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PUNITIVE DAMAGES

Panelists

PROF. KATSORIS: We move on to our next topic, which will be covered both today and on December 5th,[95] and that is the issue of punitive damages. I'm now relieved of my role as moderator and assume the role of gladiator, and will present what I think is the public's point of view.

Punitive damages are receiving a lot of attention lately. In *TXO v. Alliance*,[96] the Supreme Court permitted a ten million dollar punitive award to stand, which was *526 times* compensatory damages.[97] In New Mexico, a jury recently awarded $200,000 in compensatory damages and $2.7 million in punitive damages to a claimant who accidentally spilled a cup of hot coffee on herself.[98] Are these awards unsettling to the business community? The answer is yes!

The Supreme Court has broadly announced that the Constitution imposes a substantive limit on the size of punitive damages[99] and that we must guard against the "extreme results that jar one's constitutional sensibilities."[100] Yet the Supreme Court has basically issued no guidelines in determining the constitutional limits on punitive awards.

In addition to this lack of guidance, a new obstacle surfaced this past summer when the Supreme Court in *Honda Motor Co. v. Oberg*[101] held that the limited reviewability provided under Oregon law for punitive damages renders such awards unconstitutional under the Fourteenth Amendment's Due Process Clause.[102] Finally, there are those in the securities industry who feel that the industry should be immune from punitive damages because the industry is already adequately restrained through regulation, disciplinary proceedings, and compensatory damages.[103] The public does not buy that argument, nor do the courts. If the securities industry wants a clearer punitive

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95. *See infra* pp. 1651-78.

96. TXO Prod. Corp. v. Alliance Resources Corp., 113 S. Ct. 2711 (1993).

97. *Id.* at 2718.

98. *Big Jury Award For Coffee Burn*, N.Y. Times, Aug. 19, 1994, at D5 (awarding 2.7 million dollars in punitive damages to an 81-year-old woman who suffered third-degree burns after coffee spilled on her lap); *McDonalds Cup of Scalding Coffee: $2.9 Million Award*, Chi. Trib., Aug. 18, 1994, at C1. The trial judge subsequently reduced the punitive award to $480,000. *See Judge Reduces Award in Coffee Scalding Case*, Chi. Trib., Sept. 14, 1994, at C2.

99. *See* Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1 (1991).

100. *See id.* at 18.

101. Honda Motor Co. v. Oberg, 114 S. Ct. 2331 (1994).

102. *Id.* at 2341.

103. *See* John F.X. Peloso & Stuart M. Sarnoff, *Punitive Damages in Arbitration*, N.Y. L.J., Aug. 18, 1994, at 3; William J. Fitzpatrick, Address of the General Counsel of the Securities Industry Association Before the New York County Lawyers Association (May 29, 1991).

damages terrain, the industry should support broad tort reform, not a surgical strike through arbitration.

Let us now focus our discussion on securities arbitration. A few years ago, I compared the confused state of punitive damages in securities arbitration to the biblical Tower of Babel.[104] This Babel-like confusion is basically caused by three facts:

1) In 1976, the year before the Securities Industry Conference on Arbitration was created, the New York Court of Appeals in *Garrity*,[105] in a four-to-three decision, held that arbitrators lacked authority to award punitive damages, *even if agreed to by the parties*;[106]
2) Eleven years later (1987), the *McMahon*[107] decision virtually made securities arbitration mandatory;[108] and
3) Once arbitration became mandatory, brokerage firms, with greater frequency, began inserting a New York choice-of-law clause[109] making New York law applicable. The industry's rationale is that this choice-of-law clause exports the *Garrity* prohibition, no matter where the investment transaction occurred or where the arbitration hearing was to be held.

Four federal circuits, the First,[110] Eighth,[111] Ninth,[112] and Eleventh,[113] basically disagree with that rationale; two circuits, the Second[114] and the Seventh,[115] agree that the *Garrity* prohibition prevails. Such diversity among the circuits causes havoc, as litigants jockey to have their arbitrations held in friendly circuits. Fortunately, light soon

104. *See* Constantine N. Katsoris, *Punitive Damages in Securities Arbitration: The Tower of Babel Revisited*, 18 Fordham Urb. L.J. 573, 574 (1991) ("[I]t often appears as though the courts and legislatures were creating a 'Tower of Babel' by discussing the issue in different languages and dialects.").

105. Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793 (N.Y. 1976).

106. *Id.* at 795.

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

108. *Id.* at 226.

109. *See* Michael Siconolfi, *Regulators Examine Smith Barney Over Limits On Arbitration Claims*, Wall St. J., Dec. 1, 1994, at C1.

110. Raytheon Co. v. Automated Business Sys., 882 F.2d 6, 11 (1st Cir. 1989) (labelling *Garrity* as "an anomaly, frustrating the goals of fairness and finality").

111. Lee v. Chica, 983 F.2d 883, 887-88 (8th Cir. 1993).

112. Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1063 (9th Cir. 1991) ("We hold that the expansive view that has been taken of the power of the arbitrators to decide disputes . . . provided the arbitration panel here with authority to make the punitive damages award.").

113. Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1387 (11th Cir. 1988) (stating that *Garrity* "dealt only with the power of arbitrators under state law and public policy, and has no application in cases arising under the Arbitration Act").

114. Barbier v. Shearson Lehman Hutton Inc., 948 F.2d 117, 121 (2d Cir. 1991).

115. On March 6, 1995 the United States Supreme Court, in an 8-1 decision, reversed the Court of Appeals and reinstated the arbitration panel's punitive damage award. Mastrobuono v. Shearson Lehman Hutton, Inc., No. 94-18, 1995 U.S. LEXIS 1820, at *21 (U.S. March 6, 1995), *rev'g* 20 F.3d 713 (7th Cir. 1994).

may be forthcoming with the Supreme Court's recent granting of *certiorari* in *Mastrobuono*.[116]

In addition to this issue of exporting *Garrity* through choice-of-law provisions, some now argue that the *Honda* decision raises new obstacles to the granting of punitive damage awards in arbitration, on the ground that their limited reviewability in arbitration results in the denial of due process. This *Honda* argument is an interesting wrinkle, yet in *McMahon* the Court unanimously sanctioned RICO[117] claims in arbitration,[118] which provides for treble damages, and, in my mind, treble damages are *punitive* in nature.

How the Supreme Court will ultimately rule on these matters is anybody's guess, and speculation is rampant. I see articles on it every day. No matter how the Court rules, problems will remain.

I would like to backtrack for just a minute and examine SICA's role in all of this. After *McMahon*, and because of the increasing trend towards more restrictive agreements, SICA amended section 31 of the Uniform Code by adding subdivision (d), which specifically prohibits any condition in arbitration agreements that "*limits the ability of the arbitrators to make any award*."[119] So far, the clear language of section 31 does not seem to have received much attention from the courts in-so-far as it restricts the use of choice-of-law clauses and other similar clauses, which in my judgment clearly attempt to limit the ability of the arbitrators to make awards.

In addition, a few years later, in order to highlight arbitrators' authority, SICA added section 28(h) to the Code, which provides that "*arbitrator(s) may grant any remedy or relief that the arbitrator(s) deem just and equitable and that would have been available in a court with jurisdiction over the matter*."[120] Section 28(h) is similar, though not identical, to the language in the AAA rules.[121] Unfortunately, although it was adopted by SICA nearly three years ago, this amendment has yet to be adopted by any SRO. The NASD has considered alternatives to this rule, but it has not yet arrived at a conclusion. Ap-

116. The Supreme Court has since rendered its decision in *Mastrobuono*. *Id.*; *see also* BMW of N. Am., Inc. v. Gore, 646 So. 2d 619 (Ala. 1994), *cert. granted*, No. 94-896, 1994 WL 664702 (Ala. Jan. 23, 1995) (appealing a two-million dollar punitive damage award for suppression of a material fact). For a summary of *BMW*, see Paul M. Barrett, *Supreme Court Will Revisit the Debate Over Punitive Damages in BMW Case*, Wall St. J., Jan. 24, 1995, at B4.

117. Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1988).

118. Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 238 (1987).

119. Uniform Code, *supra* note 14, § 31(d), at 24 (emphasis added).

120. *Id.* § 28(h), at 21 (emphasis added).

121. *See* American Arbitration Association, Securities Arbitration Rules § 42(c), AAA164-20M-4/93, *available in* WESTLAW, 1993 WL 495385, at *12 ("The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties . . . .").

parently, however, some proposals are being considered by the NASD[122] in this regard:

First, a ceiling on punitive damages should be created;

Second, punitive damage awards should be reasoned, that is, they should state the legal basis for the award;

Third, such awards should be more readily appealable than compensatory arbitration awards;

Fourth, qualification standards for arbitrators should be upgraded;

Fifth, punitive damages should be considered in separate arbitration proceedings; and,

Sixth, claimants who win punitive damage awards should pay a portion thereof to the state, federal and quasi-governmental regulators.[123]

Let's now go back to the Supreme Court and the *Mastrobuono* appeal. No matter which way the Supreme Court decides *Mastrobuono*, some accommodation will have to be made by both sides. If the Supreme Court rules for the claimants, the industry would no doubt press for some form of reviewability.

What if the Supreme Court rules for the industry? Frankly, I find it difficult to accept such a result because of the underlying unfairness of forcing people into arbitration and then inserting clauses that directly or indirectly prohibit substantive relief that they could otherwise receive in court.

Moreover, although the Supreme Court has not yet found securities arbitration agreements to be unenforceable as contracts of adhesion, that was considered before arbitration became mandatory and when arbitration agreements were still relatively simple. Arbitration was intended to provide a speedier and more economical procedural alternative to courtroom litigation. Arbitration was not intended to be used as a Trojan Horse from which to deny relief otherwise available in court through the use of restrictive clauses in arbitration agreements.

In any event, however, I never answered the question: What if the Supreme Court rules for the industry in *Mastrobuono*? I respectfully predict that in that case the public will not rest until such a rule is overturned either by the legislature, in the marketplace, or through the courts.

Anticipating a *Honda*-type problem in my *Tower of Babel* article,[124] which was written over two years before *Honda*, I suggested, as part of an overall trade-off, broader reviewability of punitive damage

122. National Ass'n of Sec. Dealers, Inc., NASD Notice to Members 94-54 (July 1994).

123. *Id.*

124. *See* Katsoris, *supra* note 104.

awards.[125] Such broader reviewability, as painful as it is—because it adds to the expense and duration of the proceeding—would go a long way towards allaying the industry's fears about catastrophic punitive awards.

If, however, the industry insists upon excluding punitive damages altogether in securities arbitration, then we must make securities arbitration voluntary once again. It's noteworthy that in the Prudential global settlement process,[126] two troublesome areas are excised by stipulation: One, the defense of the statute of limitations cannot be raised and two, no punitive damages can be awarded. Those were significant trade-offs. The big difference, however, is that in the Prudential situation the arbitration procedure is voluntary not mandatory. You cannot force people into arbitration and then "cherry-pick" away their substantive rights.

As far as the NASD is concerned, I respectfully suggest that it delay issuing any punitive damage recommendations before *Mastrobuono* is decided, and thereafter work with SICA, the other SROs, the SEC, the industry, and the public in forming a compromise in this area that is fair to all.

Now, to present a decidedly different point of view, I introduce my good friend, John Peloso.

MR. PELOSO: I wish I could assume the mantle of the "public," since it's such a wonderful mantle to have over you. It is as if the public has truth and justice on its side and everybody else does not. I'll make a couple of observations, and then let me make some suggestions as to why punitive damages are not appropriate in arbitration.

To begin with, I think there are two premises in the points you made, Gus, that are not entirely correct. The two premises are, one, that the Supreme Court "mandated" arbitration and, two, that there is a "substantive right" to punitive damages. I don't think either of those is exactly correct.

All that the Supreme Court did in the *McMahon* case was hold that the securities laws did not preclude people from agreeing to arbitrate securities claims. There is a world of difference between those two thoughts because, as we all know around this table, the whole point of arbitration is that it is a consensual thing and people can agree or not agree to whatever they please. So, nobody is forcing anybody to do anything.

125. Katsoris, *supra* note 104, at 603 ("If punitive damages in arbitration are not generally reviewable, while those obtained in courtroom litigation are, then the arbitration playing field would tilt in favor of claimants.").

126. Securities & Exchange Commission v. Prudential Sec. Inc., C.A. No. 93-2164 (D.D.C. Oct. 21, 1993) (Fourth Quarterly Report of Claims Administrator).

The second questionable premise is that punitive damages are a "substantive right."[127] I think when you go back into the cases and the history of punitive damages, you will find that this is not true at all. To begin with, this whole controversy in the courts got started in 1976 with *Garrity v. Lyle Stuart, Inc.*,[128] in the context of whether arbitration agreements should be construed and enforced under New York law. But, as often as I hear people talk about that case, I never hear anybody talk about what the rationale of the case was.

The rationale of the case, which is to be given some weight, is that when you go back into the history of punitive damages, to the extent that they were considered to be appropriate, to the extent that punitive damages was a right or a remedy, the power to grant them lay with the state.[129] It was not a right of an individual. The only right that an individual should have is to prove his or her damages. Whether somebody should be punished for an egregious activity is not something that a private citizen had a right to determine. It was rather something that was the province of the state. Therefore, judges had that power. So, the concept was that even if two people agree to arbitrate a dispute, neither of them has the power to convey to an arbitrator the power to punish; that power comes from the state.

There is a real question in my mind as to whether any private individual in our society, as opposed to the state and the judges who are given that authority, should have the right to punish another individual. That is the rationale of *Garrity* and that is what is at the heart of this whole question.

The reasons why punitive damages are not appropriate for arbitrators to award are several, in my opinion. I think the strongest is the due process point that you mentioned, Gus, that was recognized by the United States Supreme Court in the *Honda* decision.[130] The Court recognized that if there were circumstances where it was appropriate to punish somebody for his or her activity, because that activity was so egregious, then there ought to be procedural safeguards to make sure those kinds of judgments are made under the right circumstances.

Now, the law going back into our history is replete with cases where the procedural safeguards have been held to be correct, correctly applied, or not, and those safeguards include such things as: what was the level of activity of the people involved, to what extent was it so bad that it required punishment, what was the legal basis for imposing

127. *But see* Mastrobuono v. Shearson Lehman Hutton, Inc., No. 94-18, 1995 U.S. LEXIS 1820, at *18 (U.S. March 6, 1995) (referring to punitive damages as "an important substantive right").

128. 353 N.E.2d 793 (N.Y. 1976).

129. *Id.* at 794.

130. Honda Motor Co. v. Oberg, 114 S. Ct. 2331, 2335 (1994).

punitive damages, what standards were applied, and what level of intent to violate the law or harm someone was involved.

So, the question becomes, what assurances do any of us have that arbitrators will apply those kinds of standards in handing down an opinion that will punish somebody, particularly if the arbitrators don't write an opinion, and even more particularly, if they don't give the reasons for what they have done.

That is a serious problem and it is the problem that is recognized in the *Honda* case,[131] because if those procedural safeguards are not present, then there is a violation of the Fourteenth Amendment in our procedures, and those things are very important to us.

A second reason why I suggest to you that punitive damages are not appropriate in the securities industry is because it is such a heavily regulated industry. To make my point, I have to go back a little bit in history. If you read back into the history of punitive damages in our jurisprudence, you will find that there are two essential purposes that were advanced by a concept of punitive damages. To get right down to it, "punitive damages" is a phrase that is a contradiction in terms. When you study the history of punitive damages, you will find that it grew as a way of preventing and deterring crime.

Typically, the reason common law courts started awarding so-called punitive or exemplary damages was to make an example of people in situations where the law couldn't handle it, or where it was not likely that the case would be prosecuted.[132] It was to fill a gap.

I suggest to you that, in this industry, there surely is not any gap! You have the Securities and Exchange Commission, you have the Department of Justice in appropriate circumstances, you have the New York Stock Exchange, the NASD, the American Stock Exchange, the Chicago Board of Options Exchange, and if that's not enough, you have the entire plaintiff's bar, half of which is sitting around this table, who are just chomping at the bit to bring people to justice.

Under those circumstances, why do you need punitive damages? The history of that concept in our jurisprudence is to deter and prevent crime. We don't need it in the securities industry. You have about as much deterrence as anybody can stand, and some people might think a little bit too much.

The third point is that there really shouldn't be a right to punish someone. It's just a conceptual thing. Why should a private litigant get a windfall profit because that person has brought a case for certain losses? If a defendant or respondent has acted so badly as to deserve punishment, even if somebody is going to punish that person, why

131. *Id.* at 2340.

132. *See* Michael Rustad & Thomas Koenig, *The Historical Continuity of Punitive Damages Awards: Reforming the Tort Reformers*, 42 Am. U. L. Rev. 1269, 1322-24 (1993); Leslie E. John, Comment, *Formulating Standards for Awards of Punitive Damages in the Borderland of Contract and Tort*, 74 Cal. L. Rev. 2033, 2051 (1986).

should money flow to the plaintiff and the plaintiff's attorney—unless the plaintiff's bar wants to give up any right to those punitive damages? That would be a positive step forward, it seems to me, for those who are urging punitive damages. So, I question whether there is any right to it. Even if somebody should be punished, why should the benefit run to the plaintiff?

The whole point here is that if there is this power to punish, if it exists at all in civil cases—and I think it's questionable in the securities industry—it should reside in the courts and in the state.[133] In any event, any amount of money so levied against a defendant certainly shouldn't go to a private litigant.

Discussion

PROF. KATSORIS: Before I throw open the floor for comment, I would like to comment on something that John mentioned.

I said *McMahon* made arbitration *basically* mandatory, meaning absent cash accounts, most people must sign a pre-dispute arbitration agreement when opening an option or a margin account.[134] So, I think most of us will readily admit that *McMahon* basically did make it mandatory.

MR. PELOSO: I don't agree.

PROF. KATSORIS: As far as punitive damages in court, you mention that well-trained judges make those decisions. Yet, juries also award punitive damages, and they are less trained than arbitrators. So, I don't agree with your conclusion.

Moreover, when I used the term substantive rights, I meant it in the broad sense that if you can get punitive damages in court, you should be allowed to get them in arbitration. That's my point.

MR. PELOSO: I just want to comment on this point: It's unfair to say that juries are less trained than arbitrators. The whole point is that, as was said in the *Honda* case, if juries are going to return verdicts with punitive damages, they are tightly controlled or should be tightly controlled by the judge's charge to the jury.[135] That is under the control of the judge, and there is a right to appeal.

While arbitration is a perfectly fine forum for resolving disputes, you don't have any procedural safeguards, such as someone telling the arbitrators what standards to apply. I was going to comment that I thought the NASD subcommittee suggestions were really well thought out and go a long way to solving most of these problems.

133. *See* Ira P. Rothken, Comment, *Punitive Damages in Commercial Arbitration: A Due Process Analysis*, 21 Golden Gate U. L. Rev. 387, 397 (1991). *But see* Stephen J. Ware, *Punitive Damages in Arbitration: Contracting Out of Government's Role in Punishment and Federal Preemption of State Law*, 63 Fordham L. Rev. 529, 561-64 (1994).

134. *See* 1992 GAO Report, *supra* note 54, at 28.

135. Honda Motor Co. v. Oberg, 114 S. Ct. 2331, 2341 (1994).

PROF. KATSORIS: That's what I was going to mention, once comments subsided. I was going to go back to the NASD suggestions, and although some were a little bit overlapping, I think we can use them as a foundation for discussion from which we might be able to build a consensus for the future.

MR. BECKLEY: The linchpin of the argument is apparently a historical one, that punitive damages historically lay in the hands of the state and not private individuals. I think historical argument in this case is very perilous because, historically, arbitration was inappropriate and looked down upon by the courts, and even though both parties agreed to an arbitration they could go into court and get an adverse decision set aside.[136]

If we're going to rely upon the early history, we're not going to be here very long because arbitration would be back where it was, and as *Garrity* sort of enshrined, it's really a suspect procedure and most suspect when it involves punitive damages. If we were going to rely on a historic approach in which only the state can punish, SROs wouldn't have any authority either because they certainly weren't known in common law. They are a creature of recent legislation. If only the state can punish, then no broker can be barred from the industry by the NASD or the New York Stock Exchange.

So, I don't think we can go too far with history. What we can go pretty far with is that the common law solved problems as they arose as an instinctive result of the Judeo-Christian ideal of justice. When a situation was not being addressed adequately by the state, by a regulatory organization or by informal groups such as the high-powered courts, punitive damages arose as a way in which the individual citizen could somehow say, "Enough." Through the use of the jury system, which brings the common sense of the community to dispute resolution, the community could say, "Enough."

Is the community saying "Enough" in the second part of John's argument, which is that this is a heavily regulated industry? No, it's not. The community isn't saying "Enough, enough." The gentleman sitting to John's right works for an organization that, although it was very, very heavily regulated, only recently added another $330 million to the pot rather than suffer an indictment in the Southern District of New York.

The layers of regulation that Prudential is encountering, or had to deal with every day, didn't stop the damage. Mr. Milken was able to put together an enormous and successful junk bond operation. None of the regulators ever looked into it until well after the fact.

John knows and I know that for every Business Conduct Committee proceeding there must be another five brokers out there who are flipping mutual funds, telling little old ladies they really need this CMA

136. *See* Ian R. Macneil et al., Federal Arbitration Law § 4.1.2 (1994).

account, telling people there are really still tax advantages in limited partnerships. There isn't enough money or time for the regulators on any level—SRO level, state level, national level—to get all the people who are drawn to the industry because of the immense compensation. The only reason for punitive damages is that the regulators can only do so much, and the fear this industry has of punitive damages is the best safeguard protecting the investing public.

When the first five million dollar hit comes down against a major wirehouse, and by the way, there hasn't been one so far that I know of, the next Monday the branch managers all over the United States, at whatever house it is, will be on the horn saying, "Look guys, last week we took a five million dollar hit in an arbitration with one member of the industry sitting on the panel because somebody churned a widow's account from a hundred thousand bucks down to a $50,000 debit balance and it cost the firm five million." That will have a far more deterrent effect than any compliance lecture that a branch manager can give.

MR. LIPNER: On the subject of non-compensatory damages, we go sometimes from talking about punitive damages to talking about attorneys' fees, I saw Mike lump them together a few minutes ago. A word about attorneys' fees as a remedy, because I think it's wrong to automatically lump punitive damages and attorneys' fees together.

There are some arguments that are properly addressed to tort reform, to an agreement, to an arbitrator, to a court, as to why punitive damages should not be appropriate in a given instance or why they wouldn't be appropriate in a situation. Attorneys' fees fall into a different category. When we have statutes that permit the recovery of attorneys' fees or that authorize treble damages, which are in a sense non-compensatory, they need to be given effect in an arbitration system, even if you decide or it is decided for us that punitive damages are not appropriate.

But, to get back to the punitive damages point for a minute, John points out, from the *Garrity* case, the notion that the state should be the sole engine for distributing punishment. It is the sole engine rationale that is closely linked in the *Garrity* decision to the evil manipulator rational—the notion that arbitrators are easily manipulated by the parties in securities arbitration.

As Judge Ash points out in the *Kent*[137] case, the evil manipulator rationale is on the other foot when it comes to securities litigation, and the sole engine rationale, as appropriate as it might be to certain industries, must give way in an industry that is entrusted with the sensitive fiduciary task of managing another person's money on a commission basis. Whether it's truly the imprimatur of the Supreme Court or not, when the industry is able to use arbitration agreements

137. *In re* Dreyfus Serv. Corp., 584 N.Y.S.2d. 483 (1st Dep't 1992).

to supplant the state as the engine for adjudicating claims, punitive damages in arbitration must be permitted. Otherwise, there is no one who can effectively engage in this kind of deterrence, which is an important part of our jurisprudence, even in heavily regulated industries.

PROF. KATSORIS: I wanted to say something regarding *Garrity*. First of all, the industry tries to export *Garrity* through choice-of-law provisions, because some courts say that the parties have agreed that New York law applies. Yet, you are applying a 4-3 decision of the New York Court of Appeals, which states that you can't have punitive damages in arbitration *even if the parties agree otherwise*. So, it seems to me that *Garrity* itself is being inconsistently applied: you can use it consensually to prohibit punitive damages, but you can't agree under it to allow such damages.

Secondly, on *Garrity*, I understand that the New York County Lawyers Association last year, or the year before, recommended to the New York legislature that *Garrity* be overturned.[138]

Let me add one other thing on appealability. I'm not in favor of appealability of arbitration awards generally. I have fought appealability of arbitration awards since the beginning of SICA, but I do appreciate the industry's concern on punitive damages. If the price of punitive damages in arbitration is appealability of punitive awards, so be it. We then might also have to facilitate that process by making a better record and perhaps requiring a written opinion so as to make the appealability of such awards more meaningful. I'm willing to accept that tradeoff. I don't know about the rest of the panel, but I'm willing to trade appealability of punitive damage awards in arbitration as the price for permitting punitive damages in arbitration.

MR. CELLA: I think in the securities industry you have to relate the ability to award punitive damages directly to the problem the industry has had through the decades and still has, and that is the drifting through the industry of the rip-off artist. Regrettably, managers love to see producers, the broker-dealers love to see producers. This is understandable. That is how they make their money. But amongst them are people with a malevolent outlook and the outlook is to pocket the money, enrich themselves, and abuse the public investors.

It seems to me the U-5[139] is a document whose lack of use or misuse is a key to the problem. It's the bad guy who drifts from house to house with a big book without the record reflecting the kind of conduct he engaged in, without the oversight of a manager who is happy to get his overrides, that is the danger. That danger requires punitive damages in arbitration. When you identify the bad guy, you don't let him stay in the business, or you track him and know where he goes. If

138. New York County Lawyers' Association, Committee on Arbitration and ADR, Punitive Damages: A Proposal For Relief 9 (July 12, 1993).

139. Form U-5, Uniform Termination Notice for Securities Industry Registration.

you get that under control, you needn't fear punitive damages because the occurrence will be a negligent occurrence, an occurrence below the standard for a punitive damage award. So, I see the linkage there that really requires further effort on the part of the industry to get rid of this type of broker who does the damage to the house and to the public.

MR. PELOSO: I have one observation and one question. The observation is prompted by your remarks. My observation is that in most of the cases that I've seen, which is a very, very small percentage of the cases, the language that gets put into the U-5 is usually negotiated by the broker's lawyer.

The question I really wanted to ask is this: What is the argument for the claimant receiving the punitive damage award? That's what I don't understand. Even if someone were to accept the concept that punitive damages ought to be awarded by arbitrators to deter wrongdoing and such, even if you accept that as necessary for this industry, what is the rationale for the plaintiff getting it? Why isn't it more appropriate for that money to get thrown into some fund somewhere to fund arbitration or to fund law enforcement?

MR. CELLA: There is an answer to that, John. The answer is, first, the plaintiff suffered the wrong and the wrong was a horrendous one in order to meet the level of punitive damages. Second, he brought the claim and proved the case at his expense, time, and whatever other problems he had to bear to do it. Third, he had a skilled attorney who presented his case and won it. And just as I have to pay back the Worker's Compensation Board when I recover for a worker in a tort claim in court, I have done my job for the compensation board as well as my client, and I think the attorney is entitled to have his or her fee calculated on the award. Those are the reasons I think punitive damages are properly awarded.

MR. PELOSO: If that's true, you could solve it with attorneys' fees, not punitive damages.

MR. EPPENSTEIN: That was the best idea you have had so far, John. My recollection of the *McMahon* majority opinion, and I don't really cite it often, is that the *Wilko*[140] Court was wrong in its distrust of the arbitration system back in 1953.[141] In fact, Justice O'Connor, as I recall, writing the majority opinion, quoted from Justice Frankfurter's dissent in *Wilko* saying that, in effect, there was no evidence that the arbitration system would not afford the plaintiff the rights to which he is entitled.[142]

Now, in *McMahon*, the claimant had a claim for RICO, as Professor Katsoris stated, compensatory damages and punitive damages. The

140. Wilko v. Swan, 346 U.S. 427 (1953).
141. Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 231-32 (1987).
142. *Id.* at 231.

industry didn't argue to the Supreme Court in 1987 that arbitration is great, or that arbitrators can do whatever a court can do, except for punitive damages. The Court went ahead and sent the whole case to arbitration. So, we have the *McMahon* majority saying that, in effect, arbitrators can do whatever a judge and jury can do, and there were no limitations passed.

MR. MEISTER: I think part of what I see is that virtually every arbitration claim that comes in seeks punitive damages,[143] and I don't think that's unique to our situation. Its probably regarded as malpractice for a claimant's lawyer not to ask for them. That feeds into the discovery issue that we talked about earlier. Because you're seeking punitive damages, the whole discovery process broadens, and that creates a dog fight at some point in the system.

There is very little regulation or concern about assuming someone did something wrong, who should punish him, and how many times he should be punished. If, as is usually the case I've seen, when you get to a point where there is legitimate concern about punitive damages, the broker has undoubtedly gone, the manager may well be gone. You may have settled with a number of other "victims" already. Punishment has already been meted out, and yet three or four different lawyers are saying, "I want punitive damages to punish again and again and again."

The message has gotten through to senior management that this was a bad situation that could probably be fixed. That doesn't mean another one isn't somewhere else. I think the concern we have is that this is an unregulated, unreviewable area, where different people for different reasons are all seeking punitive damages, and to determine which case is deserving of punitive damages and which isn't is becoming very difficult.

Moreover, I think if you had a situation where the industry said, "Okay, we will accept the concept of punitive damages," probably seventy-five percent of the damages should go to the SRO to help the budget deficit for running the arbitration process. That would speed the system along for all concerned, and you would limit, I think, the motivation to seek punitive damages to those situations where they were really merited.

Further, there ought to be some approach, and I'm not at all in a position to suggest one, to indicate that if you punish a child for being bad once, enough is enough. You couldn't keep punishing the child over and over again for doing the same thing, or else you get a [maladjusted] kid. I think that's really the concern. I don't think the notion is that you send a message by awarding punitive damages, that senior management hasn't figured it out already. I don't think that's valid.

143. *See infra* note 160 and accompanying text.

MR. STONE: I was wondering whether Seth was advocating the "English rule"[144] on attorneys' fees. I think there are some who might opt for that.

I still haven't heard what money ought to go to the state, the New York Stock Exchange, or the NASD in a punitive damage situation. I think that would take out all of the incentive, and, to harken back to some of the points I made earlier, make the case relate to the compensatory damages to the client. If you prove your punitive damage claim and are successful, let it go to benefit where it can, not to this individual claimant. I don't think there is a good argument against that position.

Second, regarding U-5s and U-4s, we have pushed very hard to get some type of protection through defamation claims, to which we are frequently subject. We try to be as candid as we can.

Finally, it seems interesting to me that *Honda* has singled out punitive damages and treated it as different, and I think we have to here. It is a different kettle of fish. It is a different concern, and again, I think, if I harken back to some of the comments I made earlier, if we can remove that issue from the arbitration process in the sense of either having those funds go elsewhere, or providing a review of some sort, as Professor Katsoris has said, I think it would move the arbitration process along quite well.

MR. ROBBINS: Last week the SEC submitted an amicus brief in *Mastrobuono*.[145] Caite, can you tell us what the SEC's position is on punitive damages in that case?

MS. McGUIRE: I can try. In summary, the Commission made three arguments in its brief.

First, the brief argued that federal law prohibits the enforcement of a contractual provision that limits remedies available to customers if the remedies are available in court. This argument applies to agreements executed after the September 1989 effective date of the arbitration clause rule.[146]

144. The "English rule" is equivalent to the loser-pays provision, which requires the loser in an arbitration proceeding to pay the winner's costs. *See* Paul M. Barrett, *Warily, Hatch Mulls Changes In Civil Justice*, Wall St. J., Jan. 31, 1995, at B1. In a recent speech, Securities and Exchange Commission Chairman Arthur Levitt said that he opposes the loser-pays rule in securities litigation. *See Subcommittee to Hold Another Hearing on Securities Litigation Reform Measure*, 27 Sec. Reg. & L. Rep. 168 (BNA) (1995). *See generally Bad Justice*, N.Y. Times, Feb. 21, 1995, at A18 (criticizing loser-pays provisions). The United States House of Representatives recently passed a bill that would require someone who brings an unsuccessful lawsuit to pay all of the court costs and legal fees of the defendant if the judge deems the suit to have been poorly grounded. Neil A. Lewis, *House Passes Bill That Would Limit Suits of Investors*, N. Y. Times, Mar. 9, 1995, at A1.

145. SEC Brief, *supra* note 3.

146. *Id.* at 10.

Second, the brief argued that courts must accord substantial deference to arbitrators' construction of an arbitration agreement under the Federal Arbitration Act.[147]

Third, the brief argued that the arbitrators did not exceed their authority in the *Mastrobuono* arbitration by concluding that they had the authority to award punitive damages because it is not reasonable to construe an arbitration contract to constrain the arbitrators' remedial power unless such constraint is made explicit in the contract—something that was not done in the contract.[148]

The brief is informed by the position that the *Garrity* rule is evidence of judicial hostility to arbitration and is not consistent with the Supreme Court's holding in *McMahon*. Therefore, the brief stated that punitive damages should be available in arbitration and indeed that the New York Stock Exchange and NASD rules currently require that they be available in arbitration for agreements entered into after 1989. It's just supposed to be an alternative dispute resolution system, which is, in part, an answer to the question of why we should not tax the awards by submitting them to the government or to the SRO rather than to the plaintiff. The answer to that would be, "Because that's not what the courts do."

Forty-one states allow for punitive damages. Most of the arguments that have been made today against punitive damages are arguments that should be addressed to the forty-one states, not to the New York Stock Exchange. The New York Stock Exchange provides an alternative forum for the resolution of the same disputes that otherwise would be resolved in court if people voluntarily agree with one another that they will do that. You cannot say we'll just split it up. Parties have to be in position to prove compensatory claims and punitive damages claims in the same forum.

If there is going to be an alternative forum for the resolution of disputes then you have to be willing to take on punitive damage claims unless and until tort reform or some other thing comes along that limits the ability to award punitive damages for the underlying claims. I believe that's the SEC's position.

With respect to *Honda*, the brief cites the *Mitsubishi*[149] decision for the propostion that when people decide to use an alternative dispute resolution system like arbitration, which does not have the kind of due process layering that we've been discussing in connection with discovery, and that sort of thing, that decision will be respected.[150] Those procedures and the opportunity for review are traded for the simplicity and speed of arbitration. By executing an arbitration agreement

147. *Id.* at 12-19.
148. *Id.* at 19-28.
149. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).
150. SEC Brief, *supra* note 3, at 20 n.14.

governed by the Federal Arbitration Act, a party consents to the limitations on judicial review established in that Act.

As the Commission argued in *McMahon*, the voluntary decision to resolve disputes through arbitration should be upheld. It shouldn't be taxed and it shouldn't be limited to one kind of violation or another, one kind of remedy or another. In fact, it should be a full alternative dispute resolution system. That's what I take from the brief.

MR. KREBSBACH: The one question I still have is, as Jim was saying before, if you have a five million dollar punitive damage award, the branch manager of the firm is going to get the message. My question is, given that as true, what happens if the punitive award comes in at $500 million? There are absolutely no safeguards whatsoever, no due process, nothing in place to protect defendants from having their lives completely ruined, even if they did nothing wrong. There is really no right of appeal.

MS. McGUIRE: I agree, in large part. That's one of the things that is a risk when you decide to move to a system that has no procedure for appeals. Both sides decide to take their chances on arbitrators, and it emphasizes more than anything else what we've said today regarding the importance of arbitrator education.[151]

Arbitrators really are the key. In its brief, however, the Commission stated that review under Section 10 of the Federal Arbitration Act may well provide the opportunity for review of grossly excessive awards under the "exceeding powers" standard.[152] Nevertheless, the Commission staff has in the past, in discussions with both the plaintiff's bar and the defense bar, as well as with SICA, indicated that because of the concern about rogue arbitrators, the one kind of SRO rule that might establish a reasonable distinction between what courts can do and what arbitrators can do would be a cap. The cap we've suggested would be double compensatory damages.[153] That certainly is well within what I think litigators and courts would hope for. It would be a very good deal.

Then the alternative that we also have put on the table, but I understand why it hasn't been successful, is to allow those people who want to claim punitive damages to resolve their cases in the court. That would effectively put the firms back where they were before *McMahon*. So, I understand why the firms haven't chosen to go there, but that is an alternative.

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151. For a discussion of arbitrator training, see *infra* pp. 1679-94.

152. SEC Brief, *supra* note 3, at 13-16.

153. A cap of two times compensatory damages has already been adopted by the CFTC. *See* Futures Trading Practices Act of 1992, Pub. L. No. 102-546, § 222(c)(3)(ii), 106 Stat. 3590, 3616 (1992); *see also CME Rule Proposal Permits Punitive Damages, Sets Criteria*, 26 Sec. Reg. & L. Rep. 859, 859 (1994) (outlining a Chicago Mercantile Exchange rule proposal that would adopt the punitive damages requirements of the 1992 Futures Trading Practices Act).

The alternative is to say, "If you want the benefit of swift and speedy resolution of your case, we at the New York Stock Exchange are going to provide a forum for compensatory damages or compensatory damages plus attorneys' fees." The Commission may be able to approve such a rule, provided that appropriate disclosures are given to investors, if it was done the same way as class actions. Class actions exit the system; they go back to court.

As long as it's clear that you know best the limitations of the forum in terms of what the arbitrators are capable of and what you can afford to staff, the alternative is to send things back to court. It is not to put people in a situation where they cannot obtain what they could have obtained in court, and that's without discussing the litigation reform aspects at all, because I think the Commission has differing views on litigation reform. Sometimes it emphasizes things like the fact that there are a lot of layers in the system. Private damage actions including punitive damage actions are one part of it. It's not like the CFTC where you have exclusive rights. Securities regulation has always been a layered system. The states provide for punitive damages for common law fraud, but that's part of the deterrent system.

On the other hand, the Commission is sympathetic to calls for tort reform in other areas and in certain cases. I don't think that's the issue with respect to arbitration, because in my view, and this is my personal view, the SROs cannot become laboratories for tort reform because they are sufficiently dominated by the defense bar so that they won't be able to obtain public credibility.

MR. CUMMINGS: What I'm hearing seems to be some insistence that the securities industry has the best of both worlds. I disagree. We have a procedure—and we're entertaining a large majority of what could fairly be called junk claims. Plaintiff's lawyers could put an article in the paper announcing, "If you lost money on this investment, send it to me." That claim is going to receive a hearing, and a dollar amount is going to be put on it because every claim today is worth something. This is what the securities industry is giving to the public investor. We're accepting the situation where we're going to a lot of expense to provide a vehicle for every individual public investor who feels he was wronged to have a hearing before three very responsible people.

On top of that, we're supposed to say, "Okay, but if you then want to go for the brass ring, you have to put in another clause and allege a punitive damage claim which will then allow you to go to court." So, we have to bear both this exposure on one side, which we're paying for, and this potential on the other side.

The other phrase I keep hearing is that we should be able to get in arbitration whatever we can get in court. I think the premise is that arbitration and civil litigation aren't very different. Having done both for years I can tell you they are very different. If a client came to me and said, "I'm entering a personal transaction. I'm going to build a house for Joe. There is a clause in the contract that says any disputes will be settled by arbitration, and I am subject to a punitive damage award under the AAA procedures of arbitration. Should I sign it?" I would say, "If you do sign it, I'm not your lawyer." I think it's as simple as that.

PROF. KATSORIS: I would like to ask a question. I think Caite brought up something very interesting—the issue that if you allege punitive damages you should be able then to take it out of arbitration. We have such a precedent in the Prudential global settlement with the SEC, and we also have precedents in the class action cases. How do you feel about that kind of exclusion option, Mike?

MR. STONE: You started with the premise that you have preordained how the court will come out in *Mastrobuono*. I'm not so convinced that case is lost for the industry. Conceptually there are some merits to that position. It does away with a lot of the problems we discussed this morning. But John has really hit on a lot of the factors that concern me.

We've set up a process here in arbitration that allows for a lot of leeway, allows for a lot of benefits to the client, and I have some real problems with Caite's position that there is a "right" to punitive damages. I think that issue is much more convoluted and difficult. I think the issue that we've raised—and I think it's not entirely accepted by some of the attorneys on the other side of the bench—is that I cannot see any reason why the individual should benefit under the punitive damage consideration.

If you're going to allow that to occur, I see no downside to allowing that money to go elsewhere. If the concept is to punish, that end can be accomplished without providing for, as John described it, the brass ring to the individual. Let that individual be compensated. Let that individual get the compensatory damages and attorneys' fees he or she is seeking. But I have some concerns about the way the process has been resolved. So, I have some doubts about it.

MR. LIPNER: Half of Mike's objection is toward punitive damages generally. I think Mike stands for a system in which you can't get punitive damages in arbitration, and you can't get them in court. That's the whole tort reform issue that I think is somewhat different from the issue of whether they should be appropriate in arbitration. I know there are a lot of investors who appreciate the beneficence of the securities industry in setting up this nice arbitration system for us to vindicate our claims.

The fact of the matter is arbitration has benefits for both sides. It doesn't just run toward the investor. We have attorneys, in-house, who try cases in states in which they are not admitted to practice. We have no depositions. We have all kinds of things in the securities arbitration realm that are beneficial to the industry and even though there may be instances where we could agree that arbitration isn't appropriate or we should just abandon the system altogether, the fact of the matter is it's here, and I don't see it disappearing.

So, the question is, given that system, whether punitive damages are appropriate. The broader question is whether punitive damages are appropriate generally or whether the industry is being beneficent in offering us this system but feeling that they are setting themselves up for some big fall at the same time. I think both of those are a bit off the track of the narrow question of whether securities arbitration is an appropriate forum for punitive damages, and whether the New York choice-of-law clause is an appropriate vehicle for restricting punitive damages.

I might add that in situations where a punitive damage award is inordinate, for example, the $500 million punitive award on a $500 compensatory award, I assume that the court's power to set aside an irrational award or one in manifest disregard of the law would do a very nice job to put an end to that.[154]

MR. KREBSBACH: Even after the *TXO*[155] decision?

MR. LIPNER: I think so. I see it rarely exercised. We all say the arbitrators acted irrationally. We all think that after we win, lose, or draw. But the fact of the matter is that something that's way out of line like that, I think that there are some mechanisms for getting it set aside, including the bankruptcy laws, which might be appropriate to a firm being penalized $500 million.

MR. CUMMINGS: I have one other comment. If arbitration were imposed by state law, and punitive damages available in arbitration were imposed by state law, is there any doubt in anyone's mind that if that came up before the Supreme Court, even with appellate procedure, that would be struck down?

PROF. KATSORIS: Let me just address one thing. I started my discussion on punitive damages by saying that no matter how the Supreme Court comes down in *Mastrobuono*, we would still have to come back to the table for some sort of consensus. In this regard, however, you need some sort of trust. Yet, since *McMahon* made arbitration mandatory, what's been the public's experience with the industry? There has been a big push to include choice-of-law clauses. Lately I've seen clauses seeking to litigate the six-year eligibility rule in court instead of being decided by the arbitrators.[156] What else is on the industry's shopping list?

Once you have the public in the clutches of arbitration, what other restrictions are you going to squeeze into the arbitration agreement?

154. *See* Ware, *supra* note 133, at 570 (arguing that arbitration law and contract law provide the tools necessary for avoiding enforcement of truly shocking arbitral awards).
155. TXO Prod. Corp. v. Alliance Resources Corp., 113 S. Ct. 2711 (1993).
156. *See supra* note 47 and accompanying text.

That's the mistrust by the public on this issue. Once you have made arbitration mandatory, it has to be an absolutely fair ball game. I think that's where the problem is.

MR. LIPNER: The fact of the matter is that the enforceability of the arbitration agreement forecloses the alternative to find a forum where punitive damages are available.

MR. CUMMINGS: Seth, you're talking about beginning a relationship with a broker-dealer where you want to be secure that you can get a punitive award if anything goes wrong, if you give it enough time and effort.

MR. LIPNER: That's really not what happens because punitive damages are awarded in such a small percentage of cases.[157] The lawyer who is out there shopping for cases that have some value, as you put it, but that really aren't very viable—if they are not viable on a compensatory level and the lawyer is willing to take them because what the heck, that's his opinion, how viable are they?

MR. CUMMINGS: We're talking about the whole brass ring concept. If you have the ability to recover punitive damages in arbitration, a case that could be settled for $50,000, let's say it's a suitability case, is not going to settle. It's going to go to a hearing. Multiply that by the hundreds of cases that are on the docket of the NASD and the New York Stock Exchange and you have a system that's in real danger of being abandoned by both sides.

PROF. KATSORIS: Playing devil's advocate, I read off to you six alternatives of things considered by the NASD. Do you find any acceptable?

To repeat: a) the ceiling on punitive damages; b) punitive damages awards should be reasoned, they should state the legal basis for the award; c) such awards should be more readily appealable than compensatory arbitration awards; d) qualification standards for arbitrators should be upgraded; e) punitive damages should be considered in a separate arbitration proceeding; and, f) claimants who won punitive damages should pay a portion to the state, federal, and governmental regulators.

MR. PELOSO: There are a couple of other very important ones in there, such as the need to show a certain level of scienter or intent, number one, and number two, a burden on the claimant to prove the case of punitive damages by a higher standard than clear and convincing evidence.

PROF. KATSORIS: I think all of this is negotiable. It is obvious that some people don't want punitive damages in any manner, shape, or form, no matter what the safeguards. I'm trying to at least breach that stone wall.

157. *See infra* note 160 and accompanying text.

MR. CUMMINGS: These are all approaches and means of compromise, but in the end, that's all it is. It's a compromise by the industry. You have to remember, when punitive damages are awarded, they are awarded by a jury and the judge is there. He watched the whole thing.

PROF. KATSORIS: Not all judges are better than arbitrators.

MR. BECKLEY: Maybe we can get a little bit of closure on this. John's original question was how come punitive damages go to the individual.

Over the last two thousand years we have attempted with a great deal of success to substitute money for blood, and the whole judicial system is basically an attempt to eliminate the blood feud.

Even people who have received complete out-of-pocket damages still, in these outrageous situations, have a great deal of outrage and that will not be assuaged by sending off part of the punitive damage award to the NASD or lighten the industry's burden of subsidizing the arbitration process.

More importantly, though, we're sort of discussing all of this in a vacuum. About two percent of the arbitration awards, by the last figure I'm aware of, granted punitive damages of any measure. What was the largest award for a customer, around $177,000?

MR. RYDER: Punitive award? There was one for $3.5 million.[158]

MR. BECKLEY: So, we have it up to $3.5 million. Those cases, punitive damage awards of any size, are a demonstration of terrible case management. It meant whoever was assigned to the case and whoever was supervising it decided that we've got a great case here and we're going to bring it home.

Secondly, if the attorneys on the plaintiff's side are doing their job, it is a very rare claimant who would sit there with an offer for one hundred cents on the dollar and maybe even payment of some attorneys' fees, and still reject it. Would you want to go to a hearing and take a chance at some indefinable amount of punitive damages rather than take that offer? Most of the people who would be the appropriate subject for a punitive damage award are people who have been wiped out by the brokers. They don't have the luxury of saying, "I'll put it all on the black and let it spin." They can't afford that luxury.

So, in an appropriate case, the manager would put that amount of money on the table and the case would go away. They could do what Merrill Lynch did in one case that I was handling. They insisted on a settlement discussion that included the claimant, and after the settlement discussion the claimant took double his out-of-pocket damages and went home. It was very simple, but it was an example of excellent case management.

158. Gage v. CIGNA Sec., Inc., NASD Docket No. 90-01371, 1992 WL 123187, at *2 (NASD Mar. 10, 1992).

That's how the industry can avoid this specter of opening up the closet in the night and seeing these terrible things. It really won't be there if they understand case management.

MS. MASUCCI: You referred to the NASD's Legal Advisory Board subcommittee report that was published.[159] I just want it clear for the record that the report was written by the subcommittee on our Legal Advisory Board. It was not voted on or adopted by any committee or board of the NASD. It was put out for comment to gain just what this group is trying to gain, consensus as to what initiatives to adopt.

We didn't receive a lot of comment letters back, but what we did receive led us to conclude that we could not come to a consensus at this time. Maybe there will be a possibility of it after *Mastrobuono*.

I was a little concerned regarding a comment that I believe I heard Caite make earlier today. She should correct me if I am wrong. The concern you had was the dominance of the SRO's staffs by the industry?

MS. McGUIRE: No. I said SROs are dominated by the industry. I don't mean their staffs. I think the New York Stock Exchange has a board half public, half not public. The NASD's board, however, is more largely member dominated, so any rules they adopt may reflect, or appear to reflect, their affiliation with the industry, which is usually in the defense posture. I think that this is not where I would start a laboratory for tort reform. I don't think it would be perceived as balanced.

MS. MASUCCI: The concern I had, which is also echoed in the media, is the problem of the public's perception of how arbitration is run at the SROs, and arguments such as that may indicate that it's time again to look at a single arbitration forum or some other organizational structure where the perception may not be as intense.

MS. McGUIRE: I guess I wouldn't need to contribute to the media's skepticism. I think we've been on record for a long time about the fairness of and professionalism of the arbitration staffs. The people who run arbitration programs do so in a way that is totally balanced on a case-by-case basis.

I appreciate the opportunity to correct that because I don't support a single forum.

PROF. KATSORIS: I think we're in agreement that we're not going to arrive at a consensus today on punitive damages. That's precisely why we also put it on the agenda for two weeks from now. Maybe between now and then we can reflect on what was said today and perhaps inch towards some consensus by the next meeting.

159. *See* NASD Notice, *supra* note 122.

Before we leave the subject, I know you track punitive damage awards, Rick. Can you tell us your experience on the number of cases that have awarded punitive damages?

MR. RYDER: The statistics that have been quoted I don't think are very far off. The General Accounting Office did a study of arbitration as a whole—SRO arbitration as a whole—a couple of years ago, and they found that at the SROs, punitive damages are requested about twenty-eight percent of the time, and awarded a percentage of that, so it came out to somewhere around three or four percent.[160]

They found essentially the same thing at the AAA in terms of the incidence of punitive awards, but at the AAA it was requested in about forty-eight percent of the decided cases.[161] It's not requested by everybody, but it is commonly requested, no doubt about it.

In terms of the incidence or occurrences, though, GAO said somewhere around three or four percent. We looked at punitive damages in the May 1993 Commentator and found it was around two percent.[162]

We also took a look at proportionality—the question whether, as a percentage of compensatory damages, punitive damages are way out of line. There, I think, is where the arbitrators have shown the most rationality. I can't give you a statistic offhand, but the ratio was less than 2 to 1; 1.1 to 1 is what I remember.[163]

So, it's been a good record. The total number of punitive damages awards, I would say, is somewhere around 200 as far as we've logged, maybe 250.[164] They seem to be coming out around ten or fifteen a quarter. The pace seems to be about the same as in the past.

The proportionality ratio still continues to be about the same. Overall, when you get to the end of the day, it cost the industry, over a three-year period, maybe twenty to twenty-five, in other words, ten to fifteen percent of the total damages awarded to customers. It's an emotional issue and important, but frankly its consequence is usually exaggerated.

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160. 1992 GAO Report, *supra* note 54, at 45.

161. *Id.*

162. *Punitive Award Survey*, Sec. Arb. Commentator, May 1993, at 7 (finding that arbitrators awarded punitive damages in 2.1% of the cases in which compensatory damages were awarded); *see also Punitive Damages in Arbitration: Update Survey of Securities Arbitration Awards*, Sec. Arb. Commentator, Jan. 1995, at 13, 17 (reporting that the incidence of punitive awards from May 1989 to December 1993, cumulatively throughout all of the states, is 2.0% of all surveyed cases).

163. *Punitive Award Survey*, *supra* note 162, at 4.

164. The *Securities Arbitration Commentator* found a total of 221 awards in which punitive damages were granted against a party. *Punitive Damages in Arbitration: Update Survey of Securities Arbitration Awards*, *supra* note 162, at 13, 15.

PROF. KATSORIS: We are going to cover this again at the December 5th session,[165] so I would like to suspend further debate until then.

I would again like to thank the New York Stock Exchange for putting on this Symposium.

165. *See infra* pp. 1651-78.