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## The Securities Arbitrators' Nightmare

Constantine N. Katsoris\*

\*Fordham University School of Law, [ckatsoris@law.fordham.edu](mailto:ckatsoris@law.fordham.edu)

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# The Securities Arbitrators' Nightmare

Constantine N. Katsoris

## Abstract

Securities arbitration panels have arisen to deal with the rising tide of securities litigation. However, the application of arbitration procedure to securities claims has caused problems with clashes of procedure and enforcement issues. The United States Arbitration Act was passed to The Supreme Court addressed some of those issues in *Dean Witter Reynolds Inc. v. Byrd*, but did not determine whether *Wilko v. Swan*'s effective repeal of the Arbitration Act as it applies to securities claims brought under the Securities Act of 1933 also covered securities claims brought under the Securities Act of 1934. The author eventually determines that because of the policy advantages of arbitration, the securities industry should relax its standards to prevent brokers and buyers from forming contracts of adhesion through securities agreements that include mandatory arbitration provisions.

**KEYWORDS:** Securities Act of 1933, Securities Act of 1934, United States Arbitration Act, securities arbitration, arbitration

# THE SECURITIES ARBITRATORS' NIGHTMARE\*

Constantine N. Katsoris\*\*

## I. Introduction

As the public increasingly invests in the securities markets—directly or indirectly through IRAs, Keogh plans and other pension devices—litigation between the public and members of the securities industry has mushroomed. The cases litigated number in the thousands every year.<sup>1</sup> These disputes, however, are being channeled into arbitration with greater frequency. Forums for arbitration have been established by the various Securities Regulatory Organizations (SROs) such as the New York Stock Exchange and the National Association of Securities Dealers.<sup>2</sup> Arbitration provides the advantage of speedy dispute resolution by persons knowledgeable in the area, without excessive costs. Unless arbitration procedures are fair both in fact and in appearance, their present popularity as a means of resolving securities disputes will be greatly diminished.

In the last few years, however, the arbitration of public securities disputes has become more complex. Aside from the usual problems

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\* Based upon comments delivered by Constantine N. Katsoris as a Panelist at the National Topical Forum (Byrd's Eye View of Arbitration) of the Securities Industry Association in New York on September 19, 1985.

\*\* Professor of Law, Fordham University School of Law; B.S., 1953, Fordham University; J.D., 1957, Fordham University School of Law; LL.M., 1963, New York University School of Law; Public Member of Securities Industry Conference on Arbitration (SICA) since its inception in 1977; Public Member of National Arbitration Committee of the National Association of Securities Dealers (NASD), 1975-1981; Public Arbitrator at New York Stock Exchange (NYSE) since 1971; Public Arbitrator at NASD since 1968; Arbitrator for First Judicial Department in New York since 1972.

1. See STATISTICAL ANALYSIS AND REPORTS DIVISION, ADMINISTRATIVE OFFICE OF U.S. COURTS, FEDERAL JUDICIAL WORKLOAD STATISTICS A-9 (March 31, 1984) (during twelve-month period ended March 31, 1984, over 3,000 securities and commodities exchange civil actions were filed in federal district courts).

2. See FOURTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION STATISTICAL REPORT Exhibit A (Nov. 1984) (available at *Fordham Urban Law Journal* office). The Securities Regulatory Organizations include the following members: American Stock Exch.; Boston Stock Exch.; Chicago Bd. Options Exch.; Cincinnati Stock Exch.; Midwest Stock Exch.; Municipal Sec. Rulemaking Bd.; National Ass'n of Sec. Dealers, Inc.; New York Stock Exch.; Pacific Stock Exch.; and Philadelphia Stock Exch. *Id.* at 12. The bulk of this arbitration is conducted by the National Association of Securities Dealers and the New York Stock Exchange. *Id.* Exhibit A.

of arbitration procedure and enforcement, questions arose as to the arbitrability of federal securities claims and the handling of the joinder of arbitrable with non-arbitrable claims in the same proceeding. The United States Supreme Court<sup>3</sup> recently held that such claims must be tried separately; but, in so holding, it left several questions unanswered. The purpose of this Article is to discuss some of those questions.

## II. Enforceability of Pre-Dispute Arbitration Agreements

Most arbitration between an investor and his broker is brought pursuant to an arbitration agreement executed at the time a customer opens an account with his broker. Securities investors are often required, as a condition to opening an account with a broker-dealer, to sign an agreement to arbitrate future disputes.<sup>4</sup> Under the United States Arbitration Act (Arbitration Act),<sup>5</sup> agreements to arbitrate future disputes are, in general, specifically enforceable.<sup>6</sup> A stay of

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3. Dean Witter Reynolds, Inc. v. Byrd, 105 S. Ct. 1238 (1985); see *infra* notes 28-31 and accompanying text.

4. The standard arbitration clause "authorizes the customer to elect the arbitration forum from a list of several organizations. If the customer does not elect the forum, within five days after receipt from the broker-dealer of a notification requesting such election, the broker-dealer becomes authorized to make the election." SEC Exch. Act. Release No. 15984 n.4 (July 2, 1979), reprinted in 17 SEC Docket 1167, 1169 n.4 (June-Aug. 1979). The extent to which customers are, as a practical matter, "required" to sign what can basically be described as a typical industry-wide agreement containing a pre-dispute arbitration clause is a critical question. This is particularly so if "the customer may be precluded from doing business with the broker-dealer" because "he or she refuses to sign the agreement or the broker-dealer is unwilling to accept any modification of its terms." 17 SEC Docket at 1169. It would appear that such agreements are largely in effect with respect to margin, option and commodity accounts, and, to a lesser degree, cash accounts. See Stansbury & Klein, *The Arbitration of Investor-Broker Disputes: A Summary of Developments*, 35 ARB. J. 30, 32 (1980). As to the presently prevailing practice in opening new accounts, however, the author's "horseback" survey indicates that customers' agreements containing pre-dispute arbitration clauses are still generally required in opening margin, option and commodity accounts, but not necessarily for cash accounts. This difference probably stems from the fact that the former usually involve an extension of some form of credit by the firm to the customer, thus increasing the need for speedy resolution of problems through arbitration.

5. 9 U.S.C. §§ 1-14 (1982).

6. Section 2 of the Arbitration Act provides: "A written provision in . . . a contract evidencing a *transaction involving commerce* to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.* § 2 (emphasis added). Because the Federal Arbitration Act applies to claims arising from transactions involving interstate commerce, *id.*; and because securities dealings usually involve such transactions,

litigation pending arbitration is also provided for under the Arbitration Act.<sup>7</sup> Similarly, most states recognize valid arbitration agreements, and have enacted statutes setting forth procedures to implement them.<sup>8</sup>

### A. *Wilko* Exemption

In *Wilko v. Swan*,<sup>9</sup> however, the United States Supreme Court was faced with the issue of whether a broker could bind a customer to arbitration under such an agreement if the customer's claim arose under the "special" provisions of the Securities Act of 1933 (1933 Act).<sup>10</sup> After recognizing these "special" provisions of the 1933 Act,

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state securities claims, as well as those arising under the federal securities laws, are usually arbitrable. See *infra* notes 13-18 and accompanying text.

7. See 9 U.S.C. § 3 (1982). The purpose of this section is to allow parties to a contract to select a less costly alternative to litigation and then to proceed in that alternative forum without delay. *Trade Arbed, Inc. v. S/S Ellispontos*, 482 F. Supp. 991 (S.D. Tex. 1980).

8. See, e.g., ARIZ. REV. STAT. ANN. §§ 12-1501 to -1518 (1982 & Supp. 1985); CAL. CIV. PROC. CODE §§ 1280-88.8 (West 1982 & Supp. 1984); CONN. GEN. STAT. §§ 52-408 to -424 (1960 & Supp. 1984); DEL. CODE ANN. tit. 10, §§ 5701-25 (1975 & Supp. 1984); N.Y. CIV. PRAC. LAW §§ 7501-7514 (McKinney 1980 & Supp. 1984). The Supreme Court has stated that the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1982), creates a substantive rule that is applicable in state courts as well as in federal courts. *Southland Corp. v. Keating*, 465 U.S. 1, 12, 16 (1984); see *Prima Paint v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 405 (1967). The Court has further stated that Congress "intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Southland*, 465 U.S. at 16; see *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 105 S. Ct. 3346, 3353-54 (1985); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 (1983); see also COMMITTEE ON ARBITRATION OF THE ASS'N OF THE BAR OF THE CITY OF NEW YORK, AN OUTLINE OF PROCEDURE UNDER NEW YORK ARBITRATION LAW 15-16 (Dec. 1970) (discussion of whether Congress' intent in passing the Federal Arbitration Act was to create a national substantive law that is applicable to states).

9. 346 U.S. 427 (1953).

10. 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (1982)). The Court noted that the Securities Act was designed to protect investors from fraud by requiring full disclosure on the part of the dealer. *Wilko v. Swan*, 346 U.S. 427, 431 (1953). In order to effectuate this policy, Congress, in section 12, specifically gave investors a special right to recover for misrepresentation which differs substantially from the common-law action in that this special right imposes upon the seller the burden of proving lack of scienter. *Id.*; 48 Stat. 84 (codified as amended at 15 U.S.C. § 77i (1982)). The Court further noted that under section 14 of the Act, 48 Stat. 84 (codified at 15 U.S.C. § 77n (1982)), an investor could not waive this special right; and, that section 22 of the 1933 Act specifically affords to the plaintiff national service of process and a broad choice of forum by making the right enforceable by the investor in any court of competent jurisdiction—federal or state. *Wilko*, 346 U.S. at 434-35; 48 Stat. 86 (codified as amended at 15 U.S.C. § 77v(a) (1982)).

the Court noted that the essential purpose of the Arbitration Act was to avoid the delay and expense of litigation,<sup>11</sup> whenever possible, in controversies involving statutes as well as those involving case law;<sup>12</sup> whereas, the purpose of the 1933 Act was to provide a judicial forum for the resolution of securities disputes.

Faced with these two conflicting policies, the Court concluded that although the enforcement of pre-dispute arbitration agreements might be economically advantageous,<sup>13</sup> Congress' desire to protect investors would be more effectively served by holding invalid any pre-dispute arbitration agreements relating to issues arising under the 1933 Act.<sup>14</sup> In effect, the Court in *Wilko* concluded that the nonwaiver provision of section 14 of the 1933 Act,<sup>15</sup> in conjunction with the special rights provision of section 12<sup>16</sup> and the special process and forum provisions of section 22,<sup>17</sup> implicitly repealed the Arbitration Act with regard to securities claims arising under the 1933 Act.<sup>18</sup>

Nothing that has been said about pre-dispute arbitration clauses, however, prevents an investor from consenting to submit to arbitration an existing controversy with a broker-dealer.<sup>19</sup> Moreover, the limitation on pre-dispute arbitration clauses in securities disputes does not extend to state claims.<sup>20</sup> Indeed, "the arbitrability of claims arising under state statutory or common law is determined solely by reference to either state arbitration law or the Federal Arbitration Act."<sup>21</sup>

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11. *Wilko*, 346 U.S. at 431.

12. *Id.* at 432.

13. *Id.* at 438.

14. *Id.*

15. 48 Stat. 84 (codified at 15 U.S.C. § 77n (1982)).

16. 15 U.S.C. § 77i (1982).

17. 15 U.S.C. § 77v(a) (1982).

18. *Wilko*, 346 U.S. at 438.

19. "The principle that emerges from the cases evaluating the validity of arbitration clauses is that, while a waiver *in futuro* will not be permitted under *Wilko*, an agreement to arbitrate an existing dispute made when a party has full knowledge of the facts therein will be excepted from the *Wilko* doctrine." *Malena v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,492, at 98,449 (E.D.N.Y. Apr. 18, 1984); see *Tullis v. Kohlmeyer & Co.*, 551 F.2d 632, 637 (5th Cir. 1977).

20. See Krause, *Securities Litigation: The Unsolved Problem of Predispute Arbitration Agreements for Pendent Claims*, 29 DE PAUL L. REV. 693, 694 (1980) [hereinafter cited as KRAUSE].

21. *Id.* at 694-95.

## B. *Wilko* Application To 1934 Act?

Most federal securities claims brought against brokers by the public, however, are brought under the Securities Exchange Act of 1934 (1934 Act).<sup>22</sup> The reason for this is that, unlike the 1933 Act which is concerned with the initial distribution of securities,<sup>23</sup> the 1934 Act deals principally with post-distribution trading.<sup>24</sup> Despite this difference, many Federal Courts presumed that the *Wilko* protection extended to the 1934 Act, and thus refused to order arbitration—under pre-dispute arbitration agreements—of customers' claims arising under the 1934 Act.<sup>25</sup>

## C. Mixed Claims

The issue regarding the *Wilko* extension to claims under the 1934 Act is further exacerbated when a public customer joins a non-

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22. Pub. L. No. 291, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a-78kk (1982)).

23. The Securities Act of 1933 provides for civil liability. 15 U.S.C. §§ 77k, 77l, 77o (1982). The 1933 Act is concerned primarily with the initial distribution of securities and requires full and fair disclosure of the character of the securities sold to the public. See Katsoris, *Accountants' Third Party Liability—How Far Do We Go?*, 36 *FORDHAM L. REV.* 191, 208-09 (1967) [hereinafter cited as Katsoris I].

24. Liability under the Exchange Act is generally founded on section 18, 15 U.S.C. § 78r (1982), and the implied provisions of section 10(b), 15 U.S.C. § 78j(b) (1982), and the Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240 (1985). Most 1934 Act investor claims against brokers, however, involve section 10(b) of the Act. Bell & Fitzgerald, *Mixed Arbitrable/Nonarbitrable Disputes*, 16 *REV. SEC. REG.* 849, 851-52 (1983); see Katsoris I, *supra* note 23, at 214.

25. See *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979) (arbitration agreement overridden by anti-waiver provision of federal securities laws); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978) (same); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 835 (7th Cir. 1977) (same); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 & n.12 (3d Cir.) (same), *cert. denied*, 429 U.S. 1010 (1976); *Newman v. Shearson, Hammill & Co.*, 383 F. Supp. 265, 268 (W.D. Tex. 1974) (same). *But see Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 513-14 (1974) (arbitration agreement enforced to avoid uncertainty in international transaction involving foreign contractor); Katsoris, *The Arbitration of a Public Securities Dispute*, 53 *FORDHAM L. REV.* 279, 301 (1984) ("although *Scherk* involved a 10b-5 [1934 Act] claim arising out of an international securities transaction, the Court's suggestion that the *Wilko* prohibition be limited to 1933 Act claims should be followed in domestic cases as well") [hereinafter cited as Katsoris II]; *Dean Witter Reynolds, Inc. v. Byrd*, 105 S. Ct. 1238, 1244 (1985) (White, J., concurring) (While Justice White stated that "*Wilko's* reasoning cannot be mechanically transplanted to the 1934 Act," the full court has not yet ruled on this issue. See *infra* note 29.); *Finkle and Ross v. A.G. Becker Paribas, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 92,399, at 92,451 (S.D.N.Y. Dec. 2, 1985); see also Palmer, *Arbitration of Securities Complaints*, Nat'l L.J., Dec. 9, 1985, at 15, col. 1.

arbitrable *Wilko* claim with an arbitrable non-federal securities claim. Some courts bifurcated the two and ordered that the *Wilko* claim be litigated and the other claim be arbitrated.<sup>26</sup> Other courts, however, found the two claims to be so intertwined that it was impractical or impossible to separate them and, therefore, ordered that both be litigated together.<sup>27</sup>

The recent case of *Dean Witter Reynolds, Inc. v. Byrd*,<sup>28</sup> involving 1934 Act claims joined with arbitrable non-federal securities claims, raised two issues: 1) whether *Wilko* extends to 1934 Act claims, and 2) whether the claims should be bifurcated or intertwined. Although the Court declined to specifically resolve the issue of whether *Wilko* applies to 1934 Act claims,<sup>29</sup> it did hold that when an arbitrable claim is joined with a non-arbitrable *Wilko* claim, it would not order the two be involuntarily tried together, even though they were intertwined.

Thus, *Byrd* rejected the concept of intertwining and supported the principle of automatic bifurcation,<sup>30</sup> when a non-arbitrable *Wilko* claim is joined with an arbitrable claim. In other words, the two claims could be tried separately and simultaneously. Whatever the merits of automatic bifurcation, it unleashes and sets two separate forums on a collision course. At the very least, it greatly complicates the task of arbitrators, who generally are not lawyers. This is particularly true since the *Byrd* court did not decide the issue of whether the *Wilko* prohibition as to 1933 Act claims also applies to the far more numerous claims by the public under the 1934 Act. That issue will be decided, eventually, by the United States Supreme Court. It is the author's opinion that *Wilko* should not apply to the 1934 Act.<sup>31</sup> Until the Supreme Court decides, however, arbitrators will not know and thus, they must consider both scenarios.

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26. See *Macchiavelli v. Shearson, Hammill & Co.*, 384 F. Supp. 21, 31 (E.D. Cal. 1974) (arbitrable contract claim severed from a Rule 10b-5 claim); Krause, *supra* note 20, at 710 (arbitrable pendent claims should be severed and proceed to arbitration).

27. See *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 335 (5th Cir. 1981); *Sibley v. Tandy Corp.*, 543 F.2d 540, 544 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

28. 105 S. Ct. 1238 (1985).

29. The Court declined because *Dean Witter* did not seek to compel arbitration of the federal securities claims at the district court level. *Id.* at 1240 n.1.

30. See Pitt, 'Byrd': *First Step to Heighten Role of Arbitration*, *Legal Times*, March 11, 1985, at 15, col 1.

31. See *Katsoris II*, *supra* note 25, at 301.



### III. Arbitrators' Dilemma

#### A. Assuming *Wilko's* Applicability

First, assuming that *Wilko* does apply to 1934 Act claims, a flood of simultaneous bifurcated litigation will result—one action in court, the other in arbitration. This causes many problems for the average arbitrator. For example:

- a) It could raise annoying issues of adjournment and/or harassment due to the fact that discovery and depositions in the litigation are being conducted at the same time as the arbitration proceeding.
- b) Complicated issues of collateral estoppel and res judicata are also certain to surface.<sup>32</sup> Renowned legal scholars of practice and procedure cautiously approach the subject of collateral estoppel and res judicata.<sup>33</sup> Arbitrators will approach it even more cautiously.

In any event, at least three distinct possibilities<sup>34</sup> arise from simultaneous arbitration and litigation of bifurcated claims:

- a) the arbitrators will decide their case first;<sup>35</sup> or, b) the court will decide its case first; or, c) the court and arbitrators will decide the cases simultaneously.

It is somewhat doubtful that a prior arbitration award would have a preclusive effect upon subsequent litigation of a federal securities claim.<sup>36</sup> As to the second possibility, it has been suggested that detailed findings of fact in litigation "should eliminate much of the

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32. Res judicata and collateral estoppel preclude the relitigation of a cause of action or an issue already determined. See Note, *Res Judicata/Collateral Estoppel Effect of a Court Determination in Subsequent Arbitration*, 45 ALB. L. REV. 1029, 1031-36 (1981) [hereinafter cited as *Res Judicata/Collateral Estoppel Effect*]; see also Brodsky, *Corporate and Securities Litigation*, N.Y.L.J., June 5, 1985, at 1, col. 1 (possible collateral estoppel effect of adverse decision in arbitration).

33. See, e.g., 18 C. WRIGHT, A. MILLER & E. COOPER, JURISDICTION 1-801 (1981) (devoting over 800 pages to current federal law on the subject, "without purporting to get into the rich and often divergent strands of state law"); C. WRIGHT, LAW OF FEDERAL COURTS 679 n.12 (4th ed. 1983).

34. Appeals, reversals and mistrials could further complicate and expand the realm of possibilities.

35. Based upon present practices, it is anticipated that arbitrators would most likely conclude their case first.

36. See *Dean Witter Reynolds, Inc. v. Byrd*, 105 S. Ct. 1238 (1985); McDonald

duplication through the impact of collateral estoppel on the subsequent arbitration."<sup>37</sup> On the other hand, any strict application of preclusion principles in arbitration can "undermine arbitration's usefulness and essential characteristics."<sup>38</sup> Finally, it is difficult to see any preclusive effect upon either forum when a court and arbitrators decide their respective cases simultaneously. Thus, similar or factually related issues might still be tried in two different forums.<sup>39</sup>

There will surely be much written in the next few years as to the effect of collateral estoppel and *res judicata* on bifurcated securities proceedings. If some reverse logic from the *Byrd* case is applied, however, it can be suggested in all three situations listed above, that the decision of the one forum should not necessarily be preclusive upon the other forum.

By deciding on a rule of automatic bifurcation, the court in *Byrd* recognized and reinforced the existence of two "Sacred Cows", namely: a) *Wilko* claims should be litigated and b) Arbitration Agreements should be enforced.<sup>40</sup> Admittedly, this recognition reflects the Congressional mandates under the 1933 Act and the Arbitration Act.<sup>41</sup> Nevertheless, the fact remains that litigation and arbitration clearly contravene one another.<sup>42</sup>

In arbitration the norm is speed and economy. There is no extensive

v. *City of West Branch*, 104 S. Ct. 1799 (1984).

We believe that the preclusive effect of arbitration proceedings is significantly less well-settled than the lower court opinions might suggest, and that the consequences of this misconception has been the formulation of unnecessarily contorted procedures. We conclude that neither a stay of proceedings, nor joined proceedings, is necessary to protect the federal interest in the federal court proceeding, and that the formulation of collateral-estoppel rules affords adequate protection to that interest.

*Dean Witter*, 105 S. Ct. at 1243. *But see* *Greenblatt v. Drexel Burnham Lambert, Inc.*, 763 F.2d 1352 (11th Cir. 1985) (district court properly required arbitrable state law contract claims to go to arbitration despite their being intertwined with an exclusively federal RICO claim, and nature of RICO claim asserted favored application of collateral estoppel to arbitrator's fact findings).

37. *Dickinson v. Heinold Sec., Inc.*, 661 F.2d 638, 644 (7th Cir. 1981).

38. *Res Judicata/Collateral Estoppel Effect*, *supra* note 32, at 1048. Indeed, because arbitrators are not bound by the customary doctrines of substantive law, it is not clear what *res judicata* or collateral estoppel effect arbitrators would accord to a prior judgment. *See* N.Y. CIV. PRAC. LAW § 7511, commentary of 7511:5, at 582 (McKinney 1982) (commentary by Joseph M. McLaughlin).

39. In an era of calendar congestion, this potential for duplication and delay is ill-advised. Automatic bifurcation also runs contrary to the federal policy of pendent jurisdiction, which encourages parties to resolve their claims in one proceeding. *See* *United Mineworkers v. Gibbs*, 383 U.S. 715, 725-27 (1966).

40. *Dean Witter Reynolds, Inc. v. Byrd*, 105 S. Ct. 1238, 1242 (1985).

41. *See supra* notes 9-18 and accompanying text.

42. *See Katsoris II*, *supra* note 25, at 294.

pretrial discovery and strict rules of evidence do not apply. Arbitrators generally do not feel bound by the customary rules of substantive law. No written opinions are issued, and no general appeal exists.<sup>43</sup> In litigation the opposite is generally true.<sup>44</sup> Any of these differences of evidence, procedure and substantive law could, on its own, easily cause different findings of fact and ultimate results.

If the Supreme Court's opinion is that claims under arbitration agreements and federal securities laws are *each* too "sacred" to be intertwined and therefore must be tried separately, it is not logical to say that the decision of the first forum to render an opinion is preclusive on the other forum because of the principles of *res judicata* or collateral estoppel—particularly if the elements of proof are different. Yet, to leave these two "Sacred Cows" totally unbridled will complicate, delay and often thwart justice through conflicting and contradictory results. The opinion in *Byrd* left this issue largely unresolved, but it surely will have to be addressed in the future. In any event, arbitration as we now know it will become greatly complicated and, in the meantime, arbitrators will be saddled with these uncertainties.

## B. Assuming *Wilko* Inapplicable

Assuming *arguendo*, that the *Wilko* prohibition does not apply to the 1934 Act, more claims will surely be forced into arbitration and, thus, the duplicative litigation of bifurcation will be avoided. Indeed, as arbitration basically becomes the "sole game in town,"<sup>45</sup> the courts must examine the adhesion issue more closely.

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43. *See id.* at 285-91.

44. *Id.*

45. This is so because most federal securities claims arise under the 1934 Act. *See supra* notes 23-24 and accompanying text; *see also* Powers, *Arbitration After Dean Witter v. Byrd: Is There Anything Left for the Courts*, *Commodities Law Letter*, Vol. V, Nos. 5 & 6, at 1, col. 2 (July/Aug. 1985). Furthermore, it is assumed, for purposes of this discussion, that claims under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1962-64 (1982), will not be unduly disruptive of the arbitration process. For a general discussion of RICO, *see* *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275 (1985); Blakey, *A Vital Hedge Against Corporate Fraud*, *N.Y. Times*, Jan. 5, 1986, § 3 (Business), at 2, col. 3; Greenhouse, *Business & the Law, The Argument Against RICO*, *N.Y. Times*, Oct. 15, 1985, at D2, col. 1; O'Brien, *RICO's Assault on Legitimate Business*, *N.Y. Times*, Jan. 5, 1986, § 3 (Business), at 2, col. 3; Saunders, *The RICO Racket Strikes Again*, *Forbes*, Dec. 2, 1985, at 82, col. 1; Strasser, *Congress Considers New RICO Limits*, 8 *Nat'l L.J.*, Oct. 21, 1985, at 3, col. 2. It is doubtful that *Wilko* would apply to RICO claims, since—like the 1934 Act—it lacks some of the provisions of the 1933 Act which the Court found as "special." *See supra* notes 15-18 and accompa-

Adhesion arises when a standardized contract, usually drafted by a party with superior bargaining power, is presented to a party whose choice is limited to either accepting or rejecting the contract, without the opportunity to negotiate its terms.<sup>46</sup> Such agreements are usually used when a party enters into similar transactions with many individuals—and the agreements resemble ultimatums or laws rather than mutually negotiated contracts.<sup>47</sup> Such contracts, even if they are consistent with the reasonable expectations of the parties,<sup>48</sup> will be denied enforcement if they are unduly oppressive, unconscionable or against public policy.<sup>49</sup> Nor is this point rendered moot by the Arbitration Act.<sup>50</sup> Specifically, even though this type of transaction constitutes “commerce” and is therefore covered by this Act, there is a specific exception when grounds exist, either at law or in equity, for the revocation of any contract.<sup>51</sup>

What effect the doctrine of adhesion will have on the enforceability of pre-dispute securities arbitration agreements will become more apparent with time. If courts view standardized securities industry

nying text; *Ross v. Mathis*, Fed. Sec. L. Rep. (CCH) ¶ 92,343, at 92,248 (N.D. Ga. Sept. 11, 1985). *But see McMahon v. Shearson/American Express, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 92,319, at ¶ 92,140 (S.D.N.Y. Sept. 25, 1985). If, however, it should be decided that RICO rights could not be waived in advance, then similar problems of bifurcation would arise. *See supra* notes 32-44 and accompanying text.

46. *M/V Am. Queen v. San Diego Marine Constr. Corp.*, 708 F.2d 1483, 1489 (9th Cir. 1983); *Finkle and Ross v. A.G. Becker Paribas, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 92,399, at 92,454 (S.D.N.Y. Dec. 2, 1985); *J. CALAMARI & J. PERILLO, CONTRACTS* § 1-3, at 6 (2d ed. 1977); *see T. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST* ¶ 2-302[A], at 2-95 to -96 (1978).

47. *Siegelman v. Cunard White Star Ltd.*, 221 F.2d 189, 206 (2d Cir. 1955); *see Slawson, Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 553 (1971).

48. Regardless of any general “duty to read,” such a contract or provision which does not fall within the reasonable expectations of the weaker or *adhering* party will not be enforced against him.

Assume that a customer is required to sign an arbitration clause typical of those found in standard broker-customer securities agreements before he can open an account. Would a customer be relieved of his arbitration obligation because there was no duty to read, and consequently no true assent? Apparently not, because the investor could reasonably have expected to find a pre-dispute arbitration clause in the agreement. Would such a clause be contrary to public policy? Again, it would appear not, because of the policies underlying the federal Arbitration Act.

*Katsoris II, supra* note 25, at 307.

49. *Finkle and Ross*, Fed. Sec. L. Rep. (CCH) ¶ 92,399, at 92,454 (S.D.N.Y. Dec. 2, 1985) (citing *Katsoris II, supra* note 25, at 307); *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 820, 623 P.2d 165, 172-73, 171 Cal. Rptr. 604, 612 (1981).

50. 9 U.S.C. §§ 1-14 (1982).

51. *Id.* § 2; *see supra* note 6.

contracts as presumptively unfair<sup>52</sup> and therefore unenforceable, a shadow will be cast over the effectiveness of pre-dispute arbitration clauses for the foreseeable future,<sup>53</sup> even in cases where *Wilko* would be inapplicable.

The initial inquiry in the resolution of this question should be whether the public, as a practical matter, must execute such an agreement to have access to portions of the securities markets?<sup>54</sup> If, as a practical matter, the answer is yes, then the next question becomes: is it fair to force the public into forums, administered by the SROs, which the public "might perceive" as being influenced by the securities industry itself?<sup>55</sup>

It has been this author's experience that securities arbitration procedures have resulted, to date, in an overall good faith effort to provide fair resolution of public securities disputes. Nevertheless, regardless of individual experiences and well-meaning SROs, the issue of adhesion will not disappear, particularly as the markets of the

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52. See *Hope v. Superior Court of Santa Clara County*, 122 Cal. App. 3d 147, 153, 175 Cal. Rptr. 851, 855 (1981); *Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 64 Cal. App. 3d 899, 903-04, 135 Cal. Rptr. 26, 28-29 (1976). *But see Parr v. Superior Court of San Mateo County*, 139 Cal. App. 3d 440, 446-47, 188 Cal. Rptr. 801, 805 (1983) (real party effectively rebutted presumption of unconscionability). The court in *Parr*, in finding that the arbitration procedures before the NYSE were not unfair and, therefore, the arbitration agreement was enforceable, noted that the NYSE arbitration rules had been approved by the Securities and Exchange Commission (SEC). *Id.* at 447, 188 Cal. Rptr. at 805. Although such SEC approval may be persuasive as to the fairness of the arbitration rules, it does not totally resolve the issue of the image of impartiality of the various SROs that administer the rules. See *infra* note 55.

53. Cf. J. CALAMARI & J. PERILLO, *CONTRACTS* § 9-46, at 347 (2d. ed. 1977).

If the industries that employ standard forms do not police themselves so as to insure inherent fairness of forms, it is likely that the courts will increasingly refuse legal effect to non-negotiated terms of a contract and that standardized forms, as in the case of insurance policies, dictated by legislatures or administrative agencies.

*Id.*

54. *Ilan v. Shearson/American Express, Inc.*, No. 83 Civ. 9319, slip op. at 12 (S.D.N.Y. Dec. 20, 1985) ("I have little doubt that few investors have sufficient bargaining power to negotiate such clauses out of their contracts"); see *supra* note 4 and accompanying text.

55. See *Hope v. Superior Court of Santa Clara County*, 122 Cal. App. 3d 147, 154, 175 Cal. Rptr. 851, 856 (1981). After emphasizing that it did not find actual bias on the part of the NYSE, the *Hope* court pointed out that the "structure of governance of the Exchange is such that there exists a presumptive *institutional* bias in favor of member firms and members who constitute the electoral constituency of the board." *Id.* (emphasis in original).

next decade expand and become increasingly diverse and complex.<sup>56</sup> The controversies arising out of the handling of such transactions will increase and become more difficult to resolve. Significant strides have already been made in establishing uniform and fair rules of arbitration procedure.<sup>57</sup> As the door of litigation options closes,<sup>58</sup> however, greater public focus will be directed to the fairness—both in fact and in *image*—of the arbitration forum.<sup>59</sup>

The issue of adhesion, therefore, should persist either until arbitration is voluntary<sup>60</sup> or until a specialized independent forum<sup>61</sup> is provided<sup>62</sup> in which the public participates not only on arbitration panels,<sup>63</sup> but also in the administration of the forum itself.<sup>64</sup>

56. See, e.g., Maidenberg, *Futures/Options, Young Markets Play Key Role*, N.Y. Times, Aug. 6, 1984, at D6, col. 3.

57. See UNIFORM CODE OF ARBITRATION (as amended), reprinted in THE FOURTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION TO THE SECURITIES AND EXCHANGE COMMISSION Exhibit C (Nov. 1984) (available at the *Fordham Urban Law Journal* office). For a discussion of the development of securities arbitration, see Katsoris II, *supra* note 25, at 283-84.

58. This will result in litigants giving up rights such as a jury trial and extensive pre-trial discovery. In addition, as a practical matter, the right to receive punitive damages will also be forfeited. See *supra* note 45 and accompanying text.

59. See, e.g., Brecher, *Customers' Rights*, Barrons, Aug. 5, 1985, at 26, col. 1. Although it may not necessarily be representative of the public's feelings generally, securities arbitration has been described as basically being:

limited to arbitration before a panel of brokerage industry representatives and employees . . . . That is not the best forum for a customer's claims.

The recent U.S. Supreme Court decision in *Byrd v. Dean Witter Reynolds* is being relied upon by brokerage firms to obtain such arbitration and to avoid jury trials when the customer's claims are not properly presented.

*Id.* at 26, col. 5. Indeed, some have suggested that securities customers should refuse to execute mandatory pre-dispute arbitration agreements. See *id.*; Meyer, *You can fight when a broker causes losses*, N.Y. Sunday News, Dec. 8, 1985, Money Talks, at 3, col. 1.

60. E.g., a warning to the customer is a prerequisite to the enforceability of a pre-dispute arbitration agreement under the Commodity Exchange Act, 7 U.S.C. §§ 1-26 (1982). The agreement is enforceable if: (a) executing the agreement is not essential to gain access to the market; (b) the customer separately signs the arbitration clause or agreement; and (c) the customer is given a warning, in bold face type, that he is surrendering certain rights to assert his claim in court. 17 C.F.R. § 180.3(b)(1), (2), (6) (1985).

61. It is conceivable that some of the present infrastructure of one or more of the SROs could be used.

62. This could be either in addition to voluntary arbitration or as an alternative to voluntary arbitration.

63. It is the SRO, however, that establishes the pool of qualified arbitrators, and it is from this pool that the SRO assigns arbitrators to the various panels. Moreover, it is the SRO that administers its Code of Arbitration. See *supra* note 57 and accompanying text. The importance of the "appearance" of objectivity is ingrained in virtually every contested event in this country, and it is inconceivable that a lesser standard can be expected of our securities markets.

64. See Katsoris II, *supra* note 25, at 312-14. An analogous concept has proved

#### IV. Conclusion

One should not lose sight of the advantages of securities arbitration. It provides a forum for the fair, speedy and inexpensive resolution of disputes between a customer and his broker. The present state of uncertainty surrounding arbitrable disputes is indeed unsettling, and could very well lead to an undermining of the effectiveness of arbitration.

Many still feel, however, that arbitration should be the primary means of settling securities disputes. If that requires some adjustments by the securities industry—so be it. The price will be small enough in view of the advantages of arbitration to the industry. The public's perception of fairness, however, must be zealously guarded, for it extends far beyond the issue of arbitration. It goes to the very heart of the public's trust in the securities markets themselves; and, this trust must be preserved for those markets to stay healthy.<sup>65</sup>

Awaiting judicial and/or legislative guidance over the next few years should prove interesting, eventful and crucial. It would be preferable for all concerned if this comes about quickly. In the meantime, may the Good Lord watch over the beleaguered arbitrators.

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workable in the accounting field. In fact, since 1977, some of the trustees of the Financial Accounting Foundation (FAF) have been selected by electors outside the accounting profession. See FINANCIAL ACCOUNTING STANDARDS BOARD, STATUS REPORT No. 68, at 2 (June 21, 1978). "The FAF appoints, oversees and finances the Financial Accounting Standards Board (FASB), which is responsible for formulating the rules by which companies account and report their financial condition." Katsoris II, *supra* note 25, at 312 n.259. Moreover, to a lesser degree, the NASD has had representatives from industries other than the securities industry on its National Arbitration Committee.

65. See Katsoris, *The Double Jeopardy of Corporate Profits*, 29 BUFFALO L. REV. 1, 19-21 (1980); Katsoris, *In Defense of Capital Gains*, 42 FORDHAM. L. REV. 1, 9-12 (1973).

