV-4183, 1998 WL 903495 (E.D.N.Y. Dec. 4, 1998).

¹⁴⁷ *Id.* at *2.

¹⁴⁸ 982 F. Supp. 609 (N.D. Ill. 1997).

¹⁴⁹ *Id.* at 612. The court found that the Illinois Uniform Arbitration Act (IUAA) applied because the dispute arose out of the contract. *Id.*

However, the court did not address whether “mediation” is within the purview of the FAA. In *Annapolis Professional Firefighters Local 1926 v. City of Annapolis*,¹⁵⁰ the Maryland state court enforced a mediation agreement under state contract law, but declined to extend the *AMF* holding to mediation by enforcing the agreement under the FAA. The court found that, because mediation is an increasingly favored method of dispute resolution, it could “see no rational basis for not enforcing agreements to utilize such methods in much the same manner as agreements to arbitrate are enforced.”¹⁵¹

In 2003, apparently in a case of first impression, a federal court explicitly held that the FAA covered an agreement to *mediate* a dispute.¹⁵² As mentioned above,¹⁵³ the primary differences between mediation and arbitration are the non-binding nature of mediation, as well as the involvement of the neutral to help the parties reach a settlement, rather than to impose a finding. The conclusion that the FAA covered a non-binding process was not new, but the conclusion that it governed a process not resulting in a finding by a third party neutral appears novel.

In *Fisher v. GE Med. Sys.*, 276 F. Supp. 2d 891 (M.D. Tenn. 2003), plaintiffs, former employees of defendant GE, filed a complaint in federal court alleging violations of the Fair Labor Standards Act.¹⁵⁴ GE moved to compel mediation pursuant to an employee dispute resolution program (called RESOLVE) that was made a condition of employment for all employees. The program is self-styled as a “written agreement for the resolution of employment issues, pursuant to the Federal Arbitration Act.”¹⁵⁵ The Program involved four levels of an “Issue Resolution Process,” the first two of which were internal, and the third of which required mediation administered by the American Arbitration Association. If the mediation did not result in a settlement, then the fourth level permitted employees to take their claim to court.¹⁵⁶

Plaintiffs argued that the court could not compel the third level of mediation pursuant to the FAA because it was not “arbitration.” The district court disagreed, stating that “‘arbitration’ in the FAA is a broad term that encompasses many forms of dispute resolution.”¹⁵⁷ To buttress its decision,

¹⁵⁰ 642 A.2d 889 (Md. Ct. Spec. App. 1994).

¹⁵¹ *Id.* at 894.

¹⁵² See *Fisher v. GE Med. Sys.*, 276 F. Supp. 2d 891 (M.D. Tenn. 2003).

¹⁵³ See *supra* notes 10–11 and accompanying text.

¹⁵⁴ *Fisher*, 276 F. Supp. 2d at 892.

¹⁵⁵ *Id.* (quoting from Agreement).

¹⁵⁶ *Id.* at 892–93.

¹⁵⁷ *Id.* at 893.

the *Fisher* court cited the federal policy of favoring non-judicial resolutions of *labor* disputes:

The policy in favor of the finality of arbitration is but one part of a broader goal of encouraging informal, i.e., non-judicial resolution of labor disputes. It is not arbitration per se that federal policy favors, but rather final adjustment of differences by a means selected by the parties. If the parties agree that a procedure other than arbitration shall provide a conclusive resolution of their differences, federal labor policy encourages that procedure no less than arbitration.¹⁵⁸

Also, to define the scope of the term “arbitration,” the *Fisher* court, like the *AMF* court, focused on the term “settle” in section two of the FAA.¹⁵⁹ Because the mediation procedure at issue required the parties to mediate disputes before filing them in court, the district court ruled that the FAA applied as a matter of federal policy.¹⁶⁰

The legislative history of the FAA does not support the *Fisher* court’s expansive interpretation of the word “arbitration” in the FAA. Rather, that history supports the view that Congress intended the Act to govern traditional, binding arbitration, rather than any non-final, non-binding dispute resolution process such as mediation. For example, the Senate Report supporting the bill describes arbitration as a process including a tribunal, a hearing, counsel, and witnesses.¹⁶¹ A representative of the Arbitration Society of America,¹⁶² a proponent of the bill, discussed the advantages of arbitration, a process in which an arbitrator decides factual and legal issues in dispute.¹⁶³

¹⁵⁸ *Id.* (quoting *Bakers Union Factory, #326 v. ITT Cont’l Baking Co., Inc.*, 749 F.2d 350, 353 (6th Cir. 1984)).

¹⁵⁹ *Id.* at 893; see also *C.B. Richard Ellis, Inc. v. Am. Envtl. Waste Mgmt.*, No. 98-CV-4183(JG) 1998 WL 903495, at *2 (E.D.N.Y. Dec. 4, 1998) (holding that, although the parties had agreed that the FAA governed the dispute, the clause fell under the FAA “[b]ecause the mediation clause in the case at bar manifests the parties’ intent to provide an alternative method to ‘settle’ controversies”).

¹⁶⁰ *Fisher*, 276 F. Supp. 2d at 894. The court did not focus on the fact that the mediation might not provide “conclusive resolution” to the parties’ controversy. The court might have been influenced by the fact that the dispute resolution agreement itself invoked the FAA.

¹⁶¹ S. REP. NO. 68-536, at 3 (1924).

¹⁶² The Arbitration Society was the predecessor organization to the American Arbitration Association. See IAN MACNEIL, *AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION* 40–41 (1992).

¹⁶³ *Arbitration of Interstate Commercial Disputes: Joint Hearings Before the Subcomms. of the H. and S. Comms. on the Judiciary on S. 1005 and H.R. 646*, 68th

The strongest evidence that Congress did not think it was passing legislation governing a mediation-like process is testimony regarding the bill at the Joint Hearings before the Subcommittees of the Congressional Committees on the Judiciary. Charles L. Bernheimer, Chairman of the Committee on Arbitration for the Chamber of Commerce of the State of New York, New York City and a sponsor of the bill,¹⁶⁴ testified:

There are four known methods based on long experience I have had by which to meet trade disputes, the ordinary everyday trade disputes, and it is for them that this legislation is proposed.

1. For parties to settle between themselves, which is the usual method, an excellent method.
2. For the parties to settle by negotiation, with the assistance of a third party, a mutual friend in whom they have confidence. That is the next best way of doing it.
3. For the parties to enter into a formal arbitration, which is the basis on which this bill is framed, namely, arbitration which has legal sanction, whereby arbitration once agreed upon must be seen through, so that the parties can not, as they can in the most of our States and certainly in connection with interstate business, back out at the last moment when they see the case is going against them. That should not be permitted. It is unmoral, unfair, and untenable.
4. The last method is that of litigation, which is, of course, the worst method of them all.¹⁶⁵

It is clear from this testimony from the primary sponsor of the FAA—and by someone whose testimony the Supreme Court has considered informative on the issue of FAA legislative intent in another context¹⁶⁶—that mediation (Bernheimer's method number two—using a third party for

Cong. 27 (1924) [hereinafter *Joint Hearings*] (statement of Alexander Rose, Representing the Arbitration Society of America, New York City).

¹⁶⁴ New York was the first state to enact legislation that called for the enforcement of arbitration agreements. MACNEIL, *supra* note 162, at 34–37.

¹⁶⁵ *Joint Hearings*, *supra* note 163, at 7 (testimony of Charles L. Bernheimer, Chairman of the Committee on Arbitration of the Chamber of Commerce of the State of New York).

¹⁶⁶ See *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 274 (1995) (citing Bernheimer's testimony when interpreting meaning in FAA of phrase "involving commerce"); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 405–406 (1967) (same).

settlement) was not included under the FAA's enabling legislation. And, Bernheimer's definition of arbitration as a final process during which the participants cannot back out before it is completed necessarily precludes the modern, entirely voluntary process of mediation.

Testimony from Mr. Julius Henry Cohen, member of the Committee on Commerce, Trade and Commercial Law of the American Bar Association and primary author of the bill, is also instructive:

Now, I think everybody to-day [sic] feels very strongly that the right of freedom of contract, which the Constitution guarantees to men, includes the right to dispose of any controversy which may arise out of the contract in their own fashion In other words, we agree to settle on the terms that these gentlemen say is proper. And we sign a letter to that effect.¹⁶⁷

This testimony supports the contention that the author of the FAA intended the law to cover a process that disposes of, or resolves, the controversy, rather than a process that is not final in its resolution of a controversy. Mr. Cohen also submitted a brief for the record, in which he wrote:

The arbitrators are given powers to call witnesses and require the production of papers, to assure that a full and fair consideration of the controversy may be had despite the possible recalcitrance of one or more parties to the dispute. They are required to execute their award with certain formality, so that there can thereafter be no question with respect either to its existence or its identity.¹⁶⁸

The process Mr. Cohen described is one in which a third party neutral imposes a binding resolution of the dispute, not one in which the neutral assists the parties in reaching a non-binding settlement. This process resembles modern binding arbitration, not non-binding mediation.

Moreover, law dictionaries contemporaneous with the enactment of the FAA defined "arbitration" as a dispute resolution procedure in which a third party neutral decides the matter in dispute.¹⁶⁹ For example, the 1910 edition

¹⁶⁷ *Joint Hearings*, *supra* note 163, at 14 (statement of Julius Henry Cohen, member, American Bar Association, comm. on commerce, trade and commercial law; General Counsel, New York State Chamber of Commerce).

¹⁶⁸ *Joint Hearings*, *supra* note 163, at 36 (Brief of Julius Henry Cohen); *see also* Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 272 (1926).

¹⁶⁹ The Supreme Court just last term looked at a law dictionary contemporaneous with the enactment of a statute in 1933 to help define the meaning of a term within that statute. *See Hibbs v. Winn*, 124 S.Ct. 2276, 2295 (2004) (interpreting meaning of the

of Black's Law Dictionary defined "arbitration" as "[t]he investigation and determination of a matter or matters of difference between contending parties, by one or more unofficial persons, chosen by the parties, and called 'arbitrators,' or 'referees.'"¹⁷⁰ Other contemporaneous dictionaries provide similar, if not identical, definitions.¹⁷¹ Thus, the common understanding of the term confirms that the process of arbitration at the time of the passage of the FAA did not include mediation.

Recent scholarship also has argued that the FAA does not cover mediation.¹⁷² Amy Schmitz forcefully argues that the courts interpreting the FAA to include non-binding procedures have focused incorrectly on the FAA's stated goal of enforcing contracts while ignoring the Act's goal of providing for finality.¹⁷³ Professor Ian Macneil's definition of arbitration necessarily excludes mediation:

(1) the parties choose to have a dispute or disputes decided by a third party, called an arbitrator; (2) the parties choose the arbitrator or a method for his or her selection; (3) the arbitrator hears the dispute; (4) the arbitrator makes a binding award; (5) the arbitrator's decision is, subject to very limited grounds of review, final and enforceable by State law in the same manner as a judgment Obviously, the fewer of the five characteristics listed are present, the less likely the process is to be called arbitration.¹⁷⁴

Professor Stipanowich contends that FAA arbitration "contemplates a procedure before one or more private third party decision makers

term "enjoin" in the Tax Injunction Act by referencing the Black's Law Dictionary current at its enactment).

¹⁷⁰ BLACK'S LAW DICTIONARY 83 (2d ed. 1910).

¹⁷¹ See, e.g., BOUVIER'S LAW DICTIONARY, STUDENTS ED. 81-82 (William Edward Baldwin ed., 1928); WALTER A. SHUMAKER & GEORGE FOSTER LONGSDORF, THE CYCLOPEDIA OF LAW 61 (1901).

¹⁷² See Schmitz, *supra* note 145 (arguing that courts should use common-law contractual remedies, such as specific performance, to enforce agreements compelling parties to submit to non-binding ADR processes as those are not covered by the FAA); Amy Schmitz, *Ending a Mud Bowl: Defining Arbitration's Finality Through Functional Analysis*, 37 GA. L. REV. 123 (2002) [hereinafter *Mud Bowl*] (arguing that the FAA governs only dispute resolution processes that yield a final, binding decision that is subject to only limited review by the courts); Thomas J. Stipanowich & William L. Matthews, *Contracts Symposium: Contract and Conflict Management*, 2001 WIS. L. REV. 831, 862-63 (arguing that mediation is incompatible with the FAA and stating that the "statute-based law of arbitration is a wholly inappropriate ground for enforcement of mediation agreements. Judicial attempts to group such processes under the statutory umbrella are likely to result in considerable confusion, not to mention bad precedents.").

¹⁷³ *Mud Bowl*, *supra* note 172, at 125-26.

¹⁷⁴ MACNEIL, *supra* note 162, at 7-8.

(‘arbitrators’), and an adjudicative process of some kind culminating in a final decision (‘award’)” that is binding on the parties.¹⁷⁵

Finally, an even more recent decision interpreting virtually the identical dispute resolution program (RESOLVE) at the same company as the one at issue in *Fisher* (GE) reached the opposite conclusion. Thus, in *Lynn v. General Electric Co.*,¹⁷⁶ the district court rejected the *Fisher* holding under more recent Tenth Circuit precedent¹⁷⁷ and instead held that mediation is *not* arbitration under the FAA.¹⁷⁸ The *Lynn* court applied a two-pronged test first used by the First Circuit¹⁷⁹ and followed by the Tenth Circuit in *Salt Lake Tribune Publ’g Co., LLC v. Mgmt. Planning, Inc.*, 390 F.3d 684 (10th Cir. 2004), to determine whether a dispute resolution procedure is arbitration within the meaning of the FAA: “(1) ‘how closely the specified procedure resembles classic arbitration;’ and (2) ‘whether treating the procedure as arbitration serves the intuited purposes of Congress.’”¹⁸⁰ Under the first prong of this test, the district court reasoned that the non-binding mediation procedure did not resemble arbitration at all.¹⁸¹ Under the second prong, the district court decided that Congress, in enacting the FAA, wanted to reverse longstanding judicial hostility towards *arbitration* agreements, and thus could not have intended the Act to encompass *mediation* agreements.¹⁸²

Nevertheless, the implications of the *Fisher* court’s holding that the FAA governs agreements to mediate are troubling.¹⁸³ Parties must consent to participate in mediation, and should be able to walk away at any time with no ramifications. It is entirely voluntary and the notion that courts could compel participation in the process or stay litigation pending compulsory mediation seems inimical to its very purpose. Indeed, one advantage of mediation is the lack of court involvement and thus the freedom of parties to operate without judicial interference. Providing one party with the power to compel another

¹⁷⁵ Stipanowich & Matthews, *supra* note 172, at 840.

¹⁷⁶ No. 03-2662-GTV-DJW, 2005 WL 701270 (D. Kan. Jan. 20, 2005).

¹⁷⁷ *Salt Lake Tribune Publ’g Co., LLC v. Mgmt. Planning, Inc.*, 390 F.3d 684 (10th Cir. 2004).

¹⁷⁸ *Lynn*, 2005 WL 701270, at *6.

¹⁷⁹ *See Fit Tech, Inc. v. Bally Total Fitness Holding Corp.*, 374 F.3d 1 (1st Cir. 2004).

¹⁸⁰ *Lynn*, 2005 WL 701270, at *5 (quoting *Fit Tech*, 374 F.3d at 7).

¹⁸¹ *Id.* at *5–6.

¹⁸² *Id.* at *6.

¹⁸³ I have previously written about the dangers of the overextension of the FAA in another context. *See* Jill I. Gross, *Over-Preemption of State Vacatur Law: State Courts and the FAA*, 3 J. AM. ARB. 1 (2004) (arguing that state courts apply the FAA to motions to vacate in situations when the Supreme Court’s FAA preemption jurisprudence suggests that state vacatur law would not be preempted).

party to submit to mediation removes the self-determination and consent that underlie the entire mediation process. Mediation should not be mandatory—educate the parties as to the process and the mediators—but let them make the choice.

Furthermore, imposing the FAA's substantive provision (section two) on mediation is functionally equivalent to enforcing an agreement to mediate future disputes under contract law. By and large, courts have refused to specifically enforce an agreement to enter into good faith negotiations on the ground that the promise is too indefinite under contract law.¹⁸⁴ Similarly, courts should not enforce agreements to mediate future disputes under either the FAA or under contract law principles because the *sine qua non* of mediation is the party's consent to mediate at the current time.¹⁸⁵ Once that consent is withdrawn, the entire foundation of the mediation has vanished and the mediation procedure should end.

Moreover, the insertion of procedural devices into the mediation and its outcome—devices such as arbitrators' subpoena power, the court's authority to appoint mediators, and the parties' ability to enforce these devices through motions or appeals—contradict its status as a flexible, informal, and mainly amicable dispute resolution process. Instead, it imposes a degree of force that mediation does not contemplate. Similarly, providing one party with the power to confirm or vacate a settlement agreement arising out of mediation confers courts with the ability to consider the mediator's process and the merits of the outcome. This consequence is totally at odds with the notion of self-determination as well as the confidentiality privilege, a hallmark of the process.

While arbitration of a securities dispute is plainly covered by the FAA,¹⁸⁶ securities mediation, in particular, does not need the framework of the FAA. The SROs have developed a simple forum rule structure to provide minimal guidance to the participants in mediation. SEC oversight¹⁸⁷ ensures that these rules cannot be changed without passing through the investor-protective administrative lawmaking process. Any additional federal regulation through a statutory scheme with policy objectives and

¹⁸⁴ Schmitz, *supra* note 145, at 67–71. Schmitz argues that this reluctance stems from anachronistic judicial doctrines and should be eliminated. *Id.*

¹⁸⁵ See *id.* 64–65 & n. 325 (citing cases in which courts have refused to enforce an agreement to mediate future disputes). Schmitz contends those cases were wrongly decided as based on outmoded principles. *Id.*

¹⁸⁶ *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002) (applying FAA to securities arbitrations).

¹⁸⁷ See discussion *supra* Part II.A.1.

considerations different than those of the 1934 Act would run the risk of imposing provisions in conflict with each other in substance or in spirit.

In sum, the extension of *Fisher* out of the labor field into the securities field would be an unwarranted extension of the FAA. Rather, to minimize federal intervention in mediation so as to keep mediation an informal and inexpensive process, courts should not apply the FAA to securities mediation. SEC oversight provides the necessary federal protection of investors; any additional regulation is unnecessary and inhibiting.

B. State Regulation

Regulation of mediation at the state level has been exploding over the past decade.¹⁸⁸ State statutes governing mediation vary from provisions mandating mediation of certain specialized types of disputes,¹⁸⁹ to provisions for court-annexed mediation,¹⁹⁰ to more general provisions facilitating the use of mediation.¹⁹¹ Most of the state statutes address the confidentiality of mediation communications, establishing some type of privilege, although these laws vary considerably in the scope of protection they offer.¹⁹²

Because of SEC oversight at the national level, and the nationwide scope of securities mediation, individualized state level regulation has the potential to interfere with the uniformity of the process. In addition, like the inhibiting effect the application of the FAA would have on securities mediation, state mediation laws could also impede the flexibility of the process. In this section, I explore whether any state mediation laws apply to securities mediation and what effect that application has on the process.

Due to the variety of legislation across the country, it is impossible to generalize about the impact of state law on securities mediation. However, since the majority of securities mediations take place in Florida, California and New York,¹⁹³ those states' mediation laws are illustrative of the potential impact. Florida's statutes governing private mediation provide that the

¹⁸⁸ See Scott H. Hughes, *The Uniform Mediation Act: To the Spoiled Go the Privileges*, 85 MARQ. L. REV. 9, 15–17 (gathering statistics and estimating that, as of 2001, states had more than 2500 statutes with provisions affecting mediation).

¹⁸⁹ See, e.g., NEV. REV. STAT. ANN. §383.160 (Lexis 1999) (legislation providing for mediation of disputes involving Native American burial sites in Nevada).

¹⁹⁰ See, e.g., CONN. GEN. STAT. ANN. §§ 46b–53a, 59a (West 2005).

¹⁹¹ See, e.g., TEX. LOC. GOV'T CODE § 174.151 (Vernon 2005).

¹⁹² Gregory Firestone, *An Analysis of Principled Advocacy in the Development of the Uniform Mediation Act*, 22 N. ILL. U. L. REV. 265, 270 (2003).

¹⁹³ Email from Kenneth Andrichik, Senior Vice President, NASD Dispute Resolution, Inc., to Jill I. Gross, Associate Professor of Law, Pace Law School (Nov. 3, 2004) (on file with author).

parties can choose whatever mediation procedures they want, and the state will grant immunity to mediators¹⁹⁴ and cloak the proceedings with a confidentiality privilege.¹⁹⁵ California law regulating private mediation¹⁹⁶ prevents mediators from testifying,¹⁹⁷ gives mediators immunity,¹⁹⁸ and deems mediation communications to be confidential and thus protected from disclosure.¹⁹⁹ Finally, New York neither has a general statute regarding mediation nor does it have a subject matter-specific statute governing securities mediation. However, the Judiciary Law provides that mediation communications are confidential,²⁰⁰ and its Civil Procedure Code requires that mediation agreements arising out of a court action be reduced to writing to be enforceable.²⁰¹

Additionally, in 2001, in response to nationwide discrepancies in mediation rules and to “establish a consistent and predictable structure for mediation,”²⁰² particularly those rules regarding confidentiality of mediation proceedings,²⁰³ the American Bar Association and the National Conference of Commissioners on Uniform State Laws enacted the Uniform Mediation

¹⁹⁴ FLA. STAT. § 44.107 (2005).

¹⁹⁵ FLA. STAT. § 44.102(3) (2005).

¹⁹⁶ See generally CAL. EVID. CODE, §§ 1115–1128 (Deering 2005).

¹⁹⁷ CAL. EVID. CODE § 703.5 (Deering 2005).

¹⁹⁸ Howard v. Drapkin, 271 Cal. Rptr. 893, 897–901 (Cal. Ct. App. 1990).

¹⁹⁹ CAL. EVID. CODE § 1119 (Deering 2005); see also Rojas v. Super. Ct. of L.A. County, 93 P.3d 260 (Cal. 2004) (interpreting broadly the scope of California’s mediation confidentiality provision to preclude the disclosure of photographs, expert reports, and derivative materials prepared for the purpose of mediation).

²⁰⁰ NY JUD. L. § 849-b (McKinney 2005); see also Wright v. Brockett, 571 N.Y.S.2d 660 (N.Y. Sup. Ct. 1991) (holding that mediation communications are confidential); People v. Snyder, 492 N.Y.S.2d 890 (N.Y. Sup. Ct. 1985) (holding that mediation confidentiality provision applies to criminal cases).

²⁰¹ N.Y. C.P.L.R. 2104 (McKinney 2003); Bartley v. Fed. Express Corp., 683 N.Y.S.2d 737 (N.Y. Sup. Ct. 1998).

²⁰² Philip J. Harter, *The Uniform Mediation Act: An Essential Framework for Self-Determination*, 22 N. ILL. U. L. REV. 251, 252 (2002).

²⁰³ While the impetus of a uniform mediation act was to increase predictability and simplicity so as to encourage greater use of mediation, the drafters also recognized “that many different models of mediation appear to work well in different settings, and it might be counterproductive to attempt to create a ‘one size fits all’ model for the practice of mediation.” Firestone, *supra* note 192, at 270; see also Prefatory Note, UNIF. MEDIATION ACT (2001) (amended 2003), <http://www.law.upenn.edu/bll/ulc/mediat/2003finaldraft.pdf> [hereinafter Prefatory Note]. The drafters, therefore, focused their efforts on areas where uniformity was required. Firestone, *supra* note 192, at 269.

Act (UMA).²⁰⁴ The UMA, in those states that have adopted it,²⁰⁵ plainly applies to securities mediation, as the Act's scope is quite broad.²⁰⁶

None of these state provisions appear to add an intrusionary layer of regulation of securities mediation. Rather, to the extent they exist at all, these provisions, particularly the confidentiality privilege, appear consistent with the mediation rules of the SRO dispute resolution forums.²⁰⁷

Notably, NASD supports the UMA because the UMA and the securities mediation forum rules are very similar.²⁰⁸ For example, NASD Rule 10326 requires that no verbatim record be kept of mediation sessions, similar to the requirement of section seven of the UMA that no final report be made by the mediator.²⁰⁹ NASD Rule 10406 and UMA's section four craft a similar

²⁰⁴ See UNIF. MEDIATION ACT (2001) (amended 2003). The ABA's approval followed shortly after in early 2002. *Id.* The Act's Prefatory Note states that the UMA has three major goals: (1) to "promote candor of parties through confidentiality of the mediation process, subject only to the need for disclosure to accommodate specific and compelling societal interests;" (2) to "encourage the policy of fostering prompt, economical, and amicable resolution of disputes in accordance with principles of integrity of the mediation process, active party involvement, and informed self-determination by the parties;" and (3) to "advance the policy that the decision-making authority in the mediation process rests with the parties." Prefatory Note, *supra* note 203, at 7.

²⁰⁵ As of the middle 2005, six states—Illinois, Iowa, Nebraska, New Jersey, Ohio and Washington—have passed the UMA, and an additional six jurisdictions—Connecticut, District of Columbia, Indiana, Massachusetts, Minnesota and Vermont—have introduced bills in their legislatures to enact the UMA. See Uniform Law Commissioners, Legislative Fact Sheet, A Few Facts About the Uniform Mediation Act, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-uma2001.asp (last visited Nov. 3, 2005).

²⁰⁶ See UNIF. MEDIATION ACT, § 3(a) (defining UMA's scope to include mediations where the parties have an expectation of confidentiality).

²⁰⁷ See NASD Code of Arbitration Procedure Rule 10406.

²⁰⁸ In issuing a letter of support for the UMA in New York, NASD-DR expressed its belief that the UMA is helpful to securities mediation because it recognizes mediation as a useful and distinct ADR process, creates a uniformity of approach, and provides a backdrop of rules that complement the NASD rules. Interview with Kenneth Andrichik, *supra* note 23.

²⁰⁹ Section 7(a) of the UMA prohibits the mediator from making any report, assessment, evaluation, recommendation, finding or other communication regarding mediation to a court, administrative agency, or other authority that may make a ruling on the dispute that is subject of the mediation. This prevents the "mediators from using the threat of an unfavorable report to compromise the self-determination of any party." Firestone, *supra* note 192, at 271–272. For further discussion of this section, see Carol L. Izumi & Homer C. La Rue, *Prohibiting "Good Faith" Reports Under the Uniform Mediation Act: Keeping the Adjudication Camel Out of the Mediation Tent*, 2003 J. DISP. RESOL. 67.

privilege that assures confidentiality in mediation communications.²¹⁰ And, like NASD mediator disclosure requirements, section nine of the UMA requires mediators to disclose conflicts of interest. Finally, NASD mediation's overall emphasis on party choice²¹¹ is entirely consistent with the UMA's promotion of the autonomy of the parties.²¹² The two sets of rules were written in the spirit of minimal intervention while securing fairness and preserving party freedom.

Furthermore, since the parties consent to be governed by the forum's mediation rules, these forum rules supplement any applicable state laws. And, if NASD's Mediation Rules conflicted with a state's mediation law, then the state law is likely to be preempted by the Exchange Act, on the ground that the NASD rules were approved by the SEC as part of its rulemaking oversight pursuant to the 1934 Act.²¹³ Unlike the intrusion threatened by an over-expansive state or federal court interpretation of the FAA, state-level mediation laws do not threaten the fairness of securities mediation.

III. THE FAIRNESS OF SECURITIES MEDIATION

As stated above, regulation is one way to ensure fairness in an ADR process.²¹⁴ In this part of the Article, I will analyze whether mediation

²¹⁰ UMA § 4 allows a mediator participant, a mediator or a third party to "refuse to disclose" any mediation communication in a "proceeding." UNIF. MEDIATION ACT § 4. The act defines "Proceeding" as "a judicial, administrative, arbitral, or other adjudicative process including related pre-hearing and post-hearing motions, conferences and discovery." UNIF. MEDIATION ACT § 2(7). Thus, mediation communications are free from discovery and not admissible in evidence in a legal or investigatory proceeding. Firestone, *supra* note 192, at 272. For a detailed analysis of the UMA's confidentiality privilege and its exceptions, see Hughes, *supra* note 188, at 24-68.

²¹¹ See discussion *infra* Part III.A.

²¹² The Prefatory Note states "it is important to avoid laws that diminish the creative and diverse use of mediation. The Act promotes the autonomy of the parties by leaving to them those matters that can be set by agreement and need not be set inflexibly by statute." Prefatory Note, *supra* note 203; see also Firestone, *supra* note 192, at 271 (noting that the drafters of the UMA were intent to preserve the power of self-determination that accompanies mediation).

²¹³ See *Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119 (9th Cir. 2005) (holding that the 1934 Act preempts the application of California's Ethics Standards for arbitrators to NASD-appointed arbitrators because the standards conflict with NASD arbitrator disclosure requirements); *Jevne v. Super. Ct. of L.A. County*, 111 P.3d 954 (Cal. 2005) (same).

²¹⁴ See *supra* note 90 and accompanying text.

contains other, non-regulatory hallmarks of fairness for investors in a securities dispute.

Fairness in adjudicatory processes typically is measured by the decision-making process and the outcome as compared to established legal rules.²¹⁵ However, as others have noted already, the confidentiality of mediation and its other unique features do not allow observers to measure its fairness using this comparison.²¹⁶ Moreover, unlike public judges, mediators are not obligated to help parties reach outcomes that take into account just distributions of public resources; they just must help parties resolve their dispute.²¹⁷

As a result, ADR scholars have identified alternative measures to evaluate the fairness of a mediation process. For example, Professors Cole, McEwen and Rogers argue that an “informed consent” model of mediation—one in which party choice dominates—ensures fairness.²¹⁸ Professor Stulberg examines the fairness of mediation through three dimensions: the jurisprudential framework (*i.e.*, did the parties secure what they were *legally* entitled to?), substantive outcome (*i.e.*, does one party end up worse off as a result of choosing mediation over another dispute resolution process?), and procedure (*i.e.*, does the manner in which the mediator conducts mediated communications undermine a party’s integrity or self?).²¹⁹ Professor Sternlight contends that participants in a dispute resolution process look for three distinct benefits: substantive justice/fair result, procedural justice and achievement of other personal and emotional goals.²²⁰ Professors Hyman and Love have identified the categories of justice in mediation as reparative

²¹⁵ COLE ET AL., *supra* note 90, § 2:2.

²¹⁶ *Id.* They also contend that the goal of fairness may also conflict with the goals of effectiveness, quality, and access. However, I believe that effectiveness, quality, and access are dimensions of fairness and need not be considered in competition with fairness.

²¹⁷ Jonathan M. Hyman, *Swimming in the Deep End: Dealing with Justice in Mediation*, 6 CARDOZO J. CONFLICT RESOL. 19, 19 (2004) (“Mediators have no authority to determine if a resolution is fair or just.”); Jonathan M. Hyman & Lela P. Love, *If Portia Were a Mediator: An Inquiry into Justice in Mediation*, 9 CLINICAL L. REV. 157, 158 (2002).

²¹⁸ COLE ET AL., *supra* note 90, § 2:2. They write: “With some exceptions, the evolving definition of ‘fairness’ in legal policies toward and commentaries about mediation is the preservation of choice by the parties. That is, a mediation process is fair if it preserves choice, and an outcome is fair if freely chosen by the parties.” *Id.*

²¹⁹ See Joseph B. Stulberg, *Fairness and Mediation*, 13 OHIO ST. J. ON DISP. RESOL. 909, 910–16 (1998).

²²⁰ Sternlight, *supra* note 16, at 299.

justice (including restorative justice, retribution and revenge), distributive justice, relationships and procedural justice.²²¹

By synthesizing what I believe to be these complementary rather than mutually exclusive views,²²² I examine in this section of the paper the fairness of securities mediation to the individual investor along five dimensions: party choice, legal justice, substantive outcome, procedural justice and achievement of non-legal goals.

A. Party Choice

This first dimension—perhaps the most important one to ensure fairness in mediation²²³—examines the nature and scope of the “informed consent” of the process participants. The securities mediation process revolves around party choice and self-determination, leaving disputants with a strong sense that they had a full opportunity to participate in its outcome. In fact, the most important decision—the decision to participate at all—is determined entirely by party choice. While one party can request mediation, no NASD mediator will conduct a mediation session unless all parties consent to participate.²²⁴ This contrasts sharply both with mediation in other contexts in which participation might be mandatory,²²⁵ as well as with arbitration, where investors’ advocates continue to argue that customers have not given meaningful consent to participate in the arbitration process.²²⁶

Furthermore, the mediation process is designed to maximize the parties’ control over the outcome. Mediators, who do not necessarily have to be

²²¹ See Hyman & Love, *supra* note 217, at 162–74 (arguing that justice in mediation comes from “below,” from the parties, and not from above, from a public adjudicator).

²²² The debate about what constitutes “justice” in mediation is beyond the scope of this paper, and not necessary to resolve to analyze the fairness of securities mediation. Indeed, I believe that many of these categories differ only by semantics, not by substance.

²²³ See COLE ET AL., *supra* note 90, at § 2:2.

²²⁴ NASD Rule 10401(c) (“Neither the [NASD] nor any mediator appointed to mediate a matter pursuant to these Procedures shall have any authority to compel a party to participate in a mediation or to settle a matter”); NASD Rule 10046(b) (“Mediation is voluntary and any party may withdraw from mediation at any time prior to the execution of a written settlement agreement by giving written notice of withdrawal to the mediator, the other parties, and the Director”).

²²⁵ See, e.g., Edward F. Sherman, *Court-Mandated Alternative Dispute Resolution: What Form of Participation Should Be Required?*, 46 SMU L. REV. 2079 (1993) (exploring obligations of parties and counsel to participate in court-annexed mediation); Maureen A. Weston, *Checks on Participant Conduct in Compulsory ADR: Reconciling the Tension in the Need For Good-Faith Participation, Autonomy and Confidentiality*, 76 IND. L.J. 591, 599 (2001) (summarizing concerns arising out of compulsory ADR).

²²⁶ See discussion, *supra* note 47 and accompanying text.

lawyers or judges, or even have securities law knowledge, are trained to “identify areas of agreement, to lead each party to some understanding of the other’s position, to introduce a measure of reality into each party’s view of its own case, to induce reasonable concessions and ultimately, if successful, to craft a mutually acceptable settlement.”²²⁷ “The mediator helps the parties’ face-to-face discussions remain focused and productive.” Then, the mediator may hold private caucuses with each party separately, and will carry messages—clarifications, questions, proposals, offers, and counter offers—back and forth between them.²²⁸ Because mediation is designed to bring the parties together through caucuses and other facilitated communications rather than force them further apart through adversarial interactions, such as those in arbitration or litigation, parties leave the mediation sessions feeling less confrontational and more in control of the outcome.

The consensual nature of securities mediation is further illustrated by the range of options offered to participants during the process. For example, NASD-DR trains its mediators in a variety of techniques specifically to maximize party choice.²²⁹ NASD’s roster of mediators²³⁰ spans the evaluative to facilitative style spectrum.²³¹ Evaluative mediators offer an

²²⁷ *Ruder Report*, *supra* note 11, at 47–48.

²²⁸ *Mediation: An Alternate Path*, *supra* note 10.

²²⁹ To be eligible for NASD’s mediator roster, applicants must receive intensive training. Interview with Kenneth Andrichik, *supra* note 23. While initially it did offer mediator training, NASD-DR no longer offers its own training, as its rosters are substantially filled with more than 1000 mediators. For outside training to qualify, it must (1) cover a broad spectrum of ADR mechanisms; (2) teach techniques for mediators in addition to theory; (3) provide significant role play opportunities; (4) address the ethical considerations of a mediator; and (5) take place over several days rather than several hours. In addition, any mediator trained outside the NASD must also have prior mediation experience in other forums and demonstrated skills, as evidenced by four references. *Id.*

²³⁰ This roster initially was comprised of NASD *arbitrators* who were already trained as mediators, as well as commercial *mediators* recruited from other industries. NASD was careful not to assume that arbitrators would automatically make good mediators. *Id.*

²³¹ In a seminal work, Professor Riskin proposed a grid to organize mediator styles into a spectrum, to attempt to capture the plethora of styles utilized by mediators today. At each end of the continuum are mediators defined as either evaluative or facilitative. See Leonard L. Riskin, *Understanding Mediators’ Orientations, Strategies, and Techniques: A Grid for the Perplexed*, 1 HARV. NEGOT. L. REV. 7, 50–51 (1996) [hereinafter *A Grid For The Perplexed*]. I will not join the debate as to whether this grid is appropriate, or whether evaluative mediation is even “mediation.” (see, e.g., Kimberlee K. Kovach & Lela P. Love, *Mapping Mediation: The Risks of Riskin’s Grid*, 3 HARV. NEGOT. L. REV. 71 (1998) (arguing that Riskin’s grid should be “remapped” and that

assessment of the merits of the respective positions of the parties, and attempt to direct the parties towards a settlement.²³² They see themselves as the “voice of reason” and provide a reality check on the parties’ expectations.²³³ In contrast, facilitative mediators let the parties craft their own solutions, by clarifying and enhancing communications between them.²³⁴ Facilitative mediators do not evaluate the merits of a position, but assist the parties in evaluating their own positions.²³⁵

As a result, the parties have the option of choosing their own mediator and mediation style from a list provided by the forum.²³⁶ That list discloses information about the mediator’s “employment, education, and professional background, as well as information on the mediator’s experience, training,

evaluative mediation is out of bounds for a mediator); Joseph B. Stulberg, *Facilitative Versus Evaluative Mediator Orientations: Piercing the “Grid” Lock*, 24 FLA. ST. U. L. REV. 985, 1001 (1997) (criticizing Riskin’s “grid” analysis as “implausible”), but rather refer to Riskin’s grid only for definitional and explanatory purposes. Moreover, in reality, many mediators offer aspects of both of these styles, and practice somewhere along the evaluative-facilitative continuum. Riskin has more recently adjusted his grid to use the alternate terms “directive” or “elicitive” to describe mediator interventions. See Leonard L. Riskin, *Decision-Making in Mediation: The New Old Grid and the New New Grid System*, 79 NOTRE DAME L. REV. 1, 2 (2003).

²³² Carole J. Brown, *Facilitative Mediation: The Classic Approach Retains Its Appeal*, 4 PEPP. DISP. RESOL. L. J. 279, 283 (2004).

²³³ Telephone Interview with Kenneth Andrichik, Senior Vice President, NASD Dispute Resolution, Inc. (Jan. 11, 2005).

²³⁴ See *A Grid for the Perplexed*, *supra* note 231, at 24. For a fuller explanation of the facilitative model of mediation, see Robert A. Baruch Bush, *Substituting Mediation for Arbitration: The Growing Market for Evaluative Mediation, and What It Means for the ADR Field*, 3 PEPP. DISP. RESOL. L. J. 111, 112–16 (2002) (comparing evaluative/directive mediation to transformative/facilitative mediation).

²³⁵ Brown, *supra* note 232, at 283. One additional mediation model—transformative mediation—was identified in 1994 by Professors Robert A. Baruch Bush and Joseph P. Folger in their book, *THE PROMISE OF MEDIATION*. ROBERT A. BARUCH BUSH & JOSEPH P. FOLGER, *THE PROMISE OF MEDIATION* (1994). Transformative mediators help the parties “identify the opportunities for empowerment and recognition shifts as they arise in the parties’ own conversation; choose whether and how to act upon these opportunities; and thus change their interaction from destructive to constructive, as they explore specific disputed issues.” Institute for the Study of Conflict Transformation, Inc., *The Transformative Framework*, <http://www.transformativemediation.org/transformative.htm> (last visited Nov. 3, 2005). This model and its underlying theory are now accepted in dispute resolution circles as one possible model of mediation. See Dorothy J. Della Noce, *From Practice to Theory to Practice: A Brief Retrospective on the Transformative Mediation Model*, 19 OHIO ST. J. ON DISP. RESOL. 925, 926 (2004). However, very few securities mediations follow the transformative model, so its relevance to securities mediation is minimal.

²³⁶ See NASD Rule 10404(a) (2005).

and credentials as a mediator.”²³⁷ The ability of the parties to choose among differing mediator styles to find the mediator style that works best for them in their particular dispute legitimizes the party’s control over the process.²³⁸

Parties also have the choice of the time frame of the mediation process. Court-annexed mediation sessions typically must take place on the spot within a short time span. In arbitration, parties must await completion of discovery before scheduling a hearing, and the scheduling of hearing sessions is often dependent on the arbitrators’ schedules and is out of the parties’ control. The time frame of mediation, in contrast, is dictated entirely by the parties, and the forum can move as quickly or as slowly as the parties desire.

Finally, party choice is reflected in the variety of options available for the presentation of the case, including the need to be represented by a lawyer, the use of experts, the presence of parties and witnesses, and the offering of documentary evidence. Unlike arbitration, where these variables are set by forum rules, in mediation, all of these variables can be negotiated with the mediator, and the forum rules contemplate only that the parties agree to the process ultimately used. The emphasis on party self-determination is a strong indicator of the fairness of securities mediation.²³⁹

B. Legal Justice

This dimension examines what the parties are legally entitled to and whether the process meets those expectations. At the outset, participants enter mediation in the spirit of compromise, hoping to reach a resolution of the dispute through settlement. Stated differently, the choice to enter mediation reflects a judgment by both the investor and the broker/firm that the dispute is not a “slam dunk” case for either side, and the nuances and complexities of the dispute require a third party to find common ground.

²³⁷ See NASD Rule 10404(b) (2005). Today, NASD-DR does not look at whether a mediator is evaluative or facilitative to consider adding him or her to its roster. Instead, NASD-DR considers the overall quality, prior mediation experience, and training of the mediator. *Id.*

²³⁸ One downside of this choice is that repeat players have resisted using mediators other than a narrow, comfortable roster as they are reluctant to acquaint themselves with new mediators. *Seminar Highlights: SLA C&L Conference, SEC. ARB. COMMENTATOR*, April 2004, at 9. One certainly may view these as party failures rather than drawbacks in the process. According to the President of NASD-DR, this phenomenon has resulted in a “bottleneck” in the NASD mediation process. This bottleneck is caused by the parties waiting for their favorite mediator and thus is a choice of the parties rather than a breakdown in the process. *Id.* (quoting Linda Fienberg).

²³⁹ This emphasis on party choice equally strengthens the case for procedural justice under Welsh’s framework. See *infra* note 273 and accompanying text.

Thus, any resolution is likely to reflect that spirit and will not secure “legal justice” in the sense of all remedies in their entirety that a party might be legally entitled to in court or arbitration.²⁴⁰ That being said, in order to achieve a mediated resolution, mediation participants necessarily must refer to legal rules and remedies as a baseline on which to set expectations.

What are investors entitled to recover? Most customer complaints against brokers involve four types of misconduct:²⁴¹ (1) unsuitable recommendations—the broker violated his duty to make recommendations consistent with the customer’s investment objective and financial condition;²⁴² (2) churning—the broker controlled the customer’s account and used that control to engage in excessive trading for the purpose of generating commissions;²⁴³ (3) misrepresentations—the broker, intentionally or negligently, made false or misleading statements of material fact on which the customer relied when making an investment decision;²⁴⁴ and (4) unauthorized trading—trading without the customer’s permission in violation of a contractual or fiduciary duty.²⁴⁵

²⁴⁰ For that reason, an investor with a clear-cut, “slam-dunk” case likely has no reason to compromise and should not consider mediation. *See supra* note 19.

²⁴¹ *See* Black & Gross, *supra* note 2, at 1008–13; *see also* Ruder, *supra* note 50, at 1102–03 (acknowledging that alleged broker-dealer misconduct “usually follows a familiar pattern characterized under recognizable headings”). Customers can charge this wrongdoing through common law causes of action such as fraudulent or negligent misrepresentation, breach of fiduciary duty, or breach of contract/agency. *Id.*

²⁴² *See* National Association of Securities Dealers Manual, Conduct Rule 2310 (2005), *available at* http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466 (follow links to particular rule); *see also* Black & Gross, *supra* note 3, at 490–92 (explaining suitability rule in more detail).

²⁴³ SEC Rule 15c1-17, 17 CFR § 240.15c1-7 (2005); *see also* Black & Gross, *supra* note 3, at 494–95 (explaining churning in more detail).

²⁴⁴ Claims for misrepresentation may be based on the antifraud provisions of the Exchange Act, on state securities statutes, or on common law theories of negligent or intentional misrepresentations. *See* Black & Gross, *supra* note 3, at 484 n.7, 495–496 nn.75–83 and accompanying text.

²⁴⁵ The NASD’s Interpretive Material under Conduct Rule 2310 states that NASD considers unauthorized transactions to be a type of fraudulent activity and thus a violation of the member’s fair dealing obligation. *See* NASD Rule 2310, IM-2310-2(b)(4)(A)(iii); *see also* Black & Gross, *supra* note 2, at 1011–12 nn.131–34 and accompanying text. Customers can also bring an unauthorized trading claim under breach of contract or agency principles.

All of these complaints require proof that the investor acted *reasonably* both before and after the challenged transactions.²⁴⁶ For example, to prove liability for negligent or fraudulent misrepresentations, including those stemming from potentially unsuitable recommendations or churning (both often considered types of fraud), the investor must establish that the alleged misstatement or omission was material—that there was a *reasonable* likelihood that a *reasonable* investor would have considered it important in making an investment decision.²⁴⁷ The investor must also show that he was *reasonable* in relying on the broker's statements.²⁴⁸ To prove liability for unauthorized trading, the investor frequently must overcome a ratification defense by proving that he acted *reasonably* after learning about a transaction by complaining to the pertinent players.²⁴⁹ Finally, proof that the investor acted with *reasonable* diligence in discovering the claim in a timely manner is necessary to defeat statute of limitations defenses to fraud claims.²⁵⁰

The “reasonable investor” standard is an offshoot of the “reasonable man” standard in tort law.²⁵¹ What is reasonable will vary depending on what is “demanded by the community for the protection of others against unreasonable risk.”²⁵² Courts today, however, expect investors to understand

²⁴⁶ Robbins posits five questions that most arbitrators will want answered in virtually any customer arbitration: (1) Did the customer reasonably trust the broker?; (2) Did the broker breach that trust?; (3) Does the documentation support the claims?; (4) How credible are the parties and the evidence?; and (5) Is the loss reasonably quantifiable and did the customer take reasonable steps to mitigate damages? *See* ROBBINS, *supra* note 21, § 1–2.

²⁴⁷ *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231–232 (1987); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

²⁴⁸ *See Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1031 (2d Cir. 1991).

²⁴⁹ *See, e.g., Modern Settings, Inc. v. Prudential-Bache Sec., Inc.*, 936 F.2d 640, 645–46 (2d Cir. 1991).

²⁵⁰ Under the limitations provision of the Sarbanes-Oxley Act, “a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws . . . may be brought not later than the earlier of (1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation.” 28 U.S.C. § 1658(b) (2005). Courts find that a plaintiff in a federal securities case has “actual knowledge” of the fraud for purposes of triggering the one-year limitations period when he “obtains actual knowledge of the facts giving rise to the action” or when a *reasonable* investor would have discovered the existence of the fraud in the exercise of *reasonable* diligence. *LC Capital Partners, L.P. v. Frontier Ins. Group*, 318 F.3d 148, 154 (2d Cir. 2003) (internal quotations omitted) (emphasis added).

²⁵¹ *See Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 384 n.6 (citing *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1964)).

²⁵² *See* RESTATEMENT (SECOND) OF TORTS § 283 cmt. (c) (1965).

sophisticated investment concepts such as margin trading and its consequences,²⁵³ the time-value of money,²⁵⁴ diversification and risk,²⁵⁵ and the securities industry's compensation structure.²⁵⁶ If investors seeking damages in court acted or failed to act because they did not understand these concepts, courts (at least under the federal securities laws) will not permit them to surmount the legal hurdle of reasonableness and will deny recovery. Similarly, arbitrators, who look to this same law for guidance, must also apply these anachronistic concepts even in today's complex securities world.²⁵⁷

Does the mediation process alter this high standard at all? The answer depends, in part, on whether the mediator has an evaluative or facilitative style. In securities mediation, the evaluative mediator has gained favor more recently, as lawyers practicing in this field want a prediction as to the likelihood of success in arbitration.²⁵⁸ Using an evaluative mediator offers an opportunity for investors to recover what they might be entitled to in arbitration. Those mediators assess the governing law and help the parties reach a settlement that conforms to the boundaries of that law and does not exceed what investors would recover in arbitration, yet does not overly penalize investors for choosing to forego arbitration. In addition, evaluative mediators can revisit the capabilities and limits of the reasonable investor in light of the complexities of the current markets. The evaluative process can help the parties adjust their unreasonable expectations that might be preventing a negotiated settlement.²⁵⁹ As a result, I believe that the evaluative mediation process has the potential to resolve the dispute for the reasonable investor through the dimension of legal justice, by assisting the

²⁵³ *Zerman v. Ball*, 735 F.2d 15, 21 (2d Cir. 1984); *Newman v. L.F. Rothschild, Unterberg, Towbin*, 651 F. Supp. 160, 164 (S.D.N.Y. 1986).

²⁵⁴ *Levitin v. PaineWebber, Inc.*, 159 F.3d 698, 702 (2d Cir. 1998).

²⁵⁵ *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 351 (2d Cir. 1993).

²⁵⁶ *Platsis v. E.F. Hutton & Co., Inc.*, 946 F.2d 38, 41 (6th Cir. 1991).

²⁵⁷ See *Black & Gross*, *supra* note 2, at 1013–26 (arguing that the law governing customer-broker disputes is frozen in development since arbitration took over as the mandatory forum for their resolution).

²⁵⁸ At PLI's Securities Arbitration 2004 Program, several panelists expressed this view. The program was held in New York City on August 11, 2004.

²⁵⁹ See *supra* notes 21–22 and accompanying text. Brokerage firm lawyers also praise mediation as a method to convince the broker to resolve disputes, as it gets the broker to the settlement table sooner than in arbitration, and provides a reality check to brokers who think they have done nothing wrong.

parties reach a settlement that takes into consideration relevant law, adjusted for developments in the industry.²⁶⁰

One limitation to this potential, at least in theory, is that NASD-DR does not require that the mediator have securities law knowledge. A mediator who is evaluative in style but not knowledgeable about securities laws or the industry might react to an investor's dispute with disdain for the investor's lack of sophistication, or conversely, might overreact to the broker's seemingly unprofessional conduct that did not violate any legal standards. Without a securities background, the mediator cannot be fully evaluative, and cannot steer the parties to a settlement that comports with legal justice.²⁶¹

Another detractor from the potential for legal justice is the availability and use by the parties of a facilitative mediator who does not view it as her role to steer the parties in a settlement direction that comports with the parameters of the law. Instead, a facilitative mediator will guide the parties to a settlement that focuses on compromising the parties' legal rights and sacrificing entitlements in order to resolve the dispute. In facilitative mediation, an individual investor has the chance to avoid the neutral's potentially harsh judgment in light of the demanding body of law and achieve a resolution that partially satisfies the investor's perception that the broker treated her improperly, even if the law would not permit recovery. As a result, facilitative mediation has less potential to resolve the dispute through the dimension of legal justice, but still has potential to resolve the dispute satisfactorily.

²⁶⁰ While NASD-DR's current published materials suggest that its forum relies predominantly on a facilitative model of mediation (*see Mediation: An Alternate Path*, *supra* note 10 (stating that "[m]ediation is an informal, voluntary process in which an impartial person, trained in *facilitation* and negotiation techniques, helps the parties reach a mutually acceptable resolution" and explaining that the "mediator uses the private caucus and other techniques to *facilitate* the negotiation" [emphasis added])), in fact, the forum offers a wide variety of mediator styles, and the use of the word "facilitative" in its materials does not necessarily express an institutional preference for facilitative mediation. Rather, because arbitration already was evaluative in nature, and NASD was trying to create an alternative for parties to arbitration, it chose to emphasize the facilitative possibilities offered by mediation to raise awareness of the full spectrum of possible mediation styles. Ultimately, the mediators disclose in their descriptive biographies the style they use in mediation, and the parties can choose the style of mediation they want to resolve their dispute. Interview with Kenneth Andrichik, *supra* note 23.

²⁶¹ Of course, in practice, parties choose their mediator with full disclosure as to that mediator's style and background, so an investor can avoid this problem by choosing only those evaluative mediators who have securities law knowledge.

C. Substantive Outcome

This dimension explores whether investors are better off in mediation than the mandatory alternative of arbitration as measured by the outcome of the process. At first glance, arbitration is an appealing option. Statistics show that investors recover some amount of monetary damages in about fifty percent of cases that proceed to an arbitration hearing.²⁶² Those statistics reveal an arguably investor-friendly forum.

Yet, upon further review, it becomes apparent that arbitration is becoming more like litigation,²⁶³ and arbitrators frequently are applying harsh legal standards to decide their disputes.²⁶⁴ Thus, arbitration might be evolving into a less investor-friendly forum. With an eighty percent or more settlement rate in mediation, investors must consider that mediation has a greater chance of resulting in a satisfactory outcome,²⁶⁵ whereas arbitration has a less than fifty percent chance of doing so.²⁶⁶

Ultimately, though, any conclusions about the substantive justice of securities mediation are tentative without empirical data.²⁶⁷ Because mediation is confidential in both process and outcome, no empirical data exists analyzing the outcomes of mediation. Moreover, by entering

²⁶² See NASD Dispute Resolution, Inc., Dispute Resolution Statistics, Results of Customer Claimant Arbitration Award Cases, http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=516&ssSourceNodeId=12 (last visited Nov. 3, 2005) [hereinafter Dispute Resolution Statistics].

²⁶³ See Black & Gross, *supra* note 2, at 998–1005.

²⁶⁴ See Black & Gross, *supra* note 3.

²⁶⁵ Those familiar with negotiation theory might argue that the 80% settlement rate is skewed upward because parties who choose to enter mediation already have determined that mediation is their best alternative to a negotiated agreement (“BATNA”), so those parties have a strong incentive to reach a settlement. Even if the data is skewed, it still is a relevant fact for those parties who choose mediation to know—as they also are the ones who have determined that their BATNA is mediation. This paper does not argue that investors with an extremely strong case on the merits should compromise by mediation; rather, this paper argues that mediation is a viable alternative to arbitration or negotiation for individual investors and not a process for investors to shun as unfair or unlikely to yield a just outcome.

²⁶⁶ I say less than 50% because investors who technically “win” an award but recover a very small sum of damages may very well be unsatisfied with this outcome.

²⁶⁷ An illustration of this is a recently conducted empirical study of the impact of a mediator’s style on party satisfaction in EEOC mediation. See E. Patrick McDermott & Ruth Obar, “What’s Going On” In Mediation: An Empirical Analysis of the Influence of a Mediator’s Style on Party Satisfaction and Monetary Benefit, 9 HARV. NEGOT. L. REV. 75 (2004). This study demonstrates that scholars’ academic debate about mediator style and the fairness of mediation in a particular context is enhanced by empirical data.

mediation, investors indicate their willingness to compromise. Assuming they could establish liability at an arbitration and recover their losses, investors consenting to resolve their dispute in mediation are giving up the possibility of being made whole in light of a purist legal standard.

Thus, any analysis of substantive outcomes in mediation cannot be fairly compared to outcomes in arbitration. Given this inability to assess substantive outcomes combined with the inherent concession of legal justice (especially with a facilitative mediator), our legal system should allow this form of resolution of customer disputes only if we can be sure that parties do not also sacrifice procedural justice.

D. Procedural Justice

What determines whether a dispute resolution process is procedurally fair to the participants? As a threshold matter, the participants must have unfettered access to the forum. In the case of securities mediation, investors and brokers are provided with equal access to the forum. Parties to a securities dispute can enter the mediation process through several avenues.²⁶⁸ First, NASD-DR suggests mediation at two points during the arbitration process—a letter encouraging mediation sent to parties just after a case is filed and a suggestion that the parties consider mediation during the arbitrators' initial pre-hearing conference call.²⁶⁹ Second, the staff prospects cases ripe for mediation from the arbitration roster and proactively contacts the parties and suggests mediation. Third, parties to a pending arbitration can agree on their own to attempt mediation. Finally, parties can initiate mediation without ever filing for arbitration.²⁷⁰ These multiple levels of access to the mediation forum ensure that parties who want to mediate their dispute are not turned away.

Once a party has access to a forum, it is critical for the participants to *perceive* that the system is fair.²⁷¹ Professor Welsh, a leading advocate of

²⁶⁸ For a flow chart depicting the progression of a case through NASD mediation, see NASD Dispute Resolution, Inc., *Mediation Case Flow*, http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=531&ssSourceNodeId=522 (last visited Nov. 3, 2005).

²⁶⁹ Interview with Kenneth Andrichik, *supra* note 23.

²⁷⁰ *Id.* Roughly 85% of cases that enter mediation originated as arbitration. Only 15% of mediation cases originated directly in mediation. Telephone Interview with Kenneth Andrichik (Dec. 13, 2004).

²⁷¹ Sternlight, *supra* note 16, at 296–97 (“Most of us would agree that it is important for disputants to feel that they have been treated fairly and justly by society’s dispute resolution systems.”).

procedural justice in mediation,²⁷² has identified four key elements that “reliably lead people to conclude that a dispute resolution process is procedurally fair”: (1) the process provides an opportunity for disputants to voice their concerns to a third party; (2) the disputants perceive that the third party actually considered these concerns; (3) the disputants perceive that the third party treated them in an “even-handed” way; and (4) the disputants feel that they were treated in a dignified and respectful manner.²⁷³

As for the first criteria, the very nature of the process enables the disputants to voice their concerns to a neutral third party, the mediator. An effective mediator listens to the parties’ concerns throughout the proceeding, and responds to those concerns during the settlement process. Moreover, by using highly trained mediators, NASD contributes to the parties’ perception of fairness.²⁷⁴

NASD-DR’s Mediation Ground Rules that set forth standards of conduct for parties and mediators also contribute to the parties’ perception of fairness.²⁷⁵ These Ground Rules stress the voluntary nature of the process,²⁷⁶

²⁷² E.g., Nancy A. Welsh, *Stepping Back Through the Looking Glass: Real Conversations with Real Disputants About Institutionalized Mediation and Its Value*, 19 OHIO ST. J. ON DISP. RESOL. 573, 580 (2004) (arguing that disputants both before and after the mediation “value the process primarily for the *procedural justice and the resolution* that it provides”) (emphasis added).

²⁷³ Nancy A. Welsh, *Remembering the Role of Justice in Resolution: Insights from Procedural and Social Justice Theories*, 54 J. LEGAL EDUC. 49, 52 (2004) (citing Nancy A. Welsh, *Making Deals in Court-Connected Mediation: What’s Justice Got to Do With It?*, 79 WASH. U. L.Q. 787 (2001)). Professor Sternlight also recognizes the importance of parties’ perceptions of procedural justice, rather than distributive justice, to measure whether participants believe the system is fair, but says more studies are needed. See Sternlight, *supra* note 16, at 297–98.

²⁷⁴ Some investors’ advocates have argued that some mediators of customer cases are “repeat players” who derive a substantial portion of their income from mediating for certain brokerage firms, and thus have an inherent bias favoring the firm. See Brian N. Smiley & Steven J. Gard, *A Message to Mediators*, SEC. ARB. COMMENTATOR, Jan. 2005, at 1 (contending that “there is a gathering concern that the process is serving the needs of the brokerage community more than it is helping injured investors achieve fair recoveries” and stating that “[t]o some extent, this perception stems from the realization that fulltime mediators sell their services to a fairly small number of brokerage firms and thus cannot afford to offend their repeat clients”). Smiley and Gard also contend that certain mediators who are “often judged on and tout their own closure rates, would rather convince an investor to take an inadequate settlement than let the negotiations ‘fail.’” *Id.* However, mediators are obligated to fully disclose the scope of their mediation practice and claimants are free to reject any mediator who appears to serve a particular firm frequently to eliminate this potential bias.

²⁷⁵ NASD Rule 10406 (2005).

²⁷⁶ NASD Rule 10406(b) (2005).

expressly deprive the mediator of the authority to “determine issues, make decisions or otherwise resolve the matter,”²⁷⁷ provide for joint sessions as well as separate communications between the mediator and each party,²⁷⁸ require cooperation and good faith from all participants,²⁷⁹ permit direct negotiations if the parties desire it,²⁸⁰ and preserve the confidentiality of mediation communications.²⁸¹ The Ground Rules also provide for enormous flexibility in adopting the process to meet the parties’ needs as they allow parties to amend the Ground Rules at any time during the process. These Ground Rules focus on the integrity of communications among the participants, strike a balance of decision-making authority between the mediator and the parties, and empower the parties to communicate through the mediator.

Additionally, with respect to the last three criteria, NASD-DR conducted an informal study of party satisfaction in all three of the areas and found a very high level of satisfaction with the mediation process and perception of fairness by party participants.²⁸² Some of this satisfaction stems from the fact that the entire process can be completed in a few months, whereas a securities arbitration case takes an average of fourteen months to reach an award from the date of filing.²⁸³ Additionally, pursuing a customer dispute in mediation typically costs less than pursuing it through award in arbitration. Most mediations finish in one day, as opposed to the typical multi-session, multi-day arbitration hearings, for which forum fees and attorney’s fees accrue rapidly.²⁸⁴

²⁷⁷ NASD Rule 10406(c) (2005).

²⁷⁸ NASD Rule 10406(d)–(e) (2005).

²⁷⁹ NASD Rule 10406(d)–(f) (2005).

²⁸⁰ NASD Rule 10406(f) (2005).

²⁸¹ NASD Rule 10406(g) (2005).

²⁸² NASD Dispute Resolution, *Mediation Survey* (2003) (on file with author) (reporting that an overwhelming number of those who responded to the survey felt that the mediation was fair and unbiased and were satisfied with the mediation process). See discussion *supra* notes 86–87 and accompanying text.

²⁸³ NASD-DR posts statistics on turnaround time of both arbitrations and mediations filed in its forum. The most recent statistics available indicate that the average turnaround time for mediation was about four months, whereas the average turnaround time for arbitration was fourteen months. See Dispute Resolution Statistics, *supra* note 262. While NYSE does not publish turnaround time data on its website, it is known anecdotally that the NYSE turnaround time for arbitrations is slightly less than at NASD-DR.

²⁸⁴ For example, for a \$75,000 claim, a customer must pay \$975.00 to file the claim and for the first pre-hearing conference. After that, each day of hearings costs \$1500.00. See NASD Dispute Resolution, Inc., Arbitration Filing Fee Calculator, http://apps.nasd.com/Mediation_&_Arbitration/Arb_Calc/Arb_Calc1.asp (last visited

Parties are, of course, far less satisfied if there is no resolution of the dispute.²⁸⁵ In that scenario, the parties have consented to mediate, paid the forum fees, gone through the process incurring costs, including attorneys' fees, and still ended up back where they started—needing to proceed with an arbitration to resolve the dispute. Also, most mediations start out as arbitrations. By proceeding with mediation, the parties participate in the voluntary exchange of information that is characteristic of mediation. Yet, if the mediator fails to resolve the dispute, the parties have disclosed information for the other side to use at the arbitration hearing that they otherwise might not have (for example, documents that parties did not need to exchange before the arbitration hearing because they were reserving them for their rebuttal case). Thus, by mediating the case, parties risk sacrificing their informational advantage.²⁸⁶

One other procedural disadvantage in mediation is that parties who lack access to documents and information in the possession, custody or control of the adverse party are mediating at an informational disadvantage as compared to a party to an arbitration or litigation who has been served with discovery materials. Moreover, the fact that discovery devices are available if parties are proceeding with a parallel mediation and arbitration might incentivize parties to pursue both devices, even if mediation were otherwise more suitable. This eliminates any cost and time saving advantage of mediation. As a result, mediation is only an efficient process if the parties settle their dispute.

E. Achievement of Non-Legal Goals

This dimension of fairness measures the degree to which the process provides the parties with an opportunity to achieve any of their non-legal goals. Investors with disputes against their brokers that arise in connection with the business of their securities account typically want one outcome from the dispute resolution process: monetary recovery. While money is the

Nov. 3, 2005). The same claim would cost \$150.00 to directly file in mediation, and \$100.00 to file from a pending arbitration, and then the parties must pay the mediator's costs and expenses, typically for one day of service and travel expenses. NASD Rule 10407 (2005).

²⁸⁵ Given that 80% or more of mediations settle, only a small number of parties fall into this category.

²⁸⁶ Those documents would not necessarily fall under the NASD mediation confidentiality clause, which covers only "opinions, suggestions, proposals, offers or admissions obtained or disclosed during the mediation . . ." NASD Rule 10406(g) (2005). Because the vast majority of mediations originated as an arbitration filing, this drawback is palpable.

primary motivator in customer cases, investors might have other objectives to achieve in pursuing the resolution of their dispute. These motives could include the desire to punish the wrongdoers, the desire for an apology for the broker's alleged unprofessional conduct, the desire for the firm to increase its supervision over the broker so another customer does not become another victim, or the desire to continue the investment relationship at the firm but perhaps with a different broker. Conversely, investors might seek to minimize the acrimony between them, as they formerly had a mutually beneficial business relationship. Some customers simply want recognition that the broker mishandled their investments, and it was not the customer's lack of diligence that caused the losses.²⁸⁷

Mediation can achieve these non-legal goals far better than arbitration, which usually takes place over several hearing sessions, following months of the adversarial discovery process. The parties only build more animosity in the zero-sum process of arbitration and end up with one result: win or loss, and some percentage of the claimed damages. A mediation settlement, on the other hand, can include any provision the parties consent to enforce, including an apology, a framework for future dealings, or even a provision for the firm to step up its compliance efforts in the future.

Moreover, while many customer disputes are fact intensive, they can raise significant public policy issues regarding the scope of the broker's duty to his customer. Some customers might want to use their dispute to develop the public law governing the brokers' duties. Some scholars have argued that mediation is inappropriate to resolve disputes involving issues affecting the public interest, because there will no development of precedent or public announcement of rights.²⁸⁸ However, this concern is not pertinent to securities mediation because the alternative to mediation is not adjudication in court, but arbitration.²⁸⁹ Even in arbitration there is no development of

²⁸⁷ I have discerned these motives based on my experiences while co-director of Pace Law School's Securities Arbitration Clinic, in which law students—under faculty supervision—provide free legal representation to small investors who have arbitrable disputes with their brokerage firms and brokers. In this capacity, over the past five years, I have attended the interviews of countless public customers, and have heard investors express a wide variety of non-legal objectives.

²⁸⁸ Sander & Goldberg, *supra* note 17, at 60 (stating that litigation may serve the public interest better than mediation in the consumer fraud context where violations have the potential to recur); Harry T. Edwards, *Alternative Dispute Resolution: Panacea or Anathema?*, 99 HARV. L. REV. 668, 676 (1986) (contending that “if ADR is extended to resolve difficult issues of constitutional or public law—making use of non-legal values to resolve important social issues or allowing those the law seeks to regulate to delimit public rights and duties—there is real reason for concern.”).

²⁸⁹ Furthermore, if we view investors participating in securities mediation as part of the disadvantaged class in America, then there might be cause for concern. *See* Edwards,

precedent and no public announcement of a prevailing party's rights.²⁹⁰ Thus, choosing mediation over arbitration will not decrease the already frozen development of precedent in connection with broker-dealer liability to customers.

In sum, the dimensions of party choice, procedural justice, and achievement of non-legal goals clearly favor mediation over arbitration. Investors have the potential to achieve legal justice in both arbitration and mediation. The remaining dimension of fairness—substantive justice—requires more empirical data in both mediation and arbitration before any conclusions can be drawn about the fairness of their comparative outcomes. This analysis illustrates that mediation is another ADR device that investors have at their disposal other than arbitration, containing hallmarks of fairness and offering the potential for a fair outcome.

IV. CONCLUSION

Lela P. Love's powerful image of justice in mediation depicts the mediator as a supportive bridge between the real parties in interest that reminds the parties of their need to communicate with each other to reach a resolution, but leaves the parties to freely determine that resolution.²⁹¹ This image resonates in securities mediation. Its procedures and emphasis on party choice, as well as its flexibility to achieve non-legal goals, provide justice to disputants. And, this justice is obtained without the concomitant baggage of its anti-investor distant cousin of court or its sister forum of litigation-like (and arguably mandatory) arbitration.

For those disputes that are not a slam-dunk for the individual investor, this image also suggests that securities mediation is a real alternative to arbitration, rather than a replacement. By expanding its mediation program and by ensuring its fairness, NASD has promoted a diversity of ADR methods for resolution of customers' disputes with their brokerage firms and

supra note 288, at 679 ("We must also be concerned lest ADR becomes a tool for diminishing the judicial development of legal rights for the disadvantaged."). However, investors today transact business in capital markets that are highly regulated with a view to investor protection. While individual investors may have less bargaining power than the repeat-player brokerage firm, they are not totally unprotected.

²⁹⁰ Black & Gross, *supra* note 2.

²⁹¹ See generally Lela P. Love, *Images of Justice*, 1 PEPP. DISP. RESOL. L.J. 29 (2000) (presenting images of justice of a judge, an arbitrator, and a mediator, and expressing concern that current arbitration and mediation practices have "strayed" from these images, risking a diminution of justice in these processes). For mediation, Professor Love questions the fairness of an "attorney-dominated, adversarial and ever more costly [mediation] proceeding." *Id.* at 34.

brokers. Arbitration is still available for some; direct negotiation for others. But, since securities mediation is a fair and flexible alternative, investors and their advocates have no reason to shun the mediation process as a different and unprotected forum. Instead, SEC oversight combined with harmonious state mediation law provides an adequate level of regulation over the process.

The real danger lurks in the potential of overregulation. If courts continue to follow the reasoning of the *Fisher* court and stretch the FAA beyond its plain meaning to cover mediation of securities disputes, then investors could be faced with airing the merits of the dispute in mediation, and simultaneously battling collateral issues in court. Under this interpretation, parties could invoke FAA provisions to create an infinite list of litigable issues. This scenario would endanger the fairness and appeal of securities mediation, as it would reduce party choice, flexibility and procedural justice, decrease efficiency, and increase cost. The legislative history is clear that the Congress that enacted the FAA intended the statute to cover binding arbitration only, not non-binding mediation.

The history, development and modern state of dispute resolution for individual investors suggest that mediation has the potential for exponential growth. There is no reason why the securities mediation programs of NASD-DR and NYSE should not be expanded to allow for maximum participation by any willing disputants, as the process yields a satisfactory outcome for a stunning eighty percent of participants who report an even higher percentage of satisfaction with the process itself.

In light of the current controversy over the fairness of securities arbitration, investors should more frequently choose Door Number Three—Mediation. There is no pot of gold (is there ever?) behind it, but there is a valuable prize: a real possibility of a fair opportunity to resolve a dispute. To me, that's a deal worth making.