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## NOTE

# INEQUITIES IN THE RESOLUTION OF SECURITIES DISPUTES: INDIVIDUAL OR CLASS ACTION; ARBITRATION OR LITIGATION

*Farah Z. Usmani\**

Investment in securities is more prevalent now than ever.<sup>1</sup> People are investing with goals such as sending their children to

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\* J.D. Candidate, 2002, Fordham University School of Law. Dedicated to my family - Mom, Dad, Rashad, Omar, and Noor – and my friends – you know who you are.

1. [T]he number of investors has been growing almost as fast as the value of the markets themselves over the last fifteen years. In 1983, 19% of American households owned stocks; today over 48% of households are in the market through direct ownership of shares, mutual funds or employer-provided retirement programs such as 401(k) plans, according to an exhaustive study released late last month by two securities trade associations. It's not just the rich who have taken the plunge: half of all equity owners earn less than \$ 60,000 a year. In all, nearly seventy-nine million people now own stock.

See Ronald Brownstein, *Washington Outlook; National Perspective; Though Workers Are Now Investors, They Don't Think Like Capitalists; If anything, the buoyant economy (symbolized by the soaring markets) has taken the edge off the public's anti-government sentiments of the early 1990s*, L.A. TIMES, Nov. 15, 1999, at A5; see also S. REP. NO. 104-98 (1995) ("In just the past ten years, capital raised [by securities investment] has risen by 1,000%."); Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous*, 40 WM. & MARY L. REV. 1055, 1056 (noting that stock ownership by Americans in 1965 was at 10.4% and grew to 43% by 1997) (citing Peter D. Hart Research Associates, "A National Survey Among Stock Investors," Conducted for the NASDAQ Stock Market (1997)) available at,

<http://www.marketdata.nasdaq.com/asp/Sec1VolComp.asp> (last visited Nov. 17, 2001) (showing the yearly share volume increase from 1975-2000).

college,<sup>2</sup> early retirement,<sup>3</sup> and supplementing Social Security.<sup>4</sup> Many of the investors today are not as sophisticated or experienced in investment as investors were thirty years ago.<sup>5</sup> Despite this growth in the securities industry, protections for these new investors are decreasing.<sup>6</sup> Recent laws passed by Congress have made it more difficult for investors to pursue securities claims.<sup>7</sup> Courts have also become stricter about allowing securities class actions to move forward.<sup>8</sup> Moreover, an investor does not have the breadth of recourse through arbitration as he does through litigation.<sup>9</sup>

This Note intends to demonstrate the diminishing options of investors in the courts and the inequity that exists in the resolution of securities disputes. Part I discusses the background and history of securities actions, class actions, and arbitration. In Part II, this Note addresses how the courts have changed their views regarding

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2. See Kathy Barks Hoffman, *Saving Up for College*, BISMARCK TRIB., May 8, 2001 at 1C ("[A]bout \$ 2.5 billion was invested [in college savings programs] by the end of 2000, an amount [C.P.A. Joseph Hurley] expects to reach \$ 10 billion by the end of the year. He expects the same fourfold increase in the number of accounts, which he says could reach 1.6 billion by the end of 2001.").

3. See Humberto Cruz, *The Key to Your Financial Success; Why All This Obsession with Being a Millionaire*, SEATTLE-POST INTELLIGENCER, Feb. 19, 2001 at D1 (quoting a study by the Million Dollar Round Table as saying "it will be a huge challenge for people to realize their hopes of an early retirement without a financial plan, especially considering the length of time their nest egg will have to last as a result of increases in the average life span").

4. Accord Brownstein, *supra* note 1.

5. See Stephen J. Choi, *Gatekeepers and the Internet: Rethinking the Regulation of Small Business Capital Formation*, 2 J. SMALL & EMERGING BUS. L. 27, 37 (1998) ("With the increase in the number of active investors on the Internet comes a corresponding increase in potentially unsophisticated investors."); cf. Michael R. Davis, Note, *Unregulated Investment in Certain Death: SEC v. Life Partners, Inc.*, 42 VILL. L. REV. 925, 927 (1997) ("The influx of individual unsophisticated investors into this unregulated market [of viatical settlements] and the large number of start-up firms offering individual investors access to this market has dramatically increased the potential for investors to be defrauded or abused by inexperienced or sham investment companies.").

6. See *infra* Parts I.B and II.A-II.B.

7. See *infra* Part I.B.

8. See *infra* Parts II.A-II.B.

9. See *infra* Part III.

securities actions, class actions, and arbitration. Part III discusses the details of arbitrating both individual and class action securities claims. Part IV argues that similar securities disputes can have varying outcomes, based on venue and the lack of uniformity undermines investor confidence in the courts and the prospect of justice.

### I. CONGRESSIONAL HISTORY OF SECURITIES ACTIONS, CLASS ACTIONS AND ARBITRATION

The sale of securities occurred concurrently with the Industrial Revolution.<sup>10</sup> As companies grew in size, they sought ways to finance new ventures.<sup>11</sup> The sale of stocks provided a means for them to raise capital.<sup>12</sup> However, the sale of these securities was essentially unregulated.<sup>13</sup> The price of securities was often inflated, due to fraud.<sup>14</sup> The result of these inflated prices culminated in the 1929 stock market crash,<sup>15</sup> which marked the beginning of the

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10. See Michael P. Catina & Cindy M. Schmitt, Note, *Private Securities Litigation: The Need for Reform*, 13 ST. JOHN'S J. LEGAL COMMENT. 295, 295-296 (1998) (noting that the modern securities market was based on the foundation provided by industrialization).

11. *Id.* at 296.

12. See Susanna M. Kim, *Conflicting Ideologies of Group Litigation: Who May Challenge Settlements in Class Actions and Derivative Suits?*, 66 TENN. L. REV. 81, 98 (1999) ("During the Industrial Revolution, the ownership of stock corporations became much more widely held, and judicial recognition of the derivative suit was needed to deal with the increasing conflicts between shareholders and managers.").

13. See United States Securities and Exchange Commission, *The Investor's Advocate: How the SEC Protects Investors and Maintains Market Integrity*, available at <http://www.sec.gov/about/whatwedo.shtml> (last visited Nov. 17, 2001).

14. See Lisa Feiner, *The Second Circuit Review - 1982-1983 Term: Commentary: Broker-Dealer's Duty to the Marketplace*, 50 BROOK. L. REV. 783, 794 (1984); see also David Ross, *Should the Law Prohibit 'Manipulation' in Financial Markets?*, 105 HARV. L. REV. 503, 504 (1991) (noting that fraud continued after the 1929 stock market crash).

15. See Jerry W. Markham, *Federal Regulation of Margin in the Commodity Futures Industry - History and Theory*, 64 TEMP. L. REV. 59, 101 (1991) (explaining that the feverish desire to get rich from stocks led to the crash of the stock market in 1929).

Great Depression.<sup>16</sup> Individual citizens lost personal fortunes, as did banks that had invested heavily in the market. People feared that the banks would be unable to cover their deposits, causing a rush to withdraw holdings, and ultimately resulting in the failure of many banks.<sup>17</sup>

President Roosevelt sought to minimize the effects of the depression by implementing the New Deal, a program of government regulations and public projects.<sup>18</sup> The New Deal sought to ease the financial burdens of the citizenry by creating jobs, establishing the Tennessee Valley Authority,<sup>19</sup> aiding the farming sector, standardizing labor and wages, and regulating the railroad industry.<sup>20</sup> It also included the passage of numerous securities regulations.

#### A. Securities Legislation as a Result of the New Deal

The first of the New Deal securities legislation enacted was the Securities Act of 1933 ("Securities Act"),<sup>21</sup> intended to protect investors<sup>22</sup> by preventing the inflated prices<sup>23</sup> that caused Black Thursday.<sup>24</sup> Congress also sought "to promote investor confidence

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16. See James R. Repetti, *Corporation Governance and Stockholder Abdication: Missing Factors in Tax Policy Analysis*, 67 NOTRE DAME L. REV. 971, 973 (1992).

17. See SEC, "The Investor's Advocate," *supra* note 13.

18. See Ramirez, *supra* note 1, at 1066; see also Duane R. Chartier, *Roosevelt's 'New Deal' - Brief Notes*, New Deal Preservation Association, available at

[http://www.newdeallegacy.org/history\\_newdeal.html](http://www.newdeallegacy.org/history_newdeal.html) (last visited Nov. 17, 2001).

19. The Tennessee Valley Authority is a public power company that also provides economic development and "supports a thriving river system." See <http://www.tva.gov/abouttva/keyfacts.htm#whatis> (last visited Nov. 17, 2001).

20. Franklin D. Roosevelt, *Outlining the New Deal Program*, Address to the American People (May 7, 1933), available at <http://newdeal.feri.org/chat/chat02.htm> (last visited Nov. 17, 2001).

21. See 15 U.S.C. § 77a (2000).

22. See Catina & Schmitt, *supra* note 10, at 297.

23. Other causes attributed to the stock market crash in 1929 include insider trading, unjustified issuances, buying on the margin, great amounts of unsecured consumer debt, investment of all assets in the stock market, speculative investment by banks.

24. See *Stock Markets*, FIN. TIMES, Oct. 25, 1999; see also Beth H. Friedman,

in the United States securities markets and thereby to encourage the investment necessary for capital formation, economic growth, and job creation."<sup>25</sup> The Securities Act requires that all offerings either be registered with the Securities and Exchange Commission ("SEC")<sup>26</sup> or be exempt from such registration.<sup>27</sup> In addition, the legislation sought to provide investors with information about the securities for sale and to prevent fraud, misrepresentation, and deception.<sup>28</sup>

The Securities Act, however, did not require any degree of disclosure from parties selling securities among themselves after the shares were initially introduced to the market.<sup>29</sup> Therefore, only a year later, Congress passed the Securities and Exchange Act of 1934 ("Exchange Act"),<sup>30</sup> requiring disclosure by dealers and brokers of such securities,<sup>31</sup> and subjecting them to SEC regulation.<sup>32</sup> The Exchange Act regulates reporting activities, such as accounting practices,<sup>33</sup> the buying back of shares by issuers,<sup>34</sup> and filing of reports.<sup>35</sup> The activities of directors and executives with more than ten percent ownership of a company are also scrutinized

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*The Preclusive Effect of Arbitral Determinations in Subsequent Federal Securities Litigation*, 55 FORDHAM L. REV. 655, 668 (1987) (noting that the Securities Act was intended to protect investors).

25. S. REP. NO. 104-98 (1995).

26. Registration has numerous requirements, including a description of an issuers business and assets, description of the issuance, information about company management, and financial statements by independent accountants. See 15 U.S.C. § 77aa (2000).

27. Exempted offerings include private offerings, offerings of limited size, intrastate offerings, and securities offered by local and federal governments. See 15 U.S.C. § 77c (2000).

28. See United States Securities and Exchange Commission, *The Laws that Govern the Securities Industry*, available at <http://www.sec.gov/about/laws.shtml> (last visited Nov. 17, 2001).

29. See Fred Knopf, *Using Federal Magistrates to Resolve Securities Disputes: A Viable Alternative*, 12 BRIDGEPORT L. REV. 537, 538 (1992) (noting that the Exchange Act was intended to fill in gaps from the Securities Act).

30. See 15 U.S.C. § 78a (2000).

31. See *id.* § 78l.

32. See *id.* § 78o.

33. See *id.* § 78m(b)(2)(B).

34. See *id.* § 78m(e).

35. See *id.* § 78m(b).

as a result of the Exchange Act.<sup>36</sup> Both the Securities Act and Exchange Act were intended to restore confidence in U.S. financial markets.<sup>37</sup>

In order to provide and enforce securities regulations, the Exchange Act created the SEC.<sup>38</sup> Significantly, only the Exchange Act preempted state securities actions.<sup>39</sup> Neither the Securities Act nor the Exchange Act explicitly allowed for private actions.<sup>40</sup> However, as will be shown in the following section, the courts nonetheless allowed such actions.<sup>41</sup>

The next in the sequence of securities legislation passed under the New Deal was the Public Utilities Holding Company Act of 1935 ("PUHCA").<sup>42</sup> By implementing federal regulation the PUHCA eliminated unfair practices and abuses by electric and gas utilities.<sup>43</sup> The legislation prohibited such companies from using their profits to subsidize unregulated business activities.<sup>44</sup> Federal Regulation was necessary because states were unable to regulate the interstate activities of local electric and gas companies.<sup>45</sup>

Several years later, the Trust Indenture Act of 1939 ("T.I.A.")<sup>46</sup> was enacted. The T.I.A. requires corporate issuers to appoint trustees for the benefit of their bondholders.<sup>47</sup> Issuers must

36. See *id.* § 78p.

37. See Lynn Katzler, *Should Mandatory Written Opinions be Required in All Securities Arbitrations?: The Practical and Legal Implications to the Securities Industry*, 45 AM. U.L. REV. 152, 153 (1995).

38. See C. Steven Bradford, *The Possible Future of Private Rights of Action For Proxy Fraud: The Parallel Between Borak and Wilko*, 70 NEB. L. REV. 306, 313 (1991) (demonstrating the breadth of regulatory powers granted to the SEC).

39. See 15 U.S.C. § 78o(h) (2000).

40. See Catina & Schmitt, *supra* note 10, at 301.

41. See discussion *infra* Parts II.A-II.B; see also Ramirez, *supra* note 1, at 1067.

42. See 15 U.S.C. § 79 (2000).

43. See Amy Abel, *Electricity Restructuring Background: Public Utility Holding Company Act of 1935 (PUHCA)*, RS20015 (1999), available at <http://www.cnle.org/nle/eng-47.html> (not paginated) (last visited Nov. 17, 2001); see also 15 U.S.C. § 79a (2000).

44. See 15 U.S.C. § 79i (2000).

45. See Abel, *supra* note 43.

46. 15 U.S.C. §§ 77aaa – 77bbbb (2000).

47. See *id.* § 77bbb.

also provide financial reports<sup>48</sup> and confirm that all conditions of the indenture have been met<sup>49</sup> to these appointed trustees. The trustee is also empowered to disclose information regarding the securities holders if three or more holders indicate a desire to communicate about their rights under the indenture.<sup>50</sup>

In 1940, Congress passed the Investment Company Act ("Investment Act").<sup>51</sup> The Investment Act extended the SEC's regulatory power to include mutual funds.<sup>52</sup> The Investment Act also distinguishes between different types of investment companies.<sup>53</sup> Additionally, it requires that control of investment companies remain in the hands of independent directors.<sup>54</sup>

That same year, the Investment Advisors Act ("Advisors Act")<sup>55</sup> was passed. The Advisors Act requires all investment advisors to register with the SEC.<sup>56</sup> Investment advisors are defined as those who counsel customers to buy, sell, or hold securities.<sup>57</sup> As with the other legislation discussed above, Congress passed the Advisors Act with the intention of protecting unsophisticated customers from fraud and misrepresentation.<sup>58</sup>

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48. *See id.* § 77nnn.

49. *See id.* § 77nnn(a)(3).

50. *See id.* § 77lll(b).

51. *Id.* §§ 80a-1 - 80a-64.

52. *See id.* § 80a-2(c).

53. *See id.* §§ 80a-4 - 80a-5 (noting that investment companies can be qualified as "face-amount certificate," "unit-investment trust," or "management company" and further divided into open or close-ended and diversified or non-diversified).

54. *See id.* § 80a-10(a).

55. *Id.* §§ 80b-1 - 80b-21.

56. *See id.* § 80b-3 ("it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment advisor").

57. *See id.* § 80b-2(11) (2000).

58. *See* Carol E. Garver, Note, *A Review of Recent Decisions of the United States Court of Appeals for the Federal Circuit: Note: Lowe v. SEC: The First Amendment Status of Investment Advise Newsletters*, 35 AM. U.L. REV. 1253, 1253 (1986) ("Congress enacted the Investment Advisers Act of 1940... to protect unsophisticated investors from unscrupulous investment advisors and to disassociate legitimate investment advisors from the professional stigma created by the fraudulent activities of their less-ethical colleagues"); *see also* 15 U.S.C. §



B. Securities Legislation in the Last Decade

While Congress was attempting to protect the unsophisticated investor, none of these statutes protected companies from investors. Investors were easily able to file "strike suits"<sup>59</sup> and fraud claims against companies.<sup>60</sup> Congress became concerned about the growing number of frivolous securities cases.<sup>61</sup>

The House and Senate Committees heard evidence that abusive practices committed in private securities litigation include: (1) the routine of filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action; (2) the targeting of deep pocket defendants, including accountants, underwriters, and individuals who may be covered by insurance, without regard to their actual culpability; (3) the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle; and (4) the manipulation by class action lawyers of the clients whom they purportedly represent. These serious injuries to innocent parties are compounded by the reluctance of many judges to impose sanctions under Federal Rule of Civil Procedure 11, except in those cases involving truly outrageous conduct. At the same time, the investing public and the entire U.S. economy have been injured by the unwillingness of the best qualified persons to serve on boards of directors and of issuers to discuss publicly their future prospects, because of fear of baseless and extortionate securities lawsuits.<sup>62</sup>

In response to this growth, Congress passed the Private Securities Litigation Reform Act ("PSLRA")<sup>63</sup> in 1995,<sup>64</sup> thereby

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80b-7 (2000).

59. A "strike suit" is "a derivative action brought against a corporation either for nuisance value or to obtain a favorable settlement." BLACK'S LAW DICTIONARY 605 (pocket ed. 1996).

60. See Catina & Schmitt, *supra* note 10, at 301 n.28.

61. H.R. REP. NO. 104-369, at 32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 731.

62. *Id.*

63. See 15 U.S.C. §§ 77z (2000); *id.* §§ 78u-4 - 78u-5.

64. See 141 CONG. REC. H140039-02 (statement of Rep. Bliley, indicating

amending both the Securities Act and the Exchange Act.<sup>65</sup> The PSLRA sought to curtail the abuses in securities actions in four ways:<sup>66</sup> 1) increasing the standards for pleading fraud by requiring specific facts that create a strong inference that the defendant acted purposefully,<sup>67</sup> 2) implementing rules limiting who can serve as lead plaintiff<sup>68</sup> and how lead counsel is chosen,<sup>69</sup> 3) staying discovery while a motion to dismiss is considered,<sup>70</sup> and 4) prohibiting most<sup>71</sup> lawsuits based on forward-looking statements.<sup>72</sup>

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that the PSLRA was intended to counter frivolous securities claims); *see also* Catina & Schmitt, *supra* note 10, at 297.

65. H.R. CONF. REP. 104-369.

66. *See* C. Evan Stewart, *While Rome Burns – Fiddling With Reforming Reform in the Securities Industry*, PERSPECTIVES ON LEGISLATION, REGULATION, AND LITIGATION, Vol. 2, No. 11, Nov. 1998, no pagination, *available at* <http://www.winston.com/catalog.nsf/DomainQuery?OpenForm&Seq=1> (last visited Nov. 17, 2001) (discussing other changes introduced by the passage of the PSLRA).

67. 15 U.S.C. § 78u-4(b)(2). Prior to the passage of the PSLRA, courts were split over what standard was needed to plead securities fraud. Some courts required a strong inference of intent, pursuant to section 10(b) of the Exchange Act. Other courts required pleadings of fraud to be particular, pursuant to Rule 9(b) of the Federal Rules of Civil Procedure. *See* Catina & Schmitt, *supra* note 10, at 306-07. The Rule 9(b) pleading, used in the Second Circuit, was codified by the PSLRA. *See* Marc I. Steinberg, Symposium, *Securities Arbitration: A Decade After McMahon: Securities Arbitration: Better for Investors Than the Courts*, 62 BROOK. L. REV. 1503, 1519-20 (1996) [hereinafter Steinberg I, McMahon] (explaining that the PSLRA's pleading standard was the same as the standard used in the Second Circuit, as demonstrated in *Wexner v. First Manhattan Co.*, 902 F.2d 169 (2d. Cir. 1990)).

68. *See* 15 U.S.C. § 77z-1(a)(2)(A); *id.* § 78u-4(a)(2)(A).

69. *See id.* § 77z-1(a)(3)(B)(v); *id.* § 78u-4(a)(3)(B)(v).

70. *See id.* § 77z-1(b); *id.* § 78u-4(b).

71. The PSLRA included two exceptions to the prohibition against suits based on forward-looking statements. Such suits were valid if (1) the future statements were made without a reasonable basis, *id.* §§ 77z-2(b)(1)(B) – 77z-2(b)(1)(D); *id.* §§ 78u-5(b)(1)(B) – 78u-5(b)(1)(D); or (2) when corporate disclosure is made in bad faith, *id.* § 77z-2(b)(1)(A)(III); *id.* § 78u-5(b)(1)(A)(III). These exceptions are applicable even if the statements in question were made with fraudulent intent. *See* Ramirez, *supra* note 1, at 1076.

72. *See* 15 U.S.C. §§ 77z-2(c); *id.* § 78u-5(c). Forward-looking statements are those that project events that are believed to occur in the future, such as company earnings, projected dividends, or anticipated product launches.

The PSLRA also requires courts to scrutinize all claims under Rule 11 of the Federal Rules of Civil Procedure<sup>73</sup> and to act upon violations that it discovered.<sup>74</sup> These requirements sought to 1) eliminate a low pleadings standard,<sup>75</sup> 2) encourage institutional investors to serve as lead plaintiffs<sup>76</sup> and to prevent lawyer driven securities litigation,<sup>77</sup> 3) prevent plaintiffs from filing suit and then using discovery to find grounds for the action,<sup>78</sup> and 4) encourage companies to disclose information without fear of litigation.<sup>79</sup>

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73. Rule 11 provides courts with discretion to impose sanctions against claims that are not supported by the law, that are not supported by any evidence, or those pursued for improper reasons. *See* FED. R. CIV. PRO. Rule 11.

74. *See* 15 U.S.C. § 77z-1(c); *id.* § 78u-4(c).

75. *See* H.R. CONF. REP. 104-369 ("The House and Senate hearings on securities litigation reform included testimony on the need to establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits."); *see also* Stewart, *supra* note 66.

76. *See* H.R. REP. NO. 104-369, at 34, *reprinted in* 1995 U.S.C.C.A.N. 730, 733; *see also* H.R. CONF. REP. 104-369 ("The Conference Committee believes that increasing the role of institutional investors in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions."). This requirement also sought to eliminate "professional plaintiffs," who owned nominal shares of numerous companies in order to serve as lead plaintiff in the case of a securities class action. *See* H.R. REP. NO. 104-369 at 32-33.

77. *See* H.R. CONF. REP. 104-369; *see also* Stewart, *supra* note 66 (recognizing that "boutique law firms who exploited to the hilt their ability to use the 'big stick' of discovery expense to obtain lucrative settlements" as a reason leading to the passage of the PSLRA).

78. As [Richard J. Egan] noted, 'once the suit is filed, the plaintiff's law firm proceeds to search through all of the company's documents and take endless depositions for the slightest positive comment which they can claim induced the plaintiff to invest and any shred of evidence that the company knew a downturn was coming.'

*See* H.R. CONF. REP. 104-369 (quoting Testimony of Richard J. Egan, Chairman of the board of EMC Corporation before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, June 17, 1993)); *see also* Stewart, *supra* note 66 (noting that the stay in discovery intended to save companies the expense of discovery if a court determined the claim was without merit).

79. *See* H.R. CONF. REP. 104-369 ("Fear that inaccurate projections will trigger the filing of securities class action lawsuit [sic] has muzzled corporate management."); *see also* Stewart, *supra* note 66.

The PSLRA has made it more difficult for potential plaintiffs to proceed in court with a securities claim, especially in class actions.<sup>80</sup> The new pleading standard is difficult to meet<sup>81</sup> and has not provided uniformity in the pleadings. Courts have varied on how to fulfill the new pleading standard.<sup>82</sup> The new rules regarding lead plaintiff have not succeeded in encouraging more institutional investors to serve as lead plaintiffs.<sup>83</sup> Nor have the rules regarding lead counsel created more competition in the area of securities

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80. See generally, John C. Coffee, Jr., *Commentary on Seligman*, 33 HOUSTON L. REV. 376, 380-81 (1996) ("Another reason . . . [an] investor may find arbitration more attractive than litigation involves a recent development known as the Private Securities Litigation Reform Act . . . [because] the Reform Act is adverse to the interests of small investors."); see also Ramirez, *supra* note 1, at 1058, 1072-80 (1999) (discussing additional barriers to securities actions imposed by the PSLRA, such as heightened causation requirements, limitations on joint and several liability, and greater disclosure requirements in the settlement of class actions).

81. See Douglas M. Branson, *Running the Gauntlet: A Description of the Arduous, and Now Often Fatal Journey for Plaintiffs in Federal Securities Law Actions*, 65 U. CIN. L. REV. 3 (1996-97); see also Ramirez, *supra* note 1, at 1074-75. Some have held that the new scienter requirement cannot be met without an explicit confession of intent. The new scienter requirement could also prevent plaintiffs from bring suit against parties that were jointly responsible for drafting the allegedly false or misleading materials. See Ramirez, *supra* note 1, at 1075-76. Additionally, the new scienter requirement is made more difficult meet because plaintiffs do not have discovery to help them find evidence of intent. See 15 U.S.C. § 78u-4(b)(2) (2000); see also Ramirez, *supra* note 1, at 1076.

82. See Stewart, *supra* note 66 (noting that after PSLRA, some courts require pleadings to demonstrate "recklessness" or "motive and opportunity", while others will accept only "recklessness" or "motive and opportunity", and still others have accepted "deliberate recklessness") (citations omitted). See, e.g., *In re Baesa Sec. Litig.*, 969 F. Supp. 238, 242 (S.D.N.Y. 1997); *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 757 (N.D. Cal. 1997). But see *Zeid v. Kimberley*, 930 F. Supp. 431, 434 (N.D. Cal. 1996); *Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1308 (C.D. Cal. 1996).

83. See Stewart, *supra* note 66 ("[F]ew large institutional investors . . . have been eager to take the lead or co-lead in suits filed since the PSLRA became effective"). In fact, it has been suggested that the new lead plaintiff rules will only promote additional litigation to determine who will serve as the lead plaintiff. See John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 374 (1996); see also Ramirez, *supra* note 1, at 1087.

litigation.<sup>84</sup> It has not been shown that companies have been providing investors with more information.<sup>85</sup> As a result, private enforcement of securities violations has been severely compromised.<sup>86</sup> The required Rule 11 assessment has also diminished private securities claims, as sanctions tend to be frequent in securities litigation.<sup>87</sup> Essentially, passage of the PSLRA has been detrimental to investors<sup>88</sup> and has further burdened securities plaintiffs.<sup>89</sup>

Despite its detrimental effect on investors, the passage of the PSLRA resulted in increased filing of securities actions in state courts.<sup>90</sup> Many companies were sued in both federal and state

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84. See Stewart, *supra* note 66 (noting that Milberg, Weiss Bershad Hynes & Lerach, the pre-eminent plaintiffs law firm in securities actions, has been involved in over 60% of securities cases nationwide, as opposed to 31% prior to the passage of the PSLRA); see also K. Donovan, *Class Action War Heats Up*, NAT'L L. J. A1 (Dec. 22, 1997); D. Osborne, *Getting Back at Lerach*, AM. LAW. 49 (Sept. 1997).

85. See Stewart, *supra* note 66 (noting the lack of empirical evidence showing that this intention was met and suggesting that because securities claims in state courts would continue with greater disclosure, because of the lack of specific examples of correct disclosures, and because of a lack of law interpreting the scope of the PSLRA exception, companies would not be inclined to offer more forward-looking statements).

86. See 141 Cong. Rec. S19040 (daily ed. Dec. 21, 1995) (letter from Professor Arthur R. Miller of Harvard University Law School); see also Ramirez, *supra* note 1, at 1060, 1087-89 ("The PSLRA has the obvious side-effect of throwing out the meritorious with the frivolous . . . they simply seem to be an arbitrary means of terminating or chilling claims . . . far from facilitating a merits-based adjudication, the PSLRA seems certain to further delay any merits reckoning.").

87. See Ramirez, *supra* note 1, at 1074; see also Hope Viner Samborn, *Fear of Filing*, A.B.A. J., May 1997, at 28.

88. See Steinberg I, McMahon, *supra* note 67, at 1507 (noting that "[e]nactment of The Private Securities Litigation Reform Act of 1995 . . . also spells 'gloom' for uninitiated investors"); see also Marc I. Steinberg, *Litigation Reform Act Will Have Major Impact*, 24 SEC. REG. L.J. 115 (1996) [hereinafter Steinberg II, *Litigation Reform Act*].

89. See Steinberg I, McMahon, *supra* note 67, at 1529; Interview by Deborah Marchini with Mike Oxley, Congressman, Ohio, CNN (Mar. 8, 1995) [hereinafter Oxley Interview] (asking "[w]hy is it necessary to tilt the balance further in favor of the securities industry" by passing the PSLRA).

90. See M. Perini, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273 (1998); see also Samborn, *supra*

courts in order to circumvent the stay of discovery.<sup>91</sup> In response to this increase<sup>92</sup> and at the urging of high-tech and accounting companies,<sup>93</sup> Congress passed the Securities Litigation Uniform Standards Act ("Uniform Standards Act").<sup>94</sup> The Uniform Standards Act provides that claims of securities fraud brought in state court are to be pleaded at the level outlined in the PSLRA.<sup>95</sup>

### C. Congress and Arbitration

In 1925, Congress passed the Federal Arbitration Act ("FAA").<sup>96</sup> Congress intended to overcome judicial distrust of

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note 87 (reporting a study done by Joseph A. Grundfest and Michael A. Perino that supported that while litigation rates did not change very much after the PSLRA, twenty-six percent of the activity moved to state courts); Securities and Exchange Commission Office of the General Counsel, Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995 (1997), *reprinted in* Practising Law Institute, *Sailing in 'Safe Harbors': Drafting Forward Looking Disclosures*, 61, 72 (1997) [hereinafter SEC Report to the President] (claiming that the number of securities class actions filed in state courts had increased in an attempt to circumvent the provisions of the PSLRA, including the stay of discovery. *But see* O. Starkman, *Securities Class-Action Lawsuits Make Comeback in Federal Court*, WALL ST. J., at B11, July 9, 1997.

91. *See* Stewart, *supra* note 66 (noting that the PSLRA allowed investors to choose the forum in which they brought suit, even if they had little or no contact with the state).

92. For a discussion of the pros and cons of reform after the PSLRA, *see generally* Catina & Schmitt, *supra* note 10, at 312-17. Congress considered both the Uniform Standards Act and the Securities Litigation Improvement Act, which proposed amending both the Securities Act and the Exchange Act by creating uniform pleading standards. *See* Marcel Kahan & Linda Silberman, *The Inadequate Search for "Adequacy" in Class Actions: A Critique of Epstein v. MCA Inc.*, 73 N.Y.U.L. REV. 765, 786 n.88 (1998) ("[S]everal bills have been introduced to ensure the effectiveness of the [PSLRA] by halting migration of class actions to state courts and avoiding inconsistent standards in state court litigation . . . [including the] Securities Litigation Improvement Act . . . and Securities Litigation Uniform Standards Act . . .").

93. *See* Robert A. Prentice et al., *Corporate Web Site Disclosure and Rule 10b-5: An Empirical Evaluation*, 36 AM. BUS. L.J. 531, 549-50 (1999).

94. Pub. L. No. 105-353 (1998).

95. *See* Bruce J. Heiman, *The Do-something Congress*, J. COM., Oct. 30, 1998.

96. Federal Arbitration Act, 9 U.S.C. §§ 1-14 (2000).

arbitration agreements<sup>97</sup> and recognized that a party in arbitration does not lose his statutory rights, but simply exchanges one forum for another.<sup>98</sup> The FAA essentially provides that agreements to arbitrate are "valid, irrevocable, and enforceable."<sup>99</sup> In theory, the existence of pre-dispute arbitration agreements prevents courts from hearing disputes it otherwise had jurisdiction over.<sup>100</sup> The FAA also limits the grounds on which courts can vacate arbitration decisions. Arbitration decisions can only be set aside if the proceedings were based on fraud,<sup>101</sup> corruption,<sup>102</sup> or if the arbitrator did not act properly.<sup>103</sup> Moreover, courts can only alter or correct arbitration decisions if there is a mistake,<sup>104</sup> if the matter was not submitted to the arbitrator,<sup>105</sup> or if the award was improper in its form.<sup>106</sup>

#### *D. Congress and Class Actions*

"Class actions historically have proved critical to the protection of rights of employees, consumers, medical patients, racial or ethnic minorities, and others who lack the resources to litigate individual claims."<sup>107</sup> Congress recognized the benefits of

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97. See *Schrek v. Alberto-Culver, Co.*, 417 U.S. 507, 510-11 (1974) (quoting H.R. REP. NO. 96, 68<sup>th</sup> Cong., 1<sup>st</sup> Sess., 1, 2 (1924)).

98. 137 CONG. REC. S14,154 (1991) ("By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum.") (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991)).

99. 9 U.S.C. § 2.

100. *Id.* § 2.

101. *Id.* §§ 10(a)(1).

102. *Id.* § 10(a)(2).

103. *Id.* §§ 10(a)(3) – 10(a)(4); see also Caroline E. Mayer, *Hidden in Plain Print: 'You Can't Sue Us' Arbitration Clauses Block Consumers From Taking Companies to Court*, WASH. POST, May 22, 1999, at A01 ("Arbitration . . . usually doesn't allow for appeals.").

104. 9 U.S.C. § 11(a).

105. *Id.* § 11(b).

106. *Id.* § 11(c).

107. Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. AND MARY L. REV. 1, 12 (2000). Class actions also promote judicial efficiency, consistent outcomes, fairness, justice for those with small claims that do not justify individual litigation, and

class actions with the passage of Rule 23 of the Federal Rules of Civil Procedure in 1938.<sup>108</sup> With the passage of Rule 23, Congress aimed to increase the use of the class action in the courts.<sup>109</sup> Congress was aware that class actions could prevent inconsistent verdicts among individual class members.<sup>110</sup> Congress also considered the fact that class actions promote judicial efficiency.<sup>111</sup> Moreover, class actions provide a means by which small monetary harms against a large number of people can be heard, as the monetary value of such individual harms is often less than the cost of adjudicating the claim.<sup>112</sup>

Rule 23 was amended in 1966, with the addition of numerous procedural protections and rules regarding case management by the courts.<sup>113</sup> Congress sought to eliminate inconsistent or incompatible decisions in cases with similar factual circumstances and to encourage the use of the class action in civil rights cases and other disputes that were not individually worth litigating.<sup>114</sup> Current members of Congress continue to note the individual and societal benefits of class actions, including racial desegregation of schools, compensation for those who suffer injury due to toxic and other dangerous products, and justice for victims of employment discrimination.<sup>115</sup>

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save taxpayers money. See Daniel R. Waltcher, Note, *Classwide Arbitration and 10b-5 Claims in the Wake of Shearson/American Express, Inc. v. McMahon*, 74 CORNELL L. REV. 380, 393 (1989).

108. 28 U.S.C. § 1332 (2000); see also Joel Seligman & Lindsey Hunter, *Rule 23 Class Actions: At the Crossroads: Introduction*, 39 ARIZ. L. REV. 407, 407 (1997).

109. *Id.*

110. See FED. R. CIV. P. 23(b)(1)(A).

111. See 147 CONG. REC. E 1234 (2001) (statement of Bob Goodlatte); see also FED. R. CIV. P. 23(b)(3).

112. See 147 CONG. REC. E 1234.

113. Seligman & Hunter, *supra* note 108, at 408-09.

114. *Id.*

115. 145 CONG. REC. S1145 (1999). But see 147 CONG. REC. E. 1234 (statement of Bob Goodlatte, introducing the Class Action Fairness Act of 2001, aimed at limiting the flood of class actions in state courts and forum shopping).



## II. SECURITIES DISPUTES, ARBITRATION, AND CLASS ACTIONS IN THE COURTS

The courts were once supportive of the rights of investors and interpreted securities legislation broadly and to the advantage of plaintiffs.<sup>116</sup> However, with the increase in securities investment and in securities disputes, the Supreme Court and other federal courts have become less sympathetic towards plaintiffs.<sup>117</sup>

### A. Securities Actions and Arbitration

After the passage of the Securities Act and the Exchange Act, courts generally interpreted these statutes broadly.<sup>118</sup> Despite the existence of the FAA,<sup>119</sup> the Supreme Court in *Wilko v. Swan*<sup>120</sup> held that claims brought under the Securities Act could not be arbitrated<sup>121</sup> because the Securities Act provided that "any condition, stipulation, or provision binding any person acquiring any securities to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."<sup>122</sup> The Court interpreted this portion of the Securities Act to prohibit investors from waiving their right to choose the

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116. See *infra* Part II.B.

117. See *infra* Part II.B.

118. See Ramirez, *supra* note 1, at 1067-68.

119. 9 U.S.C. §§ 1-14 (2000).

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

121. *Id.* at 188-89. For a discussion of the historical reluctance of courts to enforce arbitration agreement, going back to English law, see Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternate Dispute Resolution*, 85 CALIF. L. REV. 577, 599-608 (1997).

122. 15 U.S.C. § 77n (2000). In fact, "[a]ll six SEC statutes [the Securities Act, the Exchange Act, PUHCA, TIA, the Investment Act, and the Advisors Act] specify that any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of the Act or any rule of the Commission 'shall be void.'" Joel Seligman, *The Quiet Resolution: Securities Arbitration Confronts the Hard Questions*, 33 HOUSTON L. REV. 327, 330 (1996) (quoting the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* (2000); Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* (2000); Public Utilities Holding Company Act of 1935, 15 U.S.C. §§ 78o(h) *et seq.* (2000); Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa *et seq.* (2000); Investment Company Act, 15 U.S.C. §§ 80a-1 *et seq.* (2000); Investment Advisors Act, 15 U.S.C. §§ 80b-1 *et seq.* (2000)).

forum in which to resolve disputes.<sup>123</sup> The Court was also concerned that arbitrators who were not bound by the law, could not properly protect the rights of plaintiffs, who could not investigate securities as thoroughly as sellers.<sup>124</sup> Additionally, the Court was also worried about the limited judicial review of arbitration decisions<sup>125</sup> and the fact that arbitrators did not have to explain their decisions.<sup>126</sup> Therefore, the Court held that judicial redress was guaranteed by federal securities laws and that the right to bring a claim in court could not be waived, pursuant to section 12(2)<sup>127</sup> of the Securities Act.<sup>128</sup>

Almost twenty years later, however, the Court took a step towards recognizing the validity of arbitration agreements, in *Scherk v. Alberto-Culver Co.*<sup>129</sup> In *Scherk*, the respondent purchased three foreign entities believing that the trademarks of the companies were unencumbered.<sup>130</sup> When Alberto-Culver learned that the trademarks were encumbered, they sought restitution under Rule 10b-5 of the Exchange Act.<sup>131</sup> The Court held that the arbitration clause included in the sale contracts were enforceable because of concerns that parties would be hesitant to enter into international contracts.<sup>132</sup>

Lower courts extended the Supreme Court's rationale to the Exchange Act and refused to compel enforcement of pre-dispute arbitration agreements.<sup>133</sup> However, a new problem arose when a plaintiff's claim included both a federal securities claim that was

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123. 346 U.S. at 434-35.

124. *Id.* at 435-36.

125. *Id.* at 436.

126. *Id.*

127. Now section 15 U.S.C. § 12(a)(2).

128. 15 U.S.C. §§ 77a *et seq.* (2000).

129. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

130. *Id.* at 508.

131. *Id.* at 508-09.

132. *Id.* at 516.

133. See Constantine N. Katsoris, *Securities Arbitration After McMahon*, 16 FORDHAM URB. L.J. 361, 364-67 (1988) [hereinafter Katsoris I, McMahon]. See, e.g., *Berg v. Administrator of Fund for Participating Pledgers of F. I. DuPont, Glore, Fagan & Co.*, 378 N.Y.S. 2d 875 (2000); *Kiehne v. Purdy*, 309 N.W.2d 60 (1981); *Sandefur v. District Court, City of Denver*, 44 Colo. App. 343 (1980); *Moran v. Paine, Webber, Jackson & Curtis*, 422 Pa. 66 (1966).

subject to litigation and a non-federal securities claim that was subject to arbitration.<sup>134</sup> Various courts sought the conflict in different ways: some courts required the bifurcation of the claims<sup>135</sup> and others required the litigation of the claims.<sup>136</sup> The Supreme Court finally resolved this conflict in 1985, with *Dean Witter Reynolds, Inc. v. Byrd*.<sup>137</sup> The Court held that a federal securities claim could be litigated while a related non-federal claim proceeded to arbitration.<sup>138</sup> This created the danger that two claims based on similar facts could be resolved differently.<sup>139</sup>

Only two years later, in *Shearson/American Express Inc. v. McMahon*,<sup>140</sup> the Supreme Court found that securities actions brought pursuant to the Exchange Act could be arbitrated.<sup>141</sup> The Court based its decision on the growing prevalence of commercial arbitration and of arbitration by many of the stock exchanges, under the SEC regulation.<sup>142</sup> The Court found that "there is no reason to assume at the outset that arbitrators will not follow the law."<sup>143</sup> The Court also relied on the FAA<sup>144</sup> and section 29(a) of the Exchange Act, which voids any waiver of rights granted under that statute.<sup>145</sup> As a result of *McMahon*, the party contesting arbitration has the burden of demonstrating that Congress intended to preserve the right to judicial recourse, despite the existence of any outstanding arbitration agreement.<sup>146</sup>

Securities Act claims became subject to arbitration shortly thereafter, with the decision in *Rodriguez de Quijas v.*

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134. See Constantine N. Katsoris, *The Resolution of Securities Disputes*, 6 *FORDHAM J. CORP. & FIN. L.* 307 (2001) [hereinafter Katsoris II, *Resolution*].

135. See *id.*

136. See *id.*

137. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985).

138. *Id.* at 223.

139. See Katsoris II, *Resolution*, *supra* note 134, at n.19; see also Katsoris I, *McMahon*, *supra* note 133, at 9-11.

140. *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987).

141. *Id.* at 238.

142. *Id.* at 234.

143. *Id.* at 232.

144. See 9 U.S.C. §§ 1-14 (2000).

145. *McMahon*, 482 U.S. at 227-38.

146. See *McMahon*, 482 U.S. at 227.

*Shearson/American Express, Inc.*<sup>147</sup> *Wilko* was overturned.<sup>148</sup>

*B. The Attitude of the Supreme Court Toward Securities Litigation*

Although the courts initially favored securities actions after the passage of the Securities Act and the Exchange Act,<sup>149</sup> they became less tolerant as the number of such actions grew.<sup>150</sup> As a result, their approach to securities actions became narrower.<sup>151</sup> Even before *McMahon* and *Rodriguez*, beginning in the mid 1970s, the Supreme Court limited the ability of investors to bring securities claims.<sup>152</sup>

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

148. *Id.* at 485. Ironically, when *Wilko* was overturned, investors were unhappy, fearing that the trade organized arbitrations would favor the brokerages. See Robert Gregory, *Arbitration: It's Mandatory But It Ain't Fair*, 19 SEC. REG. L.J. 181 (1991). An article in the *New York Times* stated, "the brokerage houses basically like the current system because they own the stacked deck." William Glaberson, *When the Investor Has a Gripe*, N.Y. TIMES, Mar. 29, 1987, at 1, 8. However, since then, many authors have recognized the fairness of securities arbitration. See Shelly R. James, Note, *Arbitration in the Securities Field: Does the Present System of Arbitration Between Small Investors and Brokerage Firms Really Protect Anyone?*, 21 J. CORP. L. 363, 376-84, 389 (1996); see also Steinberg I, *McMahon*, *supra* note 67, at 1531-32; William A. Gregory & William J. Schneider, *Securities Arbitration: A Need for Continued Reform*, 17 NOVA L. REV. 1223, 1241 (1993); Ramirez, *supra* note 1, at 1102-04.

149. Steinberg I, *McMahon*, *supra* note 67, at 1510, 1517-18 (noting that "secondary liability doctrines seeking to hold brokerage firms and supervisory personnel liable encompassed aiding and abetting, controlling person, and respondeat superior" and recognizing the "expansionist decisions" rendered in the 1960s and early 1970s) (citations omitted).

150. See Ramirez, *supra* note 1, at 1068-69; see also Steinberg I, *McMahon*, *supra* note 67, at 1518 (recognizing that "[b]eginning with the mid 1970s and continuing to the present, investors generally have fared progressively worse under federal law).

151. See Ramirez, *supra* note 1, at 1069.

152. See Branson, *supra* note 81, at 6 ("In forty federal securities law decisions, the [Burger and Rehnquist] Court[s] decided thirty-two cases for defendants and, in almost every one, significantly narrowed the reach of federal securities laws."). But see Ramirez, *supra* note 1, at 1069 (recognizing only the Supreme Court's limitation on private securities actions in the 1990s).

In *Ernst & Ernst v. Hochfelder*,<sup>153</sup> the Supreme Court required a showing of scienter<sup>154</sup> in private securities actions. The Court found that in passing the Exchange Act, Congress was specific about which scienter elements, such as knowledge, intention, negligence, and innocent mistake, applied to various statutory violations.<sup>155</sup> Despite disagreement by the SEC,<sup>156</sup> the Court held that "when a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances – the commonly understood terminology of intentional wrongdoing – and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct."<sup>157</sup>

In *Santa Fe Industries v. Green*,<sup>158</sup> the Court held that scienter under Rule 10b-5 of the Securities Act required a showing of deception or manipulation.<sup>159</sup> The Court also specified that manipulation is a "term of art" in securities actions,<sup>160</sup> indicating actions such as wash sales,<sup>161</sup> matched orders,<sup>162</sup> or rigged prices.<sup>163</sup> If the plaintiff could not meet the federal pleading standard, the Court held that "it is entirely appropriate... to relegate respondent and others in his situation to whatever remedy is

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153. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

154. "(1) The fact of an act's having been done knowingly, esp[ecially] as a ground for damages or criminal punishment. (2) Prior knowledge or intention. (3) Loosely, guilty knowledge; intent to defraud." BLACK'S LAW DICTIONARY, 563 (pocket ed. 1996).

155. *See Ernst & Ernst*, 425 U.S. at 207-08.

156. *See id.* at 197-98.

157. *Id.* at 214.

158. *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977).

159. *See id.* at 473.

160. *See id.* at 476.

161. "The simultaneous, or nearly simultaneous, selling and buying of the same asset, esp[ecially] stock, by the same person to create the impression of market activity." BLACK'S LAW DICTIONARY, 560-61 (pocket ed. 1996).

162. "The illegal practice of simultaneously entering identical or nearly identical buy and sell orders for a security to create the appearance of active trading." *See* <http://www.investorwords.com/m2.htm#matchingorders> (last visited Nov. 17, 2001).

163. "The practice of artificially inflating stock prices, by a series of bids, so that the demand for those stocks appears to be high and investors will therefore be enticed into buying the stocks." BLACK'S LAW DICTIONARY, 551 (pocket ed. 1996).

created by state law."<sup>164</sup>

In *Chiarella v. United States*,<sup>165</sup> the Supreme Court found that silence does not create liability unless there is a duty of disclosure. In *Chiarella*, a printer of takeover bid announcements was able to deduce the names of companies to be acquired and bought shares in the companies before the announcements were public, later selling the shares at a profit after the announcements were made public.<sup>166</sup> The Court found that the printer was not guilty of fraud because "one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so."<sup>167</sup> Either a fiduciary duty or a relationship of trust or confidence creates a responsibility to disclose.<sup>168</sup> The printer did not receive the names of the companies to be taken over from the acquirers and therefore did not have a duty of confidentiality.<sup>169</sup>

In *Lampf, Pleva, Lipkind, Prupis & Petrigrow v. Gilbertson*,<sup>170</sup> the Supreme Court shortened the statute of limitations for private 10(b) claims.<sup>171</sup> It found that while in some cases, federal courts should "borrow" the statute of limitations imposed by the relevant state, state law was not generally applicable for securities fraud claims because of the need for national consistency and the fact that other sections of the Securities Act and the Exchange Act established statute of limitations for other violations.<sup>172</sup> Therefore, a maximum three-year statute of limitations was established.<sup>173</sup> The Court also held that time calculated to determine the statute of limitations is not subject to equitable tolling because the three year maximum served to limit actions and tolling would undermine that

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164. *Santa Fe Indus.*, 430 U.S. at 478 (quoting *Cort v. Ash*, 422 U.S. 66 (1975)).

165. *Chiarella v. United States*, 445 U.S. 222, 235 (1980)

166. *See id.* at 224.

167. *Id.* at 228.

168. *See id.*

169. *See id.* at 231.

170. *Lampf, Pleva, Lipkind, Prupis & Petrigrow v. Gilbertson*, 501 U.S. 350 (1991).

171. *Id.* at 361-62.

172. *Id.*

173. *Id.*

goal.<sup>174</sup>

In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*,<sup>175</sup> the Court held that aiding and abetting claims under Rule 10b-5 of the Exchange Act was no longer permissible.<sup>176</sup> "[T]he private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)"<sup>177</sup> and "the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation."<sup>178</sup> Thus, securities statutes that do not expressly allow aiding and abetting liability no longer allow claims to be made under that theory.<sup>179</sup> In the dissent, Justice Stevens noted that liability under the theories of conspiracy and respondeat superior would soon follow.<sup>180</sup>

In *Gustafson v. Alloyd*,<sup>181</sup> the Court limited rescission claims under the Securities Act by limiting such actions to purchasers of the securities.<sup>182</sup> The Court also limited the types of communications that plaintiffs could use to demonstrate reliance, finding that face-to-face conversations and telephone

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174. *Id.* at 363; see also Steinberg I, McMahon, *supra* note 67, at 1523-24; Gordon W. Stewart, *Statute of Limitations for Rule 10b-5*, 39 WASH. & LEE L. REV. 1021 (1982).

175. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

176. *Id.* at 177. For a discussion criticizing the decision in *Central Bank of Denver* and demonstrating how lower courts have circumvented that decision, see Stewart, *supra* note 174 (noting how a case in the Third Circuit found that a law firm could be held liable under Section 10(b) if it drafted a document relied upon by an investor, that a case in the Sixth Circuit held that statements made to investors by an attorney created a duty to provide non-misleading and complete information, and that a case in the Ninth Circuit found that an accounting firm could be liable for fraud for drafting a disclosure document).

177. *Central Bank of Denver*, 511 U.S. at 173.

178. *Id.* at 177.

179. *Id.* at 177-78.

180. *Id.* at 200. Lower courts have subsequently prohibited conspiracy claims in private securities actions. See, e.g., *Otto v. Variable Annuity Life Ins. Co.*, No. 82 C 4762, 1995 U.S. Dist. Lexis 3352 (N.D. Ill. 1995); *In re Faleck & Margolies, Ltd.*, Civ. Nos. 89-8548, 90-1356, 1995 U.S. Dist. Lexis 970 (S.D.N.Y. 1995); *In re Medimmune Inc. Sec. Litig.*, 873 F. Supp. 953 (D. Md. 1995).

181. *Gustafson v. Alloyd*, 513 U.S. 561 (1995).

182. *Id.*

communications could not be used to show fraud.<sup>183</sup> They stated, "it is not plausible to infer that Congress created this extensive liability for every casual communication between buyer and seller in the secondary market."<sup>184</sup> Moreover, the decision limited fraud claims under section 12(2) to issuers.<sup>185</sup> Finally, the Court prohibited fraud claims against brokerages or agents, holding that a prospectus was essentially equivalent to information in a registration statement related to the public by the issuer or controlling shareholders.<sup>186</sup>

Other courts followed suit.<sup>187</sup> The new federal restrictions have

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183. *Id.* at 575-76.

184. *Id.* at 578.

185. *Id.* at 572.

186. *Id.* at 569.

187. See Avery, *supra* note 83, at 341-47 (noting that after *Central Bank of Denver* and *Gustafson*, lower courts also disposed of cases early because of a perception of abuses in securities litigation). See, e.g., *Wells v. Monarch Capital Corp.*, No. 97-1221, 1997 U.S. App. Lexis 30031, \*20-21 (1st Cir. 1997) (finding that mistakes by accountants relying on statements by the state insurance department examiners, viewing surplus as a regulatory and not an accounting issue, and relying on an "internal collectibility analysis" did not constitute knowing, deliberate, or reckless fraud and therefore did not meet the scienter requirement for fraud); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1433 (3rd Cir. 1997) ("[C]ompanies [do not] have . . . a general obligation to disclose all material information."); *United States v. O'Hagan*, 92 F.3d 612, 618 (8th Cir. 1996) (finding that the misappropriation theory could not be used to find liability under § 10(b) of the Exchange Act because the theory is based on the breach of fiduciary duty, not "material misrepresentation or nondisclosure"); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413-15 (9th Cir. 1994) (finding that language indicating risk or the need for caution in forward-looking statements can eliminate a claim for securities fraud); *Melder v Morris*, 27 F.3d 1097, 1103 (5th Cir. 1994) (holding that allegations, without more, against an accounting firm for failure to use particular accounting standards do not support fraud claims); *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994) (determining that allegations that executives made fraudulent statements in order to maintain the benefits of their positions were insufficient to show scienter); *Raab v. General Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993) (because "predictions of future growth . . . will almost always prove to be wrong in hindsight," projections of future performance are insufficient to support allegations of fraud); *Jensen v. Kimble*, 1 F.3d 1073, 1078 (10th Cir. 1993) ("[A] manipulative or deceptive omission is an omission which renders the other affirmative statements made by an individual misleading . . . . [W]here the non-



been extended to state claims brought with federal securities claims.<sup>188</sup> Many state claims are being dismissed along with the federal claims.<sup>189</sup> Moreover, the tone of federal securities opinions has become hostile.<sup>190</sup> It has been believed that securities claims were the cause of the litigation overtaking the federal courts.<sup>191</sup>

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disclosing party explicitly informs the other party of his failure to disclose, an omission will not be misleading in the absence of special circumstances such as the inability of the dependent party to understand or appreciate the significance of the undisclosed information."); *Platsis v. E.F. Hutton & Co.*, 946 F.2d 38, 41 (6th Cir. 1991) (finding that defendant brokerage firm did not meet the scienter requirement of deception and did not have a duty to explain the compensation system for certain transactions where the broker told the apparently sophisticated plaintiff that commissions were not charged); *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990); *Pelletier v. Stuart-James Co.*, 863 F.2d 1550, 1555-56 (11th Cir. 1989) ("Where a contract [for the sale of securities] is unenforceable, an action for damages cannot be maintained on the ground of fraud in refusing to perform the contract, even though the promisor at the time of making the oral contract may have had no intention of performing it."); *Pross v. Baird, Patrick & Co., Inc.*, 585 F. Supp. 1456 (S.D.N.Y. 1984) (dismissing a section 10(b) claim for unauthorized trading on the grounds that the action was for breach of fiduciary, not fraud, because of the absence of scienter).

188. *Steinberg I, McMahon*, *supra* note 67, at 1528.

189. *See, e.g., Haralson v. E.F. Hutton Group*, 919 F.2d 1014, 1032 (5th Cir. 1990); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1130-31 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914; *Capri v. Murphy*, 856 F.2d 473, 479 (2d Cir. 1988). *But see Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 532 (5th Cir. 1992); *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1048-51 1 (11th Cir. 1987).

190. *See, e.g., In re Glenfed, Inc. Sec. Litig.*, 42 F.3d 1541, 1554-55 (9th Cir. 1994) ("These various discrete deficiencies are not the only problems with the complaint . . . [it] is unwieldy in the extreme . . . 113 pages long . . . rambles through long stretches of material quoted from defendants' public statements. . . [demonstrating] poor draftsmanship."); *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990) ("People sometimes act irrationally, but indulging ready inferences of irrationality would too easily allow the inference that ordinary business reverses are fraud. One who believes that another has behaved irrationally has to make a strong case.").

191. *See* 138 Cong. Rec. S12599 (1992); *see also Oxley Interview*, *supra* note 89 (stating that the PSLRA was necessary because:

[T]he explosion in class action lawsuits has become somewhat of a cottage industry in certain areas, and as a result, we've had enormous difficulties, particularly with entrepreneurs, startup companies that are highly capitalized and need to provide new technologies and new ideas, and in many cases those are exactly the kinds of business that are attacked in these

However, such distaste has been limited only to private claims; cases brought forth by public agencies continue to receive support from the courts.<sup>192</sup> Overall, courts have recently been less tolerant of securities claims and have been dismissing them more often.<sup>193</sup>

### C. The Supreme Court and Class Actions

The Supreme Court adopted Rule 23 of the Federal Rules of Civil Procedure in 1937.<sup>194</sup> However, even prior to its adoption, the Supreme Court allowed class action suits, where the number of parties was great.<sup>195</sup> Since the adoption of Rule 23, the Court has refined its decision, disallowing the aggregation of claims "where there are numerous plaintiffs having no joint or common interest or title in the subject matter of the suit."<sup>196</sup> Furthermore, plaintiffs cannot aggregate the amount of their losses to meet the damage

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class action suits.).

192. See Ramirez, *supra* note 1, at 1071-72; see also Steinberg I, McMahon, *supra* note 67, at 1527-28. This policy has harmed investors even more. "Investors are most sensitive to their pocketbooks and only private enforcement truly protects this interest." *Id.* at 1083. See, e.g., Rubin v. United States, 449 U.S. 424 (1981) (finding that under Section 17a of the Securities Act, a pledge of stock as collateral constitutes an offer of sale of a security); United States v. Naftalin, 441 U.S. 768 (1979) (holding that for the government to bring an action under 15 U.S.C. § 77q, the fraud could impact either investors or brokers, not just investors as was previously required).

193. Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decision on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489 (1995).

194. Jennifer Denham Henderson, *Protecting Rule 23 Class Members From Unfair Class Action Settlement: The Supreme Court's Amchem and Ortiz Decisions*, 27 WM. MITCHELL L. REV. 489, 493 (2000).

195. See, e.g., Tribe of Ben-Hur v. Cauble, 255 U.S. 356, 363 (1921) ("[A] court of equity permits a portion of the parties in interest to represent the entire body, and the decree binds all of them the same as if all were before the court."); Smith v. Swormstedt, 57 U.S. 288, 302 (1850) ("[W]here the parties interested are numerous, and the suit is for an object common to them all, some of the body may maintain a bill on behalf of themselves and of the others; and a bill may also be maintained against a portion of a numerous body of defendants, representing a common interest."); Beatty v. Kurtz, 27 U.S. 566, 585 (1829) ("[S]ome of the members of a voluntary society or company, when the parties are very numerous, may use for an account against others, without joining all.").

196. Clark v. Paul Grey, Inc., 306 U.S. 583, 588 (1939).

requirement needed for a diversity action.<sup>197</sup> The Court has also found that non-certification of a class is not subject to appeal until a final decision is rendered, as the denial of certification does not affect the merits of the case.<sup>198</sup>

Nonetheless, the Supreme Court has rendered at least one decision favoring plaintiffs where certification is denied. The statute of limitations is tolled where motions for intervention are timely filed.<sup>199</sup> "The commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action."<sup>200</sup>

The Supreme Court has also rendered other decisions in favor of class action plaintiffs. In *Hansberry v. Lee*, the Court found that "[t]here has been a failure of due process only in those cases where it cannot be said that the procedure adopted fairly insures the protection of the interests of absent parties who are to be found by it. The interests of the absent plaintiffs are sufficiently protected by the forum state when those plaintiffs are provided with a request for exclusion that can be returned within a reasonable time to the court."<sup>201</sup> In other words, specifically as long as plaintiffs have a chance to opt-out of the class, their due process rights are protected.<sup>202</sup> Moreover, parties have a right to a jury trial in a derivative class action if the corporation whose name the action is brought under would be entitled to the same.<sup>203</sup>

The Supreme Court has also found that plaintiffs alone do not necessarily bear the cost of the notice requirement of class

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197. See, e.g., *Zahn v. Int'l Paper Co.*, 414 U.S. 291, 300 (1973) (holding that all plaintiffs, not just those named in the complaint, must meet the amount in controversy requirement); *Synder v. Harris*, 394 U.S. 332, 338 (1969) (disallowing the aggregation of claims after the 1966 amendment of Rule 23).

198. See *Deposit Guar. Nat'l Bank of Jackson, Mississippi v. Rope*, 445 U.S. 326, 441 (1980); see also *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 477 (1978) ("The fact that an interlocutory order may induce a party to abandon his claim before final judgment is not a sufficient reason for considering it a 'final decision' within the meaning of § 1291.").

199. See *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974).

200. *Id.* at 553.

201. *Hansberry v. Lee*, 311 U.S. 32, 42 (1940).

202. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 814 (1985).

203. See *Ross v. Bernhard*, 396 U.S. 531, 531, 542 (1970).

actions.<sup>204</sup> The Court has allowed class members to appeal a decision where the named plaintiffs fail to do so<sup>205</sup> and allow for the resolution of disputes under the exclusive purview of the federal courts outside of the federal jurisdiction.<sup>206</sup>

The Supreme Court has recognized the benefits of class action suits. "The class-action devices save the resources of both the courts and the parties by permitting an issue potentially affecting every [class member] to be litigated in an economical fashion under Rule 23."<sup>207</sup> The Court has also recognized that class actions allow the cost of litigation to be spread among plaintiffs.<sup>208</sup> Additionally, class actions protect absent plaintiffs.<sup>209</sup> The advantages of aggregating claims have also been noted by the Court.<sup>210</sup>

### III. ARBITRATION OF SECURITIES CLAIMS

Arbitration is "a method of dispute resolution involving one or more neutral third parties who are chosen by or agreed to by the

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204. See *Martin v. Wilks*, 490 U.S. 755, 765 (1989) ("It makes sense . . . to place on [the parties to a lawsuit] the burden of bringing in additional parties . . . rather than place [the burden] on potential additional parties . . . to intervene when they acquire knowledge of the lawsuit" because the parties to the suit better understand the scope and nature of the litigation.); see also *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 356 (1978) (holding that "the district court properly may exercise its discretion under Rule 23(4) to order the defendant to perform" a required task with less difficulty and expense). *But see Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1979) (finding that plaintiffs must bear the cost of notice to class members).

205. See *United Airlines, Inc. v. McDonald*, 432 U.S. 385, 396 (1977) ("Post judgment intervention for the purpose of appeal . . . [is] timely . . . in litigation . . . and in which the intervention might . . . be thought to have a less direct interest in participation in the appellate phase.").

206. See *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 385 (1996).

207. See *General Tel. Co. v. Falcon*, 457 U.S. 147, 155 (1982), quoting *Califano v. Yamasaki*, 442 U.S. 682, 701 (1979); see also Leslie W. O'Leary, *Mass Tort Class Action: Will Amchem Spawn Creative Solutions?*, DEF. COUNS. J. (1998).

208. See *United States Parole Comm'n v. Geraghty*, 445 U.S. 388, 402-03 (1980).

209. *Id.*

210. See *Guarantee Nat'l Bank v. Roper*, 445 U.S. 326, 339 (1980); see also O'Leary, *supra* note 207.

disputing parties, and whose decision is binding."<sup>211</sup> It has many advantages. Arbitration reduces costs,<sup>212</sup> which are lower than those associated with litigation.<sup>213</sup> It is also more efficient,<sup>214</sup> typically resolving disputes within months instead of years.<sup>215</sup> Furthermore, arbitration allows claims to be resolved by experts,<sup>216</sup> as opposed to the lay people of a jury<sup>217</sup> or judges with little experience in the field at issue.<sup>218</sup> Unlike litigation, arbitration is not conducted at the expense of taxpayers<sup>219</sup> supporting the judicial system. Instead, the parties themselves pay for the arbitrator,<sup>220</sup> filing fees,<sup>221</sup> and any other costs.<sup>222</sup> Arbitration also allows the

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211. BLACK'S LAW DICTIONARY 40 (pocket ed. 1996).

212. See C. Edward Fletcher, III, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 458 (1987); see also Mayer, *supra* note 103.

213. See Fletcher, *supra* note 212, at 458; see also Roger S. Haydock, *Civil Justice and Dispute Resolution in the Twenty-First Century: Mediation and Arbitration Now and for the Future*, 27 WM. MITCHELL L. REV. 745, 759 (2000) ("Arbitration filing fees and hearing fees, and elective attorney fees, are much less than the total of litigation costs and expenses and mandatory attorney fees.").

214. See Fletcher, *supra* note 212, at 458.

215. See Deborah Masucci, *Securities Arbitration – A Success Story: What Does the Future Hold?*, 31 WAKE FOREST L. REV. 183, 188-89 (1996); see also Mayer, *supra* note 103.

216. See Anthony DeToro, *Waiver of the Right to Compel Arbitration of Investor-Broker Disputes*, 21 CUMB. L. REV. 615, 619 (1991) ("[P]arties often benefit from the arbitrators' specialized knowledge . . .").

217. See *In re Japanese Elec. Prods. Antitrust Litig.*, 631 F.2d 1069, 1086-87 (3d Cir. 1980) (noting that due process may be denied when juries hear complex cases).

218. See Ramirez, *supra* note 1, at 1119 (noting that "specialized arbitrators also may be preferable to judges; [a]n arbitrator who is an accountant is likely to know what motivates accountants better than a judge without an accounting background").

219. See Fletcher, *supra* note 212, at 458; see also Coffee, *supra* note 80, at 379 ("[T]he taxpayer does not bear the cost of these [arbitrated, securities] disputes.").

220. See Janet M. Grossnickle, *Allied-Bruce Terminix Cos. v. Dobson: How the Federal Arbitration Act Will Keep Consumers and Corporations Out of the Courtroom*, 36 B.C. L. REV. 769, 770 (1995).

221. See Constantine N. Katsoris, *SICA: The First Twenty Years*, 23 FORDHAM URB. L.J. 483, 558 (1996) [hereinafter Katsoris III, *SICA*].

parties to choose the procedural rules that will apply,<sup>223</sup> limiting the rules can save both time and money, especially in the area of discovery.<sup>224</sup> Finally, arbitration has the advantage of being fair, something the courts cannot always provide when statutory law does not support the most just outcome.<sup>225</sup>

Many of these advantages, such as lower costs, time efficiency, resolution by experts instead of lay people, and funding by the parties involved, exist in securities arbitration. Arbitration of securities disputes can result in awards based on standards other than the law, such as industry customs or equity.<sup>226</sup>

Securities arbitration also has the advantage of pleading requirements that are simpler than those required under federal litigation.<sup>227</sup> It does not require a written decision, thereby helping to provide efficient resolution of the dispute, encouraging people to serve as arbitrators, and limiting the appeal of arbitration awards.<sup>228</sup>

Nonetheless, arbitration also has disadvantages. One great concern is that it allows legal obligations and rights to be circumvented.<sup>229</sup> Parties can simply contract to use or not use statutes from specific locales.<sup>230</sup> Furthermore, parties can agree to

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222. See Nelson D. Blank & Lansing C. Scriven, *Survey of Florida Law: Alternate Dispute Resolution: 1994 Survey of Florida Law*, 19 NOVA L. REV. 33, 43-44 (1994) (noting that travel and other expenses of witnesses and arbitrators and the costs of producing evidence are born by the arbitrating parties).

223. See Andrew T. Guzman, *Arbitrator Liability: Reconciling Arbitration and Mandatory Rules*, 49 DUKE L.J. 1279, 1285 (2000).

224. See Gregg A. Paradise, *Arbitration of Patent Infringement Disputes: Encouraging the Use of Arbitration Through Evidence Rules Reform*, 64 FORDHAM L. REV. 247, 262-63 (1995) ("The limited discovery [under arbitration] . . . saves a significant amount of time, as well as money."); see also Grossnickle, *supra* note 220, at 770 ("[A]rbitration is often characterized by limited discovery.").

225. See Ramirez, *supra* note 1, at 1112.

226. See Steinberg I, McMahon, *supra* note 67, at 1514-15.

227. *Id.* at 1512-13.

228. *Id.* at 1516-17.

229. See Guzman, *supra* note 223, at 1298 ("[R]ules that offer [parties to arbitration agreements] substantial benefits will be avoided if the joint costs of the rule outweigh its benefits."); see also Mayer, *supra* note 103 ("The ability to gather evidence is much more limited than in court proceedings.").

230. See Kenneth R. Davis, *When Ignorance of the Law is No Excuse: Judicial*

limit where disputes will be resolved,<sup>231</sup> thereby affecting the procedural rights of the parties.<sup>232</sup> Some arbitration agreements have gone as far as to limit the manner in which parties address problems, by contracting to resolve problems outside of the judicial system.<sup>233</sup> These concerns are especially relevant in cases of unequal bargaining power.<sup>234</sup>

The use of arbitration has had different results throughout the country; it is more favorable to plaintiffs in some states than in others.<sup>235</sup> Requiring arbitration of securities disputes is favorable to some but deprives others of generous state laws. New York is a pro-industry state where arbitration offers plaintiffs more options than state litigation.<sup>236</sup> However, courts in other states favor plaintiffs,<sup>237</sup> allowing recovery for negligence in primary and secondary trading markets.<sup>238</sup> Some do not require plaintiffs to show reliance or that the defendant's actions caused the loss.<sup>239</sup> Collateral participant liability,<sup>240</sup> longer statutes of limitations,<sup>241</sup>

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*Review of Arbitration Awards*, 45 BUFFALO L. REV. 49, 77 (1997).

231. See Keith Highet & George Kahale III, *Decision: Arbitration – Punitive Damages – Choice of Law – Federal Arbitration Act: Mastrobuono v. Shearman Lehman Hutton, Inc.* 115 S.Ct. 1212: U.S. Supreme Court, March 6, 1995, 89 A.J.I.L. 601, 601 (1995) ("[S]ecurities firms use a nationwide standard-form brokerage contract with a choice-of-law provision . . . which [is] intended to avoid punitive damages regardless of the circumstances.").

232. See Guzman, *supra* note 223, at 1289.

233. See Mayer, *supra* note 103 ("Arbitration . . . permits less evidence-gathering that can help win a case.").

234. See Davis, *supra* note 230, at 78.

235. See Steinberg II, *Litigation Reform Act*, *supra* note 88, at 1507.

236. See Steinberg I, McMahon, *supra* note 67, at 1529.

237. See *id.* at 1530.

238. See *id.* at 1530; see, e.g., *Molecular Tech. Corp. v. Valentine*, 925 F.2d 910, 920 n.7 (6th Cir. 1991); *Kittilson v. Ford*, 608 P.2d 264, 265 (Wash. 1980); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Byrne*, 320 So. 2d 436, 440 (Fla. Dist. Ct. App. 1975); *Fakhrdai v. Mason*, 696 P.2d 1164, 1166-67 (Or. Ct. App. 1985).

239. See Steinberg I, McMahon, *supra* note 67, at 1530; see also Marilyn Cane, *Proximate Causation in Securities Fraud Actions for Rescission*, FLA. BAR Q. REP., Spring 1989 at 14. E.g., *E.F. Hutton & Co. v. Rouseff*, 537 So. 2d 978, 981 (Fla. 1989).

240. See generally, Douglas M. Branson, *Collateral Participant Liability Under State Securities Laws*, 19 PEPP. L. REV. 1027 (1992). See, e.g., *Ariz. Rev. Stat. Ann.* § 44-2003 (1994); *Ohio Rev. Code Ann.* § 1707.43 (1992); *Or. Rev. Stat.* §

and use of the theory of respondeat superior also exist in some states.<sup>242</sup> Attorney fees and punitive damages are also available to plaintiffs in some states.<sup>243</sup> Pleading standards are lower in state courts than in federal court.<sup>244</sup> State courts are also less likely to dismiss securities actions.<sup>245</sup>

Congress codified arbitration as a means to settle disputes with the passage of the FAA.<sup>246</sup> However, the courts did not sanction arbitration as a means to resolve securities disputes until over twenty-five years later, with the decisions in *McMahon* and *Rodriguez*.<sup>247</sup> Today there is a "federal policy favoring arbitration . . . [and] any doubts should be resolved in favor of arbitration."<sup>248</sup>

### A. Self-Regulatory Organizations

Arbitration in the American securities industry first began in 1872, when the New York Stock Exchange ("NYSE") offered it as a service to resolve disputes.<sup>249</sup> The National Association of Securities Dealers ("NASD") began using arbitration in 1968.<sup>250</sup>

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59.115(3) (1980); Tex. Rev. Civ. Stat. art. 581-33F (1994).

241. See, e.g., Fla. Stat. Ann. § 95.11(4)(e); N.M. Stat. Ann. § 58-13B-41; PA. Stat. Ann. tit. § 1-504(a); Tex. Rev. Civ. Stat. Ann. art. 581-33H(2).

242. See Steinberg I, McMahon, *supra* note 67, at 1530.

243. See *id.* See, e.g., Ariz. Rev. Stat. Ann. § 44-2001; Ohio Rev. Code Ann. § 2315.21; Utah Code Ann. § 61-1-22(2); Wash. Rev. Code § 21.20.430(1).

244. See Steinberg I, McMahon, *supra* note 67, at 1530. Compare R.R.S. Neb. § 25-207 (2001) (allowing for a fraud claim to be brought within four years of discovery) and N.D. Cent. Code § 28-01-16 (2001) (allowing six years after discovery to bring a fraud claim) and Burnes Ind. Code Ann. § 34-11-2-7 (2001) (granting six years within discovery to bring a fraud suit) with *Lampf, Pleva, Lipkind, Prupis & Petrigorw v. Gilberton*, 501 U.S. 350, 361-62 (1991) (allowing a maximum of three years to bring a fraud claim, without equitable tolling).

245. See Steinberg I, McMahon, *supra* note 67, at 1530.

246. 9 U.S.C. §§ 1-14 (2000).

247. See discussion *supra* Part II.A.

248. *Nielsen v. Piper, Jaffray & Hopwood, Inc.*, 66 F.3d 145, 148 (7th Cir. 1995) (quoting *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983)).

249. See Ramirez, *supra* note 1, at 1097.

250. *Id.*



However, these self-regulating organizations ("SROs")<sup>251</sup> did not have consistent rules for arbitration.<sup>252</sup> The Securities Industry Conference on Arbitration ("SICA") was established in April 1977, as a result of suggestions made to the SEC.<sup>253</sup> SICA was formed to develop a uniform set of rules for the arbitration of disputes between buyers and sellers in the securities industry.<sup>254</sup> SICA consists of the SROs, the Securities Industry Association, and four public members.<sup>255</sup>

SICA developed a uniform method for the arbitration of claims of \$2,500 or less.<sup>256</sup> In 1978, SICA developed the Uniform Code of Arbitration ("Uniform Code"), establishing uniform arbitration procedures for the securities industry.<sup>257</sup> In 1978, the SEC approved changes submitted by the American Stock Exchange, the NYSE, and NASD that were virtually identical.<sup>258</sup> These changes required increased disclosure of arbitration clauses to customers, prohibited arbitration clauses from limiting the ability of customers to file complaints or limiting recovery, increased the content of awards, and created a classification for arbitrators.<sup>259</sup>

The Uniform Code is not binding on SROs, but must be formally adopted by the organization after a formal rule filing with the SEC.<sup>260</sup> However, given that the SROs are members of SICA<sup>261</sup>

251. Other SROs include the American Stock Exchange, the Chicago Board Options Exchange, numerous regional stock exchanges, and the Municipal Securities Rulemaking Board. See National Association of Securities Dealers, Inc., *Securities Regulation in the United States*, Third Edition (1996) [hereinafter NASD, *Securities Regulation*].

252. See Katsoris II, *Resolution*, *supra* note 134, at 313.

253. See *id.* at 314 for a more detailed explanation about the events leading up to the formation of SICA. Specifically, SICA is comprised of eight stock exchanges, the NASD, the Municipal Securities Rulemaking Board, the Securities Industry Association and four members of the public. See Seligman, *supra* note 122, at 336.

254. See NASD, *Securities Regulation*, *supra* note 251, at 46.

255. *Id.*

256. See Katsoris II, *Resolution*, *supra* note 134, at 315.

257. *Id.*

258. See Seligman, *supra* note 122, at 337.

259. *Id.*

260. See Katsoris III, *SICA*, *supra* note 221, at 521-22 ("[O]nce SICA adopts a

and that all stock brokers are members of the NASD,<sup>262</sup> which has adopted the Uniform Code, it applies to most securities disputes.<sup>263</sup> Since its initial promulgation, the Uniform Code has been revised numerous times, in consideration of new issues and more complex cases.<sup>264</sup>

Today, the Uniform Code allows almost all customers to compel their brokerages to arbitrate a dispute, pursuant to the brokerage's membership with an SRO.<sup>265</sup> It also provides that the rules of evidence are not applicable to arbitrations,<sup>266</sup> does not allow for motions,<sup>267</sup> discourages the use of depositions,<sup>268</sup> and permits only informal discovery.<sup>269</sup> A dispute is heard by a panel of three arbitrators,<sup>270</sup> who have experience with securities<sup>271</sup> and arbitration training.<sup>272</sup> The panel hears the dispute and renders a

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new rule, each SRO generally goes back to their respective organization for Board approval; and, if successful, such rule is usually then submitted to the SEC for approval in a Rule 19(b) filing.); accord Katsoris II, *Resolution*, *supra* note 134, at 316 n.42 and accompanying text ("Once SICA adopts a new rule, each SRO must then generally go back to their respective organization in order to get a rule change which is then usually submitted to the SEC for approval.").

261. See text accompanying notes 254 and 255.

262. See Mark J. Astarita, *Overview of the Arbitration Process*, available at <http://www.seclaw.com/arbover.htm> (last visited Nov. 17, 2001).

263. Accord Seligman, *supra* note 122, at 346 ("[T]he securities exchanges and the NASD have required arbitration to be subject to the process of a specific exchange or the NASD."). The exchanges and NASD have adopted the Uniform Code. See sources cited nn. 254 & 258.

264. Katsoris II, *Resolution*, *supra* note 134, at 317.

265. UNIF. CODE OF ARB. (as amended), *reprinted in* Katsoris II, *Resolution*, *supra* note 134, at 381-418.

266. *Id.* § 21.

267. See Ramirez, *supra* note 1, at 1101-02 ("The Code authorizes virtually no motion practice.").

268. See *id.* ("The Code . . . discourages depositions."); see also Katsoris III, *SICA*, *supra* note 221, at 512 ("The Uniform Code omits any reference to pre-hearing depositions; however, the circumstances under which such depositions may be ordered by the arbitrators are discussed in the SICA Arbitrator's Manual.").

269. UNIF. CODE OF ARB. § 31(a)(3), *reprinted in* Katsoris II, *Resolution*, *supra* note 134 (indicating that discovery is "more limited" under the Code).

270. *Id.* § 8(b).

271. *Id.* § 31(a)(5).

272. See Ramirez, *supra* note 1, at 1102 ("The arbitrators are individuals with

decision and an award within thirty days.<sup>273</sup> Appeals are limited.<sup>274</sup>

However, the Uniform Code prohibits the arbitration of class action suits.<sup>275</sup> Because the vast majority of securities customers are required to arbitrate disputes, as required by their brokerage account agreements,<sup>276</sup> most individual claims are resolved using arbitration.<sup>277</sup> As a result, claims by individuals are subject to the Uniform Code whereas claims certified as class actions are resolved in federal courts, pursuant to federal statutes, including the Federal Rules of Civil Procedure and the Federal Rules of Evidence.

### 1. American Arbitration Association

The American Arbitration Association ("AAA") is one of the nation's leading dispute resolution organizations.<sup>278</sup> The AAA arbitrates matters in areas such as commercial finance, construction, labor and employment, health care, insurance, and securities.<sup>279</sup> Nonetheless, according to the 1996 Ruder Report, "[securities] arbitration... may no longer occur before the [AAA]" because many arbitration agreements do not list it as a possible forum for dispute resolution.<sup>280</sup> However, on January 24,

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substantial securities experience and are required to undertake significant arbitration training.").

273. UNIF. CODE OF ARB. § 28(d), *reprinted in* Katsoris, *SICA*, *supra* note 134.

274. *Id.* § 31(a)(4) (stating that the "right to appeal or to seek modification of rulings by the arbitrators is strictly limited"); *see also* Ramirez, *supra* note 1, at 1101.

275. *Id.* § 1(d)(1) ("A claim submitted as a class action shall not be eligible for arbitration under this Code . . .").

276. *See* Linda D. Fienberg & Matthew S. Yeo, *The NASD Securities Arbitration Report: A View from the Inside*, *INSIGHTS*, Apr. 1996 at 7, 8.

277. *See* Therese Maynard, *Securities Arbitration: A Decade After McMahon: McMahon: The Next Ten Years*, 62 *BROOK. L. REV.* 1533, 1557 n.46 (1996) ("[M]ost investor claims – if not virtually all claims made by individual investors – are by arbitration.").

278. *See* Jack M. Sabatino, *ADR as "Litigation Lite": Procedural and Evidentiary Norms Embedded within Alternative Dispute Resolution*, 47 *EMORY L.J.* 1289, 1301 (1998).

279. *See* [www.adr.org](http://www.adr.org) (last visited Nov. 17, 2001).

280. *See* Seligman, *supra* note 122, at 343 (*quoting* Arbitration Policy Task Force, National Ass'n of Sec. Dealers, Inc., *Securities Arbitration Reform* 3

2000, the AAA announced the creation of a two-year pilot program in conjunction with SICA.<sup>281</sup> The program proposes that brokerage firms voluntarily participate in the creation of an independent dispute resolution organization that is not affiliated with the securities industry.<sup>282</sup> Yet, the joint program does not apply to claims that cannot be filed for arbitration with an SRO.<sup>283</sup> Essentially, if a dispute cannot be brought before a traditional SRO forum, it cannot be resolved through the new AAA/SICA joint program.

## 2. JAMS and Securities Arbitration

JAMS has been a dispute resolution provider for over twenty years.<sup>284</sup> JAMS provides arbitration services in numerous areas, including employment, construction, real estate, environmental issues, intellectual property, and insurance.<sup>285</sup> It is also participating in a joint pilot program with SICA.<sup>286</sup> However, like AAA, JAMS is barred from arbitrating securities disputes that cannot be filed with an SRO.<sup>287</sup>

### B. The SEC and Arbitration

The SEC's adoption of Rule 15c2-2 initially prohibited broker-

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(1996)); *see also id.* at 363 ("[T]he investor's only choice is to select an industry sponsored arbitration forum because the AAA is infrequently included in the predispute arbitration agreement as an alternate forum.").

281. Press Release, American Arbitration Association Chosen by the Securities Industry to Resolve Broker/Customer Disputes, Jan. 24, 2000, *available at* [www.adr.org](http://www.adr.org) (last visited Nov. 17, 2001).

282. *Id.*

283. Guidelines for the SICA Securities Arbitration Pilot Program, *available at* <http://www.adr.org> (last visited Nov. 17, 2001).

284. JAMS, ALTERNATIVE DISPUTE RESOLUTION, *available at* <http://www.jamsadr.com/images/PDF/jams.pdf> (last visited Nov. 17, 2001).

285. *Id.*

286. Press Release, JAMS, JAMS Selected to Provide Alternative for Resolution of Securities Disputes (Jan. 24, 2000), *available at* [http://www.jamsadr.com/display\\_press.asp?id=55](http://www.jamsadr.com/display_press.asp?id=55) (last visited Nov. 17, 2001).

287. *See* <http://www.jamsadr.com/sica.asp> (last visited Nov. 17, 2001).

dealer use of predispute arbitration clauses that claim to bind the participants in the resolution of SEC claims.<sup>288</sup> However, after the *McMahon* decision, the SEC rescinded the rule, as it was not consistent with the Supreme Court's holding.<sup>289</sup> Since then, the SEC has endorsed the use of pre-dispute arbitration clauses in the securities industry.<sup>290</sup> It has recognized some of the aforementioned benefits, such as cost and time efficiency.<sup>291</sup> However, it has prohibited SROs from arbitrating class actions.<sup>292</sup> As a result, individual securities claims may be arbitrated whereas class actions are barred from that path of dispute resolution.

### *C. Courts and Class Action Arbitration*

While the courts have come to enforce pre-dispute arbitration agreements, the issue of arbitration of class actions has not been thoroughly addressed by the courts,<sup>293</sup> especially the Supreme

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288. See Seligman, *supra* note 122, at 340.

289. *Id.*

290. See Alternative Dispute Resolution, Exchange Act Release No. 34,40306, 63 F.R. 42891 (Aug. 11, 1998) available at <http://www.sec.gov/rules/policy/34-40306.htm> (last visited Nov. 17, 2001) (declaring that "the Commission is committed to the use of ADR . . .").

291. See <http://www.sec.gov/answers/arbproc.htm> (last visited Nov. 17, 2001).

292. See Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Amendments to NASD Rule 3110(f) Governing Use of Predispute Arbitration Agreements with Customers, Exchange Act Release No. 34,42160, 64 F.R. 66681 (Nov. 29, 1999) available at <http://www.sec.gov/rules/sro/nd9874n.htm> (last visited Nov. 17, 2001) (requiring that all agreement will state "no person shall bring a putative or certified class action to arbitration . . ."); accord Jayne Levin, *Industry Group Proposes Change in Arbitration; Would Require Class-action Suits to Go to Court*, INV. DEALERS' DIG., July 15, 1991 at 8 ("[T]he securities industry, the self-regulatory organizations, and the SEC have all agreed that the courts are better equipped to handle class-action suits than arbitration panels.").

293. Numerous authors have supported the idea of arbitrating securities class actions. See, e.g., Sternlight, *supra* note 107, at 126 ("[H]ybrid arbitral class action should be permitted, but only so long as courts maintain sufficient involvement to protect the due process rights of absent class members."); Ramirez, *supra* note 1, at 1134 (calling for an exploration of the arbitration of securities disputes); Waltcher, *supra* note 107, at 403-04 (arguing that classwide arbitration promotes efficiency).

Court.<sup>294</sup> It is unclear whether an arbitration panel can fulfill all of the traditional roles of the judiciary in a class action.<sup>295</sup> The greatest issues seem to lie in meeting the Federal Rules of Civil Procedure Rule 23 requirements<sup>296</sup> of prerequisites,<sup>297</sup> certification,<sup>298</sup> and notice.<sup>299</sup> Such concerns include who will choose the arbitrator and at what point in the dispute; awkwardness because of the need for the courts to play a role; determining the limits of class membership; deciding what constitutes adequate notice; and fear that arbitrators are unqualified to determine class issues.<sup>300</sup>

California courts have been liberal regarding the arbitration of class actions, undertaking the class issues themselves and allowing the arbitrator to determine the ultimate outcome of the action. For example, in *Keating v. Superior Court*,<sup>301</sup> a California case, the court made determinations regarding certification and notice to the class and was responsible for safeguarding the rights of class members outside of the dispute.<sup>302</sup> In another case, the court held that a securities class action should be arbitrated by the American Arbitration Association,<sup>303</sup> despite the fact that portions of the contract were illegal.<sup>304</sup> In *Dickler v. Shearson Lehman Hutton, Inc.*,<sup>305</sup> the court recognized that resolving disputes among class

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294. See Sternlight, *supra* note 107, at 38, 66 (noting that only arbitrator has taken it upon himself to resolve a class action securities dispute).

295. "[C]lass actions require great judicial discretion, while arbitrations operate outside the judiciary." Waltcher, *supra* note 107, at 400-01.

296. *Id.*

297. See, e.g., FED. R. CIV. P. 23(a) (a class so numerous as to make joinder impracticable; a common question of fact or law; claims of the class representative that are typical of the class; and a class representative able to protect the interests of the class) and 23(b) (inconsistent or dispositive discussions affecting class members; actions by the opposing party which treat members as a class; and superiority of a class action over other methods).

298. FED. R. CIV. P. 23(c)(3)-(c)(4).

299. *Id.* 23(c)(2).

300. See Sternlight, *supra* note 107, at 50-52.

301. *Keating v. Superior Court*, 645 P.2d 1192 (Cal. 1982).

302. See *id.* at 1209.

303. See *supra* note 279.

304. See *Lewis v. Prudential-Bache Sec. Inc.*, 179 Cal.App.3d 935 (1986).

305. *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860 (Pa. Super.

representatives was an additional responsibility for the courts.<sup>306</sup> While the subject of class action arbitration requires further exploration by the courts, to date, there has been little indication that courts are willing to bar such arbitration,<sup>307</sup> absent a contractual basis.<sup>308</sup>

#### IV. THE INEQUITIES IN THE RESOLUTION OF SECURITIES DISPUTES

The discussion above demonstrates that disputes in the securities arena are essentially decided in two ways:<sup>309</sup> individual actions are arbitrated whereas class actions are litigated. However, the differences between the methods creates different outcomes for actions that are based on similar facts. Due to the passage of the PSLRA, plaintiffs that undergo litigation have a higher burden of proof and must face unsympathetic courts. Plaintiffs that undergo arbitration have the advantages of efficiency, contracting for specific forums, legal applications, and procedures.

The greatest difference, however, is that arbitrators are not bound by the law. If justice or equity requires, arbitrators may overlook legislation whereas the courts are bound by statute. In essence, this allows plaintiffs in arbitrations to easily overcome legal requirements which their counterparts in litigation must prove to be more probable than not.<sup>310</sup> Furthermore, this allows

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1991).

306. *See id.* at 866.

307. *But see Levin, supra* note 292 ("To date, no class-action suits have been arbitrated.").

308. *See Sternlight, supra* note 107, at 65 ("most courts have been willing to order cases styled as class actions to arbitration"), at 62-62 (noting that in *Zawikowski v. Beneficial Nat'l Bank*, No. 98C2178, 1999 WL 35304, at \*2, the Court found that plaintiffs can contract away their right to class action dispute resolution), at 69-71 (stating that some courts have held that arbitration agreements that do not address the class action issue cannot be arbitrated).

309. Securities disputes can also be resolved by mediation. However, this method is informal and any resolution reached is based on the consent of the parties. *See Katsoris II, Resolution, supra* note 134, at 363. As such, a discussion of this method is not applicable, as this Note focuses on formal methods of dispute resolution that are involuntary.

310. Ironically, the PSLRA was enacted because "[t]he lack of congressional involvement has left judges free to develop conflicting legal standards, thereby

arbitrators to pick and choose the law, if necessary, thereby eliminating consistency in the resolution of disputes. As a result, similar cases can be decided differently, based on whether the case is litigated or arbitrated. Moreover, litigation outcomes also differ based on whether they are resolved at a state or a federal level. Such a variety of outcomes has created a system that encourages plaintiffs to forum shop.

However, this is not the real problem with the system. In theory, if arbitration is more advantageous to plaintiffs than litigation, common sense would suggest that all plaintiffs simply opt for arbitration.<sup>311</sup> Unfortunately, neither life nor the legal system is that simple. Class actions also have great advantages, such as spreading cost and risk, allowing for the aggregation of claims that might not otherwise be worth pursuing, and providing defendants with a cheaper and more efficient means of resolving mass claims.<sup>312</sup>

These advantages do not carry into arbitration. Instead, plaintiffs in a class action must pay for the arbitration themselves. While arbitration is less expensive than litigation, the cost of filing an action, paying an arbitrator, and undertaking even limited discovery can add up to a significant amount for a single investor.<sup>313</sup> "If the expected recovery is small, it will be impractical for the plaintiff to bear the cost of litigation in a federal court or to expect that the federal court will be a friendly forum after the Private Securities Litigation Reform Act."<sup>314</sup> When the damages sought are less than the cost of filing, paying for the arbitrator, and discovery, an individual plaintiff has little incentive to pursue the

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creating substantial uncertainties and opportunities for abuses of investors, issuers, professional firms and others." S. REP. NO. 104-98 (1995).

311. *Accord* Mayer, *supra* note 103 (quoting Professor Mark Budnitz as asking why mandatory arbitration provisions are not clearly and visibly explained to consumers if such clauses are so beneficial).

312. *See supra* Part III.

313. *Id.* ("[T]he cost of arbitration can sometimes be significantly higher than court fees, making it financially impossible for some consumers to seek relief. . . . [A]rbitration costs are . . . high enough to deter complaints."). Filing arbitration claims can cost anywhere from \$49 up and paying arbitrators can get as high as \$1,600 per day. *Id.*

314. *Coffee, supra* note 80, at 381-82.



cheaper arbitration. Such individual plaintiffs may find themselves "priced out of arbitration."<sup>315</sup> As a result, defendants are less likely to be held accountable for their misdeeds and "illegal actions could go undetected."<sup>316</sup> Therefore, the door has been opened for defendant brokers and dealers to benefit at the expense of their customers. Even when a defendant is confronted with his actions, the arbitration clauses prevalent throughout the securities industry may prolong the resolution of claims against him, requiring individual arbitration or individual settlements.

## V. THE SOLUTION

Securities disputes, whether individual or class actions, should be resolved in the same manner and forum. Because of the growth of securities disputes,<sup>317</sup> it may be time to create a completely independent and fair forum for their resolution. The SEC would be the obvious agency to facilitate the creation of such a forum.

Given the complexity of securities issues, it appears obvious that disputes in the area should be resolved by those with an understanding of nuances of the laws and characteristics of such investments.<sup>318</sup> This would allow all parties to feel that any decision reached would be fair and equitable under the circumstances. At the same time, potential plaintiffs should not have to sacrifice their right to an efficient<sup>319</sup> and statutorily just resolution.<sup>320</sup> This forum would essentially be similar to the numerous administrative agencies within the federal purview, such as the Social Security Administration<sup>321</sup> or National Relations Labor Board.<sup>322</sup> Likewise, this forum could constitute an Article I court,<sup>323</sup> such as the Tax<sup>324</sup>

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315. *Id.*

316. *Id.*

317. *See Katsoris II, Resolution*, *supra* note 134, at 371-78.

318. *See DeToro, supra* note 216 and accompanying text.

319. *See Fletcher, supra* note 212, at 458; *see also* text accompanying note 214.

320. *See* notes 229-234 and accompanying text.

321. *See* 42 U.S.C. § 405(b) (2000) (allowing the Commission of the Social Security Administration to make determinations on the entitlement of benefits).

322. *See* 29 U.S.C. § 160 (2000) (allowing the Board to determine whether unfair labor practices are occurring).

323. U.S. CONST. art. I, § 8, cl. 9 ("The Congress shall have Power . . . [t]o

or Bankruptcy Courts.<sup>325</sup> Either way, the forum would not have the appearance or bias of SRO arbitration.

Independence, however, is not the only characteristic a new forum would require. It is imperative that the forum and its judges be able to meet the procedural needs of class action suits.<sup>326</sup> This would include limiting class membership based on similar facts or legal premise, as well providing an ability to address the requirements of notice and certification. Without the ability to meet class action needs, such a forum would not resolve the problem of inequity.

The forum should also incorporate some of the other advantages of arbitration, such as efficiency.<sup>327</sup> This could be achieved by maintaining limited discovery<sup>328</sup> in straightforward cases. This forum could also require informal discovery. Of course, the more complicated the case, the less curtailed the discovery can be. Nonetheless, shorter allowances of time and greater supervision by judges or arbitrators will facilitate the discovery process.

Any new forum would have to address the shortcomings of the arbitration and litigation processes. Filing fees should remain consistent with other courts and the costs of the judges or the brokerage firms. Fees should be waived for low-income plaintiffs.<sup>329</sup> The costs of arbitration have been prohibitively high for individual parties whose losses are less than the cost of arbitration.<sup>330</sup>

The forum would also have to remain faithful to statutory law,

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constitute Tribunals inferior to the Supreme Court.).

324. See 26 U.S.C. § 7441 (2000).

325. See 28 U.S.C. § 151 (2000).

326. See *supra* notes 296-299 and accompanying text.

327. See Fletcher, *supra* note 212; see also *supra* note 214 and accompanying text.

328. See Paradise, *supra* note 224.

329. While it seems difficult to imagine a circumstance in which a plaintiff with enough income to invest in securities would be unable to pay filing fees, it is possible. Other federal courts allow for filing fee waivers in the case of financial hardship. See, e.g., 28 U.S.C. § 1915 (2000); TAX CT. R. 20(b).

330. See Coffee, *supra* note 80, at 382-82; see also *supra* note 314 and accompanying text.

including the rules of evidence and civil procedure. This will result in consistency in the resolution of disputes with similar factual and legal bases. Most importantly all decisions should be appealed to district court. The limited appeals of arbitration, combined with the ability to reach a decision without explaining the rationale, has created a system where parties have no alternative when justice does not prevail.<sup>331</sup>

Certainly, creating and implementing such a forum cannot be done overnight. However, the long-term benefits of a securities forum will benefit both plaintiffs and defendants. Where both parties are on equal footing, the law will prevail.

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331. See Steinberg I, McMahon, *supra* note 67; see also *supra* note 228 and accompanying text.