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Classwide Arbitration and 10b-5 Claims in the Wake of Shearson/American Express Inc. v. McMahon

Daniel R. Waltcher

CLASSWIDE ARBITRATION AND 10b-5 CLAIMS IN THE WAKE OF *SHEARSON/AMERICAN EXPRESS, INC. v. McMAHON*

The validity of superimposing class actions on arbitration proceedings is an open question under federal law. The Supreme Court's recent decision in *Shearson/American Express, Inc. v. McMahon*[1] to compel arbitration of securities fraud claims, however, makes the classwide arbitration device a likely topic of judicial attention in the near future. This Note discusses the merits of a hybrid device that combines class actions and arbitration,[2] specifically with regard to suits brought under Securities Exchange Commission ("SEC") Rule 10b-5,[3] promulgated under the Securities Exchange Act of 1934 ("Exchange Act").[4] It argues that the federal judiciary should support classwide arbitration, provided the usual due process protections[5] accorded to plaintiffs in class action litigation are available in the classwide arbitration setting.

In the wake of the *McMahon* decision, and in light of the advantages to plaintiffs in bringing 10b-5 claims as class actions, the federal courts are likely to consider the merits of courts superimposing class actions on arbitration proceedings in the near future. Now that the Supreme Court has compelled arbitration in an area traditionally popular for class actions,[6] the next logical question is whether classwide arbitration is a legitimate device for resolving 10b-5 claims. This Note first examines the arguments for and against arbitration. Second, it reviews the *McMahon* decision in light of the historical background of arbitration. Third, it evaluates the effectiveness of the class action as an instrument for bringing claims under Rule 10b-5. Finally, it discusses the merits of combining both efficiency devices and of developing a federal policy favoring classwide arbitration.[7] This Note argues that in light of the need for effi-

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1 482 U.S. 220 (1987).

2 For a discussion of the proposed structure of classwide arbitration, see *infra* notes 133-56 and accompanying text.

3 17 C.F.R. § 240.10b-5 (1988).

4 Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. §§ 78a-78kk (1982).

5 Due process rights in the class action context center around notice requirements and adequacy of representation. *See, e.g., In re* Four Seasons Sec. Laws Litig., 502 F.2d 834, 842 (10th Cir.), *cert. denied*, 419 U.S. 1034 (1974); 7B C. WRIGHT, A. MILLER & M. KANE, FEDERAL PRACTICE AND PROCEDURE § 1786 (2d ed. 1986) [hereinafter WRIGHT & MILLER].

6 "With apparent increasing frequency, Rule 23(b)(3) is being utilized in . . . securities fraud suits." 7B WRIGHT & MILLER, *supra* note 5, § 1781, at 4.

7 While the United States Supreme Court has not yet ruled on the legality of class-

ciency, the federal courts should approve such a device in 10b-5 actions. It also will recommend methods of ensuring that plaintiffs' due process rights are protected in classwide arbitration proceedings.

I
BACKGROUND

A. The Supreme Court's Traditional Refusal to Approve Arbitration of Securities Claims

Enacted in 1925, the Federal Arbitration Act ("FAA")[8] contains strong language favoring arbitration. It states that "[a] written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[9] Only in recent years, however, has the Supreme Court looked favorably upon arbitration proceedings to resolve disputes arising under various federal statutes.[10] The Securities Act of 1933 ("Securities Act")[11] and the Exchange Act are examples of such federal laws in which the Court has contemplated the use of arbitration to resolve disputes. The Court previously believed that the federal securities laws guaranteed the right to a judicial proceeding and prohibited waiver of such rights. It deemed arbitration impermissible even though parties privately had contracted to arbitrate.

The United States Supreme Court first articulated its disapproval of the arbitration of securities disputes in the landmark *Wilko v. Swan*[12] decision. In *Wilko*, the plaintiff/customer brought suit to recover for misrepresentation under section 12(2) of the Securities Act.[13] The Court held that the agreement between the customer and the securities broker to arbitrate future controversies was a void

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wide arbitration, California's Supreme Court has approved this hybrid device in Keating v. Superior Court, 31 Cal.3d 584, 645 P.2d 1192, 183 Cal. Rptr. 360 (1982), *rev'd on other grounds sub nom.* Southland Corp. v. Keating, 465 U.S. 1 (1984).

8 Federal Arbitration Act of 1925, Pub. L. No. 68-401, 43 Stat. 883 (current version at 9 U.S.C., §§ 1-14 (1982).

9 *Id.* at § 2. The legislative history of the FAA evidences the intention to extinguish judicial hostility toward arbitration. *See, e.g.*, H.R. REP. No. 96, 68th Cong., 1st Sess. 1, 2 (1924) (Congress enacted the FAA in order to place arbitration agreements "upon the same footing as other contracts . . . . The [FAA] declares simply that such agreements for arbitration shall be enforced, and provides a procedure in the Federal courts for their enforcement.").

10 *See infra* notes 55-59 and accompanying text.

11 Securities Act of 1933, 48 Stat. 74, 15 U.S.C. §§ 77a-77bbbb (1982).

12 346 U.S. 427 (1953).

13 *See infra* note 21 for the relevant text of § 12(2) of the Securities Act.

"stipulation" under section 14 of the Securities Act.[14] The *Wilko* Court acknowledged the desirability of arbitration as an alternative to litigation, but concluded that in the case of the Securities Act, section 14 obstructed the plaintiff's ability to waive his right to select a judicial forum.[15] Justice Reed, writing for the majority, asserted that the potential inequities between broker-dealers and customers were too severe to permit waiver by the customer. The Court stated that Congress clearly drafted the Securities Act "with an eye to the disadvantages under which buyers labor,"[16] and that judicial proceedings afford plaintiffs more effective protections than arbitration.

The *Wilko* Court's reluctance to resolve Securities Act claims through arbitration stemmed from the suspicion of arbitration that prevailed at that time. First, the Court believed that arbitration was inimical to cases requiring "subjective findings on the purpose and knowledge of an alleged violator of the [Securities] Act."[17] The Court feared that without the benefit of judicial instruction on the law, the arbitrators would be prone to commit errors on these complicated legal constructs. Second, arbitrators could decide cases without publishing explanations or complete records of the proceedings, and such unreasoned decisions posed potential dangers of unfairness.[18] Third, the high standards established in section 10 of the FAA for vacation of an arbitral award made appeal overwhelmingly difficult, and exacerbated the foregoing problems.[19]

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14 Section 14 of the Securities Act provides that "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the [Securities Exchange] Commission shall be void." 15 U.S.C. § 77n (1982).

15 *Wilko*, 346 U.S. at 434-35.

16 *Id.* at 435.

17 *Id.* at 435-36.

18 *Id.* at 436. *See also* R. COULSON, BUSINESS ARBITRATIONS—WHAT YOU NEED TO KNOW 29 (3d ed. 1986) ("Written opinions . . . identify targets for the losing party to attack.").

19 *Wilko*, 346 U.S. at 436. Section 10 of the FAA describes the four grounds for vacation of an arbitral award: 1) fraud or corruption in procuring the award; 2) arbitrator partiality; 3) misconduct of the arbitrators resulting in prejudice to a party; or 4) failure of the arbitrators to reach a "mutual, final, and definite award." 9 U.S.C. § 10 (1982). *See* Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 456-57 (1981). As that commentator noted:

> Courts will not vacate an arbitral award for mistakes of law made by the arbitrators unless, as a general rule, there is some indication that the arbitrators knew what the applicable law was and simply ignored it or refused to apply it. Because arbitrators are not required to give reasons for their decision . . . , some commentators question how a dissatisfied arbitrant can challenge the award on the basis of a manifest disregard of the law.

(footnotes omitted). *See also* French v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 784 F.2d 902, 906 (9th Cir. 1986) (*citing* Swift Industries, Inc. v. Botany Industries, Inc., 466

B. The Shift Towards Approval of Arbitration

In *Scherk v. Alberto-Culver Co.*,[20] the Supreme Court first questioned the applicability of *Wilko* to claims of manipulation or deception arising under section 10(b) of the Exchange Act and its companion, Rule 10b-5.[21] In *Scherk*, an American manufacturer, the Alberto-Culver Company, purchased three foreign enterprises, together with their trademark rights. The company negotiated, signed, and closed the sales contract in five different countries. The contract contained a representation by the seller that the trademarks were unencumbered, as well as an arbitration agreement. Alberto-Culver subsequently brought a 10b-5 action claiming fraudulent misrepresentation because the trademarks were subject to substantial encumbrances.[22] The Court upheld the predispute agreement to arbitrate the Exchange Act claims. It reasoned that arbitration proceedings diminished the uncertainty of international contracts and mitigated the danger that a dispute would be resolved in an unfriendly setting.[23] Thus, despite the *Scherk* Court's effort to distinguish *Wilko* because Scherk's international contract involved "considerations and policies significantly different from those found controlling in *Wilko*,"[24] *Scherk* substantially undermined *Wilko*'s ap-

F.2d 1125, 1131 (3d Cir. 1972)) ("An arbitrator's decision must be upheld unless it is 'completely irrational.' ").

20 417 U.S. 506 (1974).

21 *Scherk* raised the issue because section 12(2) of the Securities Act (the relevant section in *Wilko*) and section 10(b) of the Exchange Act contain different language and because, unlike section 12(2), section 10(b) does not expressly give rise to a private cause of action. Section 10(b) states that "[i]t shall be unlawful for any person . . .[t]o use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b) (1982). The Exchauge Act created no explicit private right of action; therefore the courts have created one. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983); Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971); Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946). In contrast, the Securities Act establishes a private right of action in section 12(2). It asserts that any person who sells a security in violation of its provisions "shall be liable to the person purchasing such security from him, *who may sue either at law or in equity in any court of competent jurisdiction.*" 15 U.S.C. § 77*l*(2) (1982) (emphasis added). In Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 225 (1985), Justice White reasoned in his concurrence that because the private right of action in section 10(b) is implied, section 29, the nonwaiver provision of the Exchange Act, 15 U.S.C. § 78cc (1982), "is thus literally inapplicable."

22 *Scherk*, 417 U.S. at 508-09.

23 *Id.* at 516.

24 In *Wilko*, American law clearly applied and the federal securities laws governed disputes arising out of the stock-purchase agreement. In contrast, the *Scherk* Court discussed international conflict-of-laws problems, stating that "considerable uncertainty existed at the time of the agreement, and still exists, concerning the law applicable to the resolution of disputes arising out of the contract [between Scherk and Alberto-Culver Company]." *Id.*

plicability to 10b-5 claims.[25]

Dean Witter Reynolds, Inc. v. Byrd[26] dealt the next blow to *Wilko*. The *Byrd* Court held that the FAA requires district courts to compel arbitration of pendent arbitrable claims. The Court elected to reserve decision on the applicability of *Wilko* to 10b-5 claims because Dean Witter had failed to seek arbitration of the federal securities claims in the trial court.[27] Justice White's concurrence, however, noted that the Court's analysis of arbitration of Securities Act claims in *Wilko* would not necessarily apply to Exchange Act claims such as those involved in *Byrd*.[28] Because the applicable provisions under the two Acts are different, Justice White stated that "*Wilko*'s reasoning cannot be mechanically transplanted to the [Exchange] Act,"[29] and that "contrary holdings of the lower courts must be viewed with some doubt."[30] Together, *Scherk* and *Byrd* demonstrated a softening in the Court's attitude towards the arbitrability of 10b-5 claims, and they set the stage for the *McMahon* decision.

II

McMahon and the Decision to Compel Arbitration

A. The Facts

The McMahons were Shearson/American Express ("Shearson") customers between 1980 and 1982. Julia McMahon signed two brokerage agreements that called for the arbitration of any controversy between Shearson and the McMahons relating to the McMahons' accounts.[31] In 1984, the McMahons filed a complaint against Shearson and its registered representative who handled

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25 *McMahon*, 482 U.S. at 229. Until the *McMahon* decision, however, numerous district courts and courts of appeals continued to apply the *Wilko* analysis to 10b-5 claims in the aftermath of *Scherk* and held that agreements to arbitrate such claims were unenforceable. *See, e.g.*, DeLancie v. Birr, Wilson & Co., 648 F.2d 1255, 1258-59 (9th Cir. 1981); Sibley v. Tandy Corp., 543 F.2d 540, 543 & n.3 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); Newman v. Shearson, Hammill & Co., 383 F. Supp. 265, 268 (W.D. Tex. 1974). *See also* cases cited *infra* note 36.

26 470 U.S. 213 (1985).

27 *Id.* at 216 n.1. While the Court did not determine the arbitrability of 10b-5 claims, it acknowledged the federal policy requiring that courts "rigorously enforce agreements to arbitrate." *Id.* at 221.

28 *Id.* at 224 (White, J., concurring).

29 *Id.*

30 *Id.* at 225.

31 The McMahons' arbitration provision stated in pertinent part:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect.

McMahon, 482 U.S. at 223.

their accounts. The McMahons alleged, *inter alia*, violation of section 10(b) of the Exchange Act and of Rule 10b-5, specifically charging their broker with churning their accounts,[32] making misleading statements, and omitting material facts from her advice.[33] Shearson responded that pursuant to the brokerage agreements and section 3 of the FAA,[34] which orders courts to stay judicial action until arbitration is sought and completed, the court should compel arbitration of the claims. On the 10b-5 issue, the district court found that the McMahons' Exchange Act claims were arbitrable based on the *Byrd* decision and the strong national policy favoring arbitration.[35] On appeal, the Second Circuit Court of Appeals reversed the trial court's ruling. The court concluded that it previously had extended *Wilko*'s bar against arbitration to 10b-5 claims, and that, notwithstanding the doubt cast on such decisions by *Byrd* and *Scherk*, it was bound by the "clear judicial precedent in [that] Circuit."[36]

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32 "Churning occurs when a broker, exercising control over the volume and frequency of trades, abuses his customer's confidence for personal gain by initiating transactions that are excessive in view of the character of [the] account and the customer's objectives as expressed by the broker." BLACK'S LAW DICTIONARY 220 (5th ed. 1979).

33 *McMahon*, 482 U.S. at 223.

34 Section 3 of the FAA states:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved . . . is referable to arbitration . . . , shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3 (1982).

35 *McMahon*, 482 U.S. at 225-26.

36 McMahon v. Shearson/American Express, Inc., 788 F.2d 94, 98 (2d Cir. 1986), *rev'd in pertinent part*, 482 U.S. 220 (1987). The Second Circuit had long denied compulsory arbitration to claims under section 10(b) and Rule 10b-5. *See, e.g.*, AFP Imaging Corp. v. Ross, 780 F.2d 202, 205 (2d Cir. 1985), *cert. denied*, 478 U.S. 1004 (1986); Allegaert v. Perot, 548 F.2d 432, 437-38 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); Greater Continental Corp. v. Schechter, 422 F.2d 1100, 1103 (2d Cir. 1970); Colonial Realty Corp. v. Bache & Co., 358 F.2d 178, 183 n.5 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966). Seven other circuits have held similarly. *See* Wolfe v. E.F. Hutton & Co., 800 F.2d 1032 (11th Cir. 1986) (en banc); Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 797 F.2d 1197 (3d Cir. 1986); King v. Drexel Burnham Lambert, Inc., 796 F.2d 59 (5th Cir 1986), *vacated*, 482 U.S. 922 (1987) (in light of *McMahon*); Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520 (9th Cir. 1986) *vacated*, 482 U.S. 923 (1987) (in light of *McMahon*); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823 (10th Cir. 1978); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831 (7th Cir. 1977). *But see* Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291, 295 (1st Cir. 1986) ("We are persuaded by the result reached by the Eighth Circuit, although for somewhat different reasons, and rule that, where parties agree to arbitrate a 10b-5 dispute, this agreement is largely enforceable."); Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 795 F.2d 1393, 1395 (8th Cir. 1986), which enforced an agreement to arbitrate section 10(b) claims ("We believe . . . that the Supreme Court's opinions in *Scherk* and *Byrd* have

B. The Supreme Court Decision

1. *The Majority Opinion*

The Supreme Court, in a 5-4 decision written by Justice O'Connor, reversed the Second Circuit's decision and held that the McMahons' Exchange Act claims were arbitrable under the provisions of the FAA.

a. *Policies Underlying the Federal Arbitration Act*

Commencing its opinion with a discussion of the FAA, the Court noted that Congress enacted the FAA to " 'revers[e] centuries of judicial hostility to arbitration agreements' "[37] by " 'plac[ing] arbitration agreements "upon the same footing as other contracts." ' "[38] Thus congressional intent indicated that a " 'federal policy favoring arbitration' " exists[39] that required the rigorous enforcement of arbitration agreements. The Court stated that the FAA " 'provides no basis for disfavoring agreements to arbitrate statutory claims by skewing the otherwise hospitable inquiry into arbitrability.' "[40] Furthermore, " '[b]y 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.' "[41] Thus the duty to enforce arbitration agreements prevails when a party raises a statutory claim,[42] unless Congress intended to require adjudication when it enacted the particular statute.

b. *Substantive Rights Under the Securities and the Exchange Acts*

Second, the Court examined the differences between the substantive rights created under the Exchange and Securities Acts. Justice O'Connor compared the nonwaiver provisions, the civil liabilities provisions, and the jurisdictional provisions in the two Acts.[43] *Wilko* ruled that the Securities Act's nonwaiver provision[44]

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invited a reexamination of the applicability of *Wilko* to claims arising under section 10(b) of the [Exchange] Act and Rule 10b-5.").

37 *McMahon*, 482 U.S. at 225, *quoting Scherk*, 417 U.S. at 510.

38 *Id.* at 225-26, *quoting Scherk*, 417 U.S. at 511, *quoting* H.R. REP. 96, 68th Cong., 1st Sess. 1, 2 (1924).

39 *Id.*, *quoting* Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

40 *McMahon*, 482 U.S. at 226, *quoting Wilko*, 346 U.S. at 432.

41 *Id.* at 229-30, *quoting* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985).

42 *Mitsubishi*, 473 U.S. at 626.

43 *Compare* 15 U.S.C. §§ 77n, 77*l*(2), and 77v (1982) (Securities Act provisions), *with* 15 U.S.C. §§ 78cc, 78j(b), and 78aa (1982) (Exchange Act provisions).

44 15 U.S.C. § 77n (1982). For the relevant text of Securities Act section 14, see *supra* note 14.

prohibited waiver of the right to enforce the civil liabilities section[45] in a state or federal court as provided by the jurisdictional provision.[46] In *McMahon*, the Court questioned whether the Exchange Act's nonwaiver provision[47] prohibited waiver of the right to enforce its civil liabilities provision[48] in a judicial forum in light of its jurisdictional provision[49] that restricts jurisdiction to federal courts. Justice O'Connor reasoned that the antiwaiver provision of the Exchange Act, which the McMahons claimed prohibited waiver of the jurisdictional provision, forbids waiver of compliance with the Act. However, because the jurisdictional provision "does not impose any statutory duties, its waiver does not constitute a waiver of 'compliance with any provision' of the Exchange Act under § 29(a)."[50] That is, a customer's agreement with a broker-dealer to forego adjudicative recourse in favor of arbitration is irrelevant to the question of the broker's "compliance" with the provisions of the Exchange Act. Therefore, Shearson did not violate the antiwaiver provision of the Exchange Act because the McMahons did not waive any substantive obligations.

In light of this comparison, the *McMahon* Court did not distinguish *Wilko* statutorily. Instead, it asserted that an agreement to arbitrate a 10b-5 claim no longer implies a waiver of the plaintiff's substantive rights because of the great improvements in arbitration as a means of recourse.[51] The Court argued that *Wilko* must be understood as holding the waiver of section 22 impermissible "*only* because arbitration was judged inadequate to enforce the statutory rights created by § 12(2)."[52] *McMahon* distinguished *Wilko* on the ground that arbitration has become the "functional equivalent" of

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45 15 U.S.C. § 77*l*(2) (1982). For the relevant text of Securities Act section 12(2), see *supra* note 21.

46 *Wilko*, 346 U.S. at 435-38. Section 22 of the Securities Act (the jurisdictional provision) establishes in part that "[t]he district courts of the United States and the United States courts of any Territory shall have jurisdiction of offenses and violations under this Subchapter. . . ." 15 U.S.C. § 77v (1982).

47 15 U.S.C. § 78cc(a) (1982). For the relevant text of Exchange Act section 29, see *infra* note 50.

48 15 U.S.C. § 78j(b) (1982). For the relevant text of Exchange Act section 10(b), see *supra* note 21.

49 Section 27 of the Exchange Act states in part that "[t]he district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter. . . ." 15 U.S.C. § 78aa (1982).

50 *McMahon*, 482 U.S. at 228. Section 29(a) of the Exchange Act establishes that "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void." 15 U.S.C. § 78cc(a) (1982).

51 *McMahon*, 482 U.S. at 228. For a discussion of improvements in the arbitration process, see *infra* notes 55-59 and 68-71 and accompanying text.

52 *Id.*, 482 U.S. at 229 (emphasis added).

adjudication.[53]

c. *Historical Changes in Arbitration*

Third, the Court considered the McMahons' assertion that the three suspect characteristics of arbitration that had weighed heavily in *Wilko*'s outcome applied with equal force in the instant case.[54] In response to the McMahons' arguments, the majority began by citing numerous cases that indicated a favorable change in the judiciary's attitude towards arbitration.[55] The Court then stressed that the 1975 amendments to section 19 of the Exchange Act[56] gave the SEC[57] "expansive power to ensure the adequacy of the arbitration procedures employed by . . . [self regulatory organizations]."[58] Jus-

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53 Comment, *Predispute Arbitration Agreements Between Brokers and Investors: The Extension of Wilko to Section 10(b) Claims*, 46 MD. L. REV. 339, 373 (1987).

54 *See supra* notes 17-19 and accompanying text.

55 *See*, Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626-27 (1985) ("[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution."); Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 220 (1985) ("[P]assage of the [FAA] was motivated first and foremost, by a congressional desire to enforce agreements into which parties had entered, and we must not overlook this principal objective when construing the statute."); Southland Corp. v. Keating, 465 U.S. I, 14 (1984) ("To confine the scope of the [FAA] to arbitrations sought to be enforced in federal courts could frustrate what we believe Congress intended to be a broad enactment . . . ."); Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983) ("[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration."); Scherk v. Alberto-Culver Co., 417 U.S. 506, 519 (1974), *quoting* The Breman v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972) (The invalidation of an arbitration agreement would allow a party "to repudiate its solemn promise" and would also reflect a " 'parochial concept that all disputes must be resolved under our laws and in our courts.' "). For a detailed discussion of the implications of *Byrd*, *Keating*, and *Cone*, see generally Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305 (1985).

56 The 1975 amendments stated that,

> The [Securities and Exchange] Commission, by rule, may abrogate, add to, and delete from . . . the rules of a self-regulatory organization . . . as the Commission deems necessary or appropriate to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purpose of this chapter. . . .

15 U.S.C. § 78s(c) (1982).

57 The SEC is the agency principally responsible for the enforcement of the federal securities laws and regulations. It oversees and regulates the activities of stock exchanges and securities associations, including the rules they prescribe for arbitration of claims against their members.

58 *McMahon*, 482 U.S. at 233. Self-regulatory organizations ("SROs") are the national securities exchanges and the registered securities associations. They include the American Stock Exchange, the Boston Stock Exchange, the Chicago Board of Options Exchange, the Municipal Securities Rulemaking Board, the National Association of Securities Dealers, the New York Stock Exchange, the Pacific Stock Exchange, and the Philadelphia Stock Exchange. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 FORDHAM L. REV. 279, 280-81 n.7 (1984).

tice O'Connor acknowledged that *Wilko*'s assumptions regarding the ineffectiveness of arbitration and the SEC's authority might have been valid in 1953, but asserted that they "most certainly . . . do not hold true today for arbitration procedures subject to the SEC's oversight authority."[59] Accordingly, the Court concluded that where the SEC monitors arbitration procedures, as it did in the McMahons' case, an arbitration agreement is not a waiver of a plaintiff's substantive rights under the Exchange Act.

2. *The Dissent*

The *McMahon* dissent sharply criticized the majority's narrow reading of the antiwaiver provisions in both the Securities Act and the Exchange Act and observed that the two provisions are "virtually identical."[60] Justice Blackmun insisted that the same reasons that led the Court to preclude arbitration for claims under the civil liabilities provision of the Securities Act applied to the civil liabilities provision of the Exchange Act;[61] thus *Wilko* should control Exchange Act claims.

The dissent diverged from the majority's evaluation of arbitration as a plaintiff protective device and adhered to *Wilko*'s analysis. While acknowledging improvements in the arbitration process subsequent to *Wilko*,[62] the dissenters did not believe that "arbitration has changed so significantly as to eliminate the essential characteristics noted by the *Wilko* Court."[63] Justice Blackmun argned that "several aspects of arbitration that were seen by the *Wilko* court to be inimical to the policy of investor protection still remain."[64] First,

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59 *McMahon*, 482 U.S. at 233.

60 *Id.* at 256 (Blackmun, J., dissenting). Some commentary suggests that the difference between the Securities Act and Exchange Act with regard to these sections is mere happenstance. *See, e.g.*, Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L.J. 548, 567; Note, *The Securities Exchange Act and the Rule of Exclusive Federal Jurisdiction*, 89 YALE L.J. 95, 109 n.58 (1979).

61 *McMahon*, 482 U.S. at 256 (Blackmun, J., dissenting).

62 *Id.* at 258 (Blackmun, J., dissenting). *See also* SEC Exchange Act Rel. No. 16390 (Nov. 30, 1979), 44 Fed. Reg. 70616, 70617 (The Uniform Code of Arbitration, which harmonizes the arbitration procedures among SROs, "marks a substantial improvement over the various arbitration procedures currently being utilized by the securities industry and represents an important step towards establishing a uniform system for resolving investor complaints through arbitration."). The Uniform Code also has increased fairness and consistency in arbitration proceedings. Katsoris, *supra* note 58, at 283-84. For further discussion of changes in arbitration proceedings, see *supra* notes 55-59 and accompanying text and *infra* notes 68-71 and accompanying text.

63 *McMahon*, 482 U.S. at 259 (Blackmun, J., dissenting).

64 *Id.* at 257 (Blackmun, J., dissenting). Justice Blackmun pointed to the lenient requirements for the preparation of a record, the continued disinterest in announcing reasons for arbitral decisions, and the substantially limited judicial review of arbitral rulings as the reasons against compelling arbitration of 10b-5 claims in which plaintiffs had signed predispute arbitration agreements. *Id.* at 258-59.

the FAA does not require arbitrators to provide reasons for their decisions or to develop complete records. Second, the grounds for vacating a decision are limited.[65] Furthermore, the dissent charged that compulsory arbitration forces plaintiffs to arbitrate in fora that the securities industry controls. Such a result would "directly contradict[] the goal of both securities acts to free the investor from the control of the market professional,"[66] a concern that Justice Reed expressed in *Wilko*.[67]

C. Analysis

The Court properly decided *McMahon* in light of both the improvements in arbitration proceedings since *Wilko* and the need for more efficient and economical means of dispute resolution.[68] In contrast to the dissent's criticisms of the arbitration process, the SEC, as the official enforcer of the securities laws,[69] expressed its confidence in arbitration in an amicus brief on behalf of Shearson to compel arbitration of the McMahons' claims.[70] In addition, the Court's decisions in the wake of *Wilko* have reflected the gradual erosion of society's mistrust of arbitration.[71] Although the *McMa-*

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65 *See supra* note 19 and accompanying text for the FAA's four grounds upon which to overturn an arbitration decision.

66 *McMahon*, 482 U.S. at 260 (Blackmun, J., dissenting).

67 *Wilko*, 346 U.S. at 435-36.

68 *See generally* Fletcher, *supra* note 19, at 458 (footnotes omitted):

> Privatization of disputes through arbitration is a good thing, particularly for securities disputes. . . . The parties have an opportunity to avoid crowded court dockets in favor of a resolution procedure whose average total time is from four to six months. . . . Arbitration is also considerably cheaper than litigation—about one-third the cost, even taking into consideration that both parties may be represented by counsel. . . . The parties are not the only beneficiaries of [arbitration]. Arbitration promotes important societal interests as well. Because of the crowded court dockets, for every claim that is litigated, another is left waiting. Thus, to the extent more cases go to arbitration, more claimants who may not have agreed to arbitrate their claims will have access to the federal courts. In addition, the unnecessary litigation of cases in federal court carries with it enormous dollar costs for society as a whole.

69 *See supra* note 57.

70 Brief for Amicus Curiae at 13-21, Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) (No. 86-44):

> The view of arbitration on which *Wilko* rested is today inappropriate in cases involving disputes between registered broker-dealers and their customers. . . . [Given the SEC's broad regulatory authority], the suspicion of arbitration on which *Wilko* rested is inappropriate, and an agreement to arbitrate accordingly should not be deemed a waiver of rights under the Exchange Act.

Id. at 13.

71 *See supra* note 55 and accompanying text. *McMahon*'s outcome also is consistent with the Court's previous commentary on arbitration in Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983), where it stated that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the

hon majority utilized a narrow reading of *Wilko* to arrive at its decision, the Court based its decision on the efficiency interests of the judiciary, the defendants, and the plaintiffs alike. The *McMahon* dissent failed to appreciate that arbitration proceedings will allow plaintiffs a speedier and less costly resolution of their disputes. In fact, plaintiffs unable to commence a formal litigation proceeding because of its costs could seek redress through arbitration.

III
CLASS ACTIONS AS EFFICIENCY-PROMOTING DEVICES IN 10b-5 CLAIMS

A. Advantages of the Class Action Device

1. *Suitability of 10b-5 Claims to the Class Action Format*

Arbitration proceedings allow plaintiffs a speedier and less costly resolution of their disputes. Class actions offer plaintiffs similar economic advantages.[72] Although the popularity of the class action has decreased in recent years,[73] its use in securities litigation has remained steady.[74] Rule 10b-5 actions usually involve large numbers of plaintiffs whose claims arise out of the same questions of law and fact; thus, 10b-5 suits are especially suited to the class action format.[75]

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problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Id.* at 24-25. *See generally* Brown, Shell & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 7 (1987) ("In the last twelve years, the Supreme Court has rendered five decisions that have created a favorable climate for commercial arbitration—including arbitration of statutory rights—by dramatically expanding the scope and applicability of the FAA.").

72 Class actions are authorized under FED. R. CIV. P. 23.

73 Several factors have led to this decline. First, the decline in antitrust litigation in recent years, an area popular for class action suits, *see generally* 7B WRIGHT & MILLER, *supra* note 5, at § 1781, has decreased the number of lawsuits brought as class actions. Martin, *The Rise and Fall of the Class-Action Lawsuit*, N.Y. Times, Jan. 8, 1988, at B7, col. 6. Second, the Supreme Court has restricted class actions through two decisions concerning notice and diversity jurisdiction. In Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 173 (1974), the Court held that "[i]ndividual notice must be sent to all class members whose names and addresses may be ascertained through reasonable effort." The Court further asserted that notice to class members is not a "discretionary consideration to be waived." *Id.* at 176. Finally, it ruled that the class representative must bear the cost of notice to members of his class. *Id.* at 177. Zahn v. Int'l Paper Co., 414 U.S. 291, 301 (1973), held that *each* class member "in a Rule 23(b)(3) class action must satisfy the jurisdictional amount [requirement in a federal diversity claim pursuant to 28 U.S.C. § 1332 (1982)], and any plaintiff who does not must be dismissed from the case."

74 Martin, *supra* note 73, at B7, col. 6 ("[S]ome experts . . . suggest an area of possible growth [in class action activity] is securities class actions, which have been running fairly steady for the last decade at about 100 cases a year.").

75 *See* Green v. Wolf Corp., 406 F.2d 291, 295-96 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). One court commented that

> [c]ontroversies involving widely used contracts of adhesion [such as that

Rule 10b-5 cases typically satisfy all of the prerequisites for a class action enumerated in Rule 23(a) of the Federal Rules of Civil Procedure. First, the plaintiffs tend to be so numerous that it would be impractical for a court to hear each of their claims individually.[76] Second, the class members usually share identical questions of law or fact.[77] Third, the alleged claims or defenses of the class representatives often typify the claims and defenses of the other class members.[78] Fourth, the representatives usually are able to provide adequate representation to absent class members.[79]

Upon satisfying these prerequisites, the class then must fall under one of the 23(b) categories in order to be certified. Courts often employ Rule 23(b)(3) in securities litigation[80] because subdivision (b)(3) "encompasses those cases in which a class action would achieve economies of time, effort, and expense, and promote uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results."[81] Rule 23(b)(3) authorizes class actions when the justification for doing so is the existence of common questions of law or fact and a finding that the class action is superior to other means for resolving the dispute fairly and efficiently.[82] "Because most securities cases involve hundreds or thousands of class members who typically possess only small individual claims, the class action provides a useful mechanism for enforcing the policies underlying the securi-

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used by Shearson in *McMahon*], present ideal cases for class adjudications; the contracts are uniform, the same principles of interpretation apply to each contract, and all members of the class will share a common interest in the interpretation of an agreement to which each is a party.

LaSala v. American Sav. & Loan Ass'n, 5 Cal.3d 864, 877, 489 P.2d 1113, 1121, 97 Cal. Rptr. 849, 857 (1971). In 10b-5 actions, a common contractual provision of the customer agreements are the boilerplate arbitration clauses. Such clauses are enforceable under most federal and state statutes. *See* M. DOMKE, ON COMMERCIAL ARBITRATION § 4.02, at 30 (G. Wilner ed. 1984).

76 One or more members of a class may sue or be sued if "the class is so numerous that joinder of all members is impracticable." FED. R. CIV. P. 23(a)(1).

77 One or more members of a class may sue or be sued if "there are questions of law or fact common to the class." FED. R. CIV. P. 23(a)(2).

78 If "the claims or defenses of the representative parties are typical of the claims or defenses of the class," one or more members of a class may sue or be sued. FED. R. CIV. P. 23(a)(3).

79 If "the representative parties will fairly and adequately protect the interests of the class," one or more members of a class may sue or be sued. FED. R. CIV. P. 23(a)(4).

80 7B WRIGHT & MILLER, *supra* note 5, § 1781, at 4.

81 *See* FED. R. CIV. P. 23 advisory committee's notes, 39 F.R.D. 69, 102-03 (1966).

82 FED. R. CIV. P. 23(b)(3) states that:

> An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition . . . the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

ties laws and should be liberally allowed."[83]

2. *The Class Action as an Efficiency Device*

Class actions increase efficiency for society as a whole as well as for the actors in litigation.[84] First, courts and society benefit because many individual claims may be resolved concurrently.[85] This greatly reduces the judiciary's caseload and saves the taxpayers' money.[86] Second, the courts avoid potentially conflicting outcomes,[87] thereby increasing certainty and fairness in the law. For example, ten plaintiffs suing individually will receive between zero and ten favorable judgments. In contrast, those same ten plaintiffs suing as a class will receive one consistent judgment. Third, many plaintiffs whose claims are too small to warrant individual litigation receive the opportunity to join the class, have their day in court, and share the litigation costs among the entire class.[88]

3. *Federal Court Recognition of Class Action Advantages*

Courts nationwide have recognized the advantages of the class action.[89] The Supreme Court has held that class relief is "peculiarly appropriate" when the "issues involved are common to the class as a whole" and when they "turn on questions of law applicable in the same manner to each member of the class."[90] In these types of cases, "the class-action device saves 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

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83 7B WRIGHT & MILLER, *supra* note 5, § 1781, at 28 and cases cited therein.

84 Arbitration affords similar benefits to the general public, the disputants, and the courts. Fletcher, *supra* note 19, at 458.

85 *See* Esplin v. Hirschi, 402 F.2d 94, 101 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 560 (2d Cir. 1968), *vacated* 417 U.S. 156 (1974).

86 Fletcher, *supra* note 19, at 458.

87 *Eisen*, 391 F.2d at 560.

88 *Id.* at 560, 566 n.16. It is important to note that this last attribute of class actions is virtually identical to a major advantage of arbitration. The cost effectiveness of arbitration proceedings is beneficial to plaintiffs with small claims because the lower cost may encourage them to bring claims that they otherwise might not litigate. *See supra* notes 71-72 and accompanying text.

89 *See* FED. R. CIV. P. 23 advisory committee's notes, 39 F.R.D. 69, 102-03 (1966); Eisenberg v. Gagnon, 766 F.2d 770, 785 (3d Cir.), *cert. denied*, 474 U.S. 946 (1985); Donovan v. University of Texas-El Paso, 643 F.2d 1201, 1206-07 (5th Cir. 1981); Hohmann v. Packard Instrument Co., 399 F.2d 711, 715 (7th Cir. 1968); *Eisen*, 391 F.2d at 560; Piel v. National Semiconductor Corp., 86 F.R.D. 357, 364, 374 (E.D. Pa. 1980), *cert. denied*, 474 U.S. 903 (1985); Steinmetz v. Bache & Co., 71 F.R.D. 202, 205-06 (S.D.N.Y. 1976); Rosenblatt v. Omega Equities Corp., 50 F.R.D. 61, 63-64 (S.D.N.Y. 1970); 7B WRIGHT & MILLER, *supra* note 5, § 1781, at 51.

90 Califano v. Yamasaki, 442 U.S. 682, 700-01 (1979):

23."[91] Furthermore, as the Second Circuit noted in *Eisen v. Carlisle & Jacquelin*,[92] securities laws depend upon private causes of action for their effectiveness.[93] Accordingly, "any error, if there is to be one, should be committed in favor of allowing the class action," because dismissal of a securities class action in many cases will "for all practical purposes terminate the litigation."[94]

B. Potential Problems with Class Actions

Courts should liberally construe the requirements of the class action rule in order to implement Rule 23's policy favoring class actions.[95] Nevertheless, fear of the due process violations that may accompany a 10b-5 class action gives rise to substantial court involvement and discretion in utilizing the class action format. The efficiency of bringing a class action may be offset by a significant degree of court involvement. In order for plaintiffs to bring a class action, the court must certify a class prior to the commencement of the litigation;[96] the decision to certify rests on the meeting of Rule 23(a)'s requirements.[97] In essence, Rule 23 obliges the court to carefully monitor the case in order to protect class members' rights.[98]

Another possible shortcoming of the 23(b)(3) class action lies in the stringent notice requirements that the Supreme Court announced in *Eisen v. Carlisle & Jacquelin*.[99] In *Eisen*, the Court ruled that any potential class member who can reasonably be notified of

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91 *Id.* at 701.

92 391 F.2d 555 (2d Cir. 1968).

93 Esplin v. Hirschi, 402 F.2d 94, 101 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); Bernfeld, *Class Actions and Federal Securities Laws*, 55 CORNELL L. REV. 78, 85 (1969).

94 *Eisen*, 391 F.2d at 566-67 (citations omitted).

95 Schwartz v. Harp, 108 F.R.D. 279, 281 (C.D. Cal. 1985).

96 The certification process is extensive and its primary purpose is to protect absentee class members from entry of binding judgment when their interests have not been adequately represented. *In re* Mid-Atlantic Toyota Antitrust Litig., 564 F. Supp. 1379 (D. Md. 1983); Vecchione v. Wohlgemuth, 80 F.R.D. 32, 50 (E.D. Pa. 1978).

97 *See* FED. R. CIV. P. 23(a). *See supra* notes 76-79 and accompanying text.

98 McGowan v. Faulkner Concrete Pipe Co., 659 F.2d 554 (5th Cir. 1981) (district court properly denied class certification where plaintiffs failed to pursue discovery for two years and lacked financial resources to maintain a class suit).

99 417 U.S. 156 (1974). *See supra* note 73. Prior to *Eisen*, the notice requirements that accompanied a Rule 23(b)(3) class action were less onerous. Rule 23(c)(2) provides that if a court permits a class action under subdivision (b)(3), it must order "the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." FED. R. CIV. P. 23(c)(2). Lower courts, attempting to prevent undue burdens on class representatives, held that individual notice was not automatically required and that judges had leeway in prescribing the type of notice. *See, e.g.*, Berland v. Mack, 48 F.R.D. 121, 129 (S.D.N.Y. 1969) (Requiring individual notice to each identifiable class member would "stymie the purpose of the class action device.").

the class's formation must receive such notification at the plaintiffs' expense.[100] The Court, in strong language, asserted that "[t]here is nothing in Rule 23 to suggest that the notice requirements [of Rule 23(c)(2)] can be tailored to fit the pocketbooks of particular plaintiffs.[101] Thus, it is well-settled that in Rule 23(b)(3) actions, all identifiable class members must be given individual notice despite the cost that may be involved.[102] This ruling unquestionably undermined the class action by detracting from its economic efficiency.

These problems notwithstanding, the total cost of bringing a given number of separate actions is substantially greater than the cost of litigating collectively in a class action. Analogizing this reasoning to an arbitration proceeding, "it is at least doubtful that [the advantages of arbitration] could compensate for the unfairness inherent in forcing hundreds, or perhaps thousands, of individuals asserting claims involving common issues of fact and law to litigate them in separate proceedings against a party with vastly superior resources."[103]

IV
CLASSWIDE ARBITRATION OF 10b-5 CLAIMS

Although the Supreme Court has not yet considered the merits of classwide arbitration, *McMahon*'s result logically suggests that the classwide arbitration issue will arise with respect to 10b-5 actions in the near future. Customers who have agreed to arbitrate claims against their brokers often will wish to pursue their lawsuits as a class, as 10b-5 plaintiffs traditionally have done.

In the aftermath of *McMahon*, judicial validation of classwide arbitration for actions arising under Rule 10b-5 is necessary to protect plaintiffs' rights for two reasons. First, *McMahon* compels arbitration of 10b-5 claims in cases where customers have sigued predispute arbitration agreements. Thus the class action format will effectively be extinguished as an option for plaintiffs if the courts find classwide arbitration impermissible. Logically, if arbitration is required and if courts deem class actions to be incompatible with

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100 *Eisen*, 417 U.S. at 173.

101 *Id.* at 176.

102 *See* Walsh v. Ford Motor Co., 807 F.2d 1000 (D.C. Cir. 1986), *cert. denied*, 482 U.S. 915 (1987); *In re* Franklin Nat'l Bank Sec. Litig., 574 F.2d 662 (2d Cir. 1978); *In re* Nissan Motor Corp. Antitrust Litig., 552 F.2d 1088 (5th Cir. 1977); *In re* Warner Communications Sec. Litig., 618 F. Supp. 735 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986); Piel v. National Semiconductor Corp., 86 F.R.D. 357 (E.D. Pa. 1980), *cert. denied*, 474 U.S. 903 (1985); Robinson v. First Nat'l City Bank, 482 F. Supp. 92 (S.D.N.Y. 1979).

103 Keating v. Superior Court, 31 Cal.3d 584, 609, 645 P.2d 1192, 1207, 183 Cal. Rptr. 360, 375 (1982), *rev'd on other grounds sub nom.* Southland Corp. v. Keating, 465 U.S. 1 (1984).

arbitration, then class actions will be precluded in the 10b-5 setting. In essence, the judiciary will have added efficiency in one area (arbitration), and subtracted it in another (class actions). Second, securities brokers may insert boilerplate arbitration clauses into their customer agreements in order to prevent class actions. "If . . . an arbitration clause may be used to insulate the drafter of an adhesive contract from any form of class proceeding, effectively foreclosing many individual claims, it may well be oppressive and may defeat the expectations of the nondrafting party."[104]

If the Court deems class arbitration impermissible, then the efficiency created through *McMahon* may be lost. Rule 10b-5 plaintiffs who might have reaped the benefits of class action litigation will lose that option once arbitration of their claims is compelled. The strong federal policy favoring both class actions and arbitration[105] suggests that the judiciary should permit the combination of the two devices rather than simply preclude class actions when courts compel arbitration. The fact that the parties contracted to arbitrate does not evidence an intent to foreclose class proceedings in resolving their disputes.

Two options exist in the post-*McMahon* era. First, courts can hold that arbitrations are necessarily and inherently incompatible with class actions and that the public policy favoring arbitration predominates. This will foreclose class action opportunities to 10b-5 claimants who sign arbitration clauses. Second, the judiciary can approve the classwide arbitration device for 10b-5 actions. This Note asserts that the latter option will increase efficiency for the courts and parties while simultaneously protecting the rights of the plaintiffs.

A. *Keating v. Superior Court*: A Discussion of Consolidation of Arbitrations and its Relation to Classwide Arbitration

1. *Consolidation Doctrine*

The policies underlying class actions are similar to those favoring the doctrine of consolidation.[106] In consolidated proceedings,

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104 *Id.* at 610, 645 P.2d at 1207, 183 Cal. Rptr. at 376.

105 *See supra* notes 37-42 and 89-94 and accompanying text.

106 Wright and Miller state that

> [c]onsolidation of actions presenting a common issue of law or fact is permitted as a matter of convenience and economy in administration. The court is given broad discretion to decide whether consolidation would be desirable. The consent of the parties is not required. It is for the court to weigh the saving of time and effort that consolidation would produce against any inconvenience, delay, or expense that it would cause.

(footnotes omitted) 9 WRIGHT & MILLER, *supra* note 5, § 2383, at 259.

courts encourage (and sometimes order) parties with claims arising out of the same law and facts to bring their lawsuits simultaneously in one forum.[107] Many cases assert that the consolidation of arbitration proceedings is permissible.[108] While the FAA does not specifically provide for the consolidation of arbitrations, courts have observed that the statute's liberal purposes suggest that consolidation of arbitration proceedings is both permitted and encouraged.[109] The courts prefer consolidation when presented with common questions of law and fact and a danger of conflicting findings. Class actions are favored for similar purposes.[110] Like consol-

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107 *See* Annotation, *State Court's Power to Consolidate Arbitration Proceedings*, 64 A.L.R.3d 528, 530 (1975). In fact, some courts argue that Rule 42 of the Federal Rules of Civil Procedure mandates such consolidation. "When actions involving a common question of law or fact are pending before the court, it may order a joint hearing or trial of any or all the matters in issue in the actions; it may order all the actions consolidated; and it may make such orders concerning proceedings therein as may tend to avoid unnecessary costs or delay." FED. R. CIV. P. 42(a). *See* Vigo S.S. Corp. v. Marship Corp., 26 N.Y.2d 157, 309 N.Y.S.2d 165, 257 N.E.2d 624, *cert. denied, sub. nom.* Frederick Share Corp. v. Vigo S.S. Corp., 400 U.S. 819 (1970). There, the New York Court of Appeals stated in dicta that

> the contention as to a lack of power to [order consolidation] flies in the face of the Federal Rules of Civil Procedure. Rule 42(a) provides expressly for consolidation in situations involving common questions of law or fact and the Federal Rules generally are made applicable to the [FAA] as to matters of procedure not covered by the [FAA]. . . .

26 N.Y.2d at 162-63, 309 N.Y.S.2d at 169, 257 N.E.2d at 626. The court noted that the FAA "is silent as to the question of consolidating arbitration proceedings." *Id. See also* Stipanowich, *Arbitration and the Multiparty Dispute: The Search for Workable Solutions*, 72 IOWA L. REV. 473, 491 (1987) (Federal courts often rely on the consolidation provisions of the Federal Rules of Civil Procedure, "which are deemed to apply to judicial proceedings enforcing agreements to arbitrate in the absence of express language in the FAA.").

108 *See, e.g.*, Compania Espanola de Petroleos, S.A. v. Nereus Shipping, S.A., 527 F.2d 966, 975 (2d Cir. 1975), *cert. denied*, 426 U.S. 936 (1976); Gavlik Constr. Co. v. H.F. Campbell Co., 526 F.2d 777, 789 (3d Cir. 1975); Sociedad Anonima de Navegacion Petrolera v. Compania de Petroleos de Chile, S.A., 634 F. Supp. 805, 809 (S.D.N.Y. 1986); In re Czarnikow-Rionda Co., 512 F. Supp. 1308, 1309 (S.D.N.Y. 1981); Marine Trading Ltd. v. Ore Int'l Corp., 432 F. Supp. 683, 684 (S.D.N.Y. 1977); Robinson v. Warner, 370 F. Supp. 828, 831 (D.R.I. 1974). *See also* Stipanowich, *supra* note 107, at 489-90:

> The trend . . . under both federal and state statutes is to allow consolidation of arbitrations that involve common issues of law and fact, at least when none of the pertinent arbitration provisions expressly excludes consolidation and the likelihood of substantial prejudice does not outweigh the time and expense involved in separate actions or the possibility of conflicting awards.

Contra, Weyerhaueser Co. v. Western Seas Shipping Co., 743 F.2d 635, 637 (9th Cir.), *cert. denied*, 469 U.S. 1061 (1984); Ore & Chem. Corp. v. Stinnes Interoil, Inc., 606 F. Supp. 1510, 1516 (S.D.N.Y. 1985).

109 *Compania Espanola*, 527 F.2d at 975. *See also Czarnikow*, 512 F. Supp. at 1309 ("Courts have frequently ordered consolidated arbitration proceedings when the interests of justice so require either because the issues in dispute are substantially the same and/or because a substantial right might be prejudiced if separate arbitration proceedings are conducted.").

110 *See supra* notes 72-83 and accompanying text.

idations, class actions arise, in part, from the desire to combine similar claims in one forum.

2. *Keating v. Superior Court*

In *Keating v. Superior Court*,[111] the California Supreme Court recognized the authority to order classwide arbitrations as existing within the penumbra of the courts' express statutory power to consolidate arbitrations.[112] The decision considered the right of franchisees to jointly arbitrate their common law and statutory claims against their franchisor. The court concluded that the plaintiffs' interests would seriously be prejudiced by mandating individual arbitrations of their respective claims.[113] *Keating* reasoned that an order for classwide arbitration in an adhesion contract context (such as is typical with broker-dealer customer agreements in 10b-5 actions) would call for substantially "less intrusion upon the contractual aspects of the relationship" than consolidation would occasion.[114] The class members would all be parties to an agreement with the defendant and the arbitration clauses would all contain similar language.[115] Accordingly, the *Keating* court concluded that the California legislature, in allowing the consolidation of arbitration proceedings, could not have intended to preclude a court from ordering classwide arbitration.[116]

Keating acknowledged that courts would have to make decisions regarding certification and notice, and "exercise a measure of external supervision in order to safeguard the rights of absent class members to adequate representation."[117] Furthermore, care would be necessary to avoid adjudication on the merits of the conflict and to "minimize complexity, costs, or delay."[118] Despite *Keating*'s concern over the juxtaposition of judicial involvement and arbitration,

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111 31 Cal.3d 584, 645 P.2d 1192, 183 Cal. Rptr. 360 (1982), *rev'd on other grounds sub nom.* Southland Corp. v. Keating, 465 U.S. 1 (1984).

112 *See* CAL. CIV. PROC. CODE § 1281.3 (West 1982), which states that

> consolidated arbitration may be compelled where one party is a party to a separate arbitration agreement or proceeding with a third party; and [t]he disputes arise from the same transactions or series of related transactions; and [t]here is common issue or issues of law or fact creating the possibility of conflicting rulings by more than one arbitrator or panel of arbitrators.

Id. If the arbitration agreements are distinct, a court may appoint an arbitrator to "resolve [any conflicts] and determine the rights and duties of the various parties to achieve substantial justice under all circumstances." *Id.*

113 *Keating*, 31 Cal.3d at 609, 645 P.2d at 1207, 183 Cal. Rptr. at 375.

114 *Id.* at 612, 645 P.2d at 1209, 183 Cal. Rptr. at 377.

115 *Id. See* M. DOMKE, *supra* note 75.

116 *Keating*, 31 Cal.3d at 613, 645 P.2d at 1209, 183 Cal. Rptr. at 377.

117 *Id.*

118 *Id.*

the court approved the classwide arbitration device. The decision became the "first of its kind in the nation . . . . [and] promise[d] to have profound impact on the way disputes arising out of contracts of adhesion [would] be resolved."[119] Although *Keating* was not a 10b-5 action, *Keating*'s reasoning unequivocably applies to securities fraud claims.

3. *Consolidations and Class Actions Distinguished*

Unlike class actions, in consolidations all parties are present to represent their own individual interests. In class actions, one class representative is the champion of the class and most other participants in the class are absent from the proceedings. As a result, due process issues arise in the class action context in the form of concerns over sufficiency of notice and adequacy of representation.[120]

B. Judicial Treatment of Class Arbitration Subsequent to *Keating*

The classwide arbitration question appeared before the Supreme Court in *Southland Corp. v. Keating*,[121] an appeal of the California *Keating* decision. The Court, however, refused to consider the issue because it lacked jurisdiction to make a determination.[122] Instead, the Court recognized that arbitrability of class actions had been approved in principle by the California Supreme Court.

Other California courts have followed *Keating*'s reasoning.[123] In *Lewis v. Prudential Bache Sec., Inc.*,[124] the California Court of Appeal noted that the "alternative to class arbitration . . . [was] to force each . . . customer to individually arbitrate claims, most of which probably [could] not justify the time and money required to

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119 *The California Supreme Court Survey, A Review of Decisions: January 1982-June 1982*, 10 PEPPERDINE L. REV. 167, 177, 178 (1982).

120 "The touchstones of due process in class actions have always been notice and adequacy of representation. . . ." *In re* Four Seasons Sec. Laws Litig., 502 F.2d 834, 842 (10th Cir.), *cert. denied, sub. nom.* Ohio v. Arthur Anderson & Co., 419 U.S. 1034 (1974). *See also* Hansberry v. Lee, 311 U S. 32, 44-45 (1940) (The Court's due process analysis of the class action centered on the question of adequacy of representation.); National Ass'n of Regional Medical Programs, Inc. v. Mathews, 551 F.2d 340, 344 (D.C. Cir. 1976), *cert. denied, sub. nom.* National Ass'n of Regional Medical Programs v. Califano, 431 U.S. 954 (1977) (Courts must sustain a careful and persistent evaluation of the adequacy of representation.). For a further discussion of the due process concerns involved in class actions, see *infra* notes 137-41 and accompanying text.

121 465 U.S. 1 (1984).

122 *Id.* at 8-9. The Court lacked jurisdiction because "it [did] not affirmatively appear that the validity of the state statute was 'drawn into question' *on federal grounds*, by Southland." *Id.* (emphasis in original).

123 Izzy v. Mesquite Country Club, 186 Cal.App.3d 1309, 231 Cal. Rptr. 315 (1986); Lewis v. Prudential Bache Sec., Inc., 179 Cal.App.3d 935, 225 Cal. Rptr. 69 (1986).

124 179 Cal.App.3d 935, 225 Cal. Rptr. 69 (1986).

prove."[125] The court concluded that arbitration properly could arise in a class action context provided there was adequate judicial supervision over the class aspects.

In *Izzy v. Mesquite Country Club*,[126] the court of appeal recognized that both class actions and arbitration are "regularly acknowledged to be valuable procedures for expediting dispute resolution and ameliorating the burdens of formal litigation."[127] The *Izzy* court concluded that "in cases in which the class action and arbitration devices would both appear to be appropriate and useful, recognition of a combined 'classwide arbitration' mechanism, if properly administered and judiciously applied, might possibly preserve the essential values of both devices."[128] The court attributed its doubts about the compatibility of arbitration and class actions to "considerable judicial precedent" against such a hybrid device.[129] The *Izzy* court refuted these cases by arguing that the proper administration of the classwide arbitration mechanism "might possibly preserve the essential values of both devices."[130] Additionally, it relied on *Keating* as authority that California already had recoguized the existence of classwide arbitration.[131]

C. Judicial Involvement in Classwide Arbitration

One theme stressed throughout the California state class arbitration cases and, to a lesser extent, in the arbitration consolidation cases, is that of judicial involvement.[132] The issue arises in consideration of classwide arbitration because class actions require great

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125 *Id.* at 946, 225 Cal. Rptr. at 75.

126 186 Cal.App.3d 1309, 231 Cal. Rptr. 315 (1986).

127 *Id.* at 1319, 231 Cal. Rptr. at 320.

128 *Id.* at 1321, 231 Cal. Rptr. at 321.

129 *Id.* These prior cases had ruled that the policy favoring arbitration prevailed over the policy favoring class actions. *Izzy* cited only three cases to show "considerable judicial precedent" against superimposing class actions on arbitration proceedings. First, it cited *Keating* for the proposition that class actions and arbitration inherently are incompatible; a mischaracterization because *Keating* approved classwide arbitration. Second, *Izzy* cited Vernon v. Drexel Burnham & Co., 52 Cal.App.3d 706, 715, 125 Cal. Rptr. 147, 152-53 (1975) ("[T]he policy of law favoring arbitration prevails over the policy of law pertaining to class actions."). The *Vernon* court's three reasons for this conclusion were: 1) arbitration is a favored means of dispute resolution; 2) there is perhaps no higher public policy than to uphold private contracts; and 3) the substantive law of contracts prevails over class actions, which are merely procedural devices. Third, *Izzy* recognized Harris v. Shearson Hayden Stone, Inc., 82 A.D.2d 87, 95, 441 N.Y.S.2d 70, 74-76 (N.Y. App. Div. 1981), *aff'd*, 56 N.Y.2d 627, 450 N.Y.S.2d 482, 435 N.E.2d 1097 (1982) ("[A]rbitration provides a relatively uncostly procedure for resolving . . . dispute[s] . . . . [M]aintenance of a class action here by assertion of a claim for which a forum is provided elsewhere, would defeat the aim of arbitration, and undercut an avowed purpose of the class action itself—the 'conservation of judicial effort.' ").

130 *Izzy*, 186 Cal.App.3d at 1321, 231 Cal. Rptr. at 321.

131 *Id.*

132 *See Keating*, 31 Cal.3d at 613, 645 P.2d at 1209, 183 Cal. Rptr. at 377; *Izzy*, 186

judicial discretion, while arbitrations operate outside the judiciary. Judicial involvement is inappropriate in a pure arbitration setting because the primary rationale of arbitration is to allow an alternative forum to the courts. However, the fact that classwide arbitration is a hybrid device in which the courts would superimpose these two efficiency instruments requires some degree of judicial involvement. In approving the hybrid device, courts must create a middle ground between excessive judicial involvement and a dormant judiciary.

In class actions, courts have a substantial degree of discretion in considering the Rule 23(a) prerequisites,[133] certifying the class,[134] and determining notice requirements.[135] Rule 23 of the Federal Rules of Civil Procedure grants this discretion because class actions present a unique situation in which plaintiffs press their claims without being present in court, relying instead on a class representative. The court's duty, therefore, is to monitor the creation of the class to ensure that the representative adequately supports the interests of each class member according to the requirements of Federal Rule 23.[136]

1. *Due Process Concerns*

The majority of class action participants are absent from the proceedings; thus, the class action device raises due process concerns. These issues arise predominantly in two areas. The first contemplates notice requirements crucial to the scheme of Rule 23(b)(3).[137] Notice informs absentees that their dispute is in litigation so that they can act to protect their interests. "In this way, [notice] guarantees each class member an opportunity to have his day in court or, at least, to oversee the conduct of the action by the representatives."[138] Without such requirements, it would be unconstitutional to enforce a judgment against absent class members.[139]

The second due process issue that courts have raised in class

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Cal.App.3d at 1321, 231 Cal. Rptr. at 321; *Lewis*, 179 Cal.App.3d at 945, 225 Cal. Rptr. at 75.

133 *See supra* notes 76-79 for a discussion of Rule 23(a). For examples of grants of court discretion, see Milonas v. Williams, 691 F.2d 931, 936-38 (10th Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983), and McGowan v. Faulkner Concrete Pipe Co., 659 F.2d 554, 559 (5th Cir. 1981), for a grant of court discretion.

134 FED. R. CIV. P. 23(c)(1).

135 FED. R. CIV. P. 23(c)(2).

136 *See, e.g.*, Bernard v. Gulf Oil Co., 596 F.2d 1249, 1259 (5th Cir. 1979); Handwerger v. Ginsberg, 519 F.2d 1339, 1342 (2d Cir. 1975).

137 7B WRIGHT & MILLER, *supra* note 5, § 1786, at 188. 10b-5 actions based on Federal Rule 23(b)(3) are common. *See supra* note 80 and accompanying text.

138 7B WRIGHT & MILLER, *supra* note 5, § 1786, at 190.

139 Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950); Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 568 (2d Cir. 1968).

actions is whether the class representatives adequately represent the interests of the absent class members.[140] Adequate representation is "especially important in Rule 23(b)(3) actions because the class members are only loosely associated by common questions of law or fact, rather than by any pre-existing or continuing legal relationship."[141]

These same due process concerns would predominate in the classwide arbitration context. In spite of the fact that courts traditionally hesitate to intervene in an arbitral forum, judicial discretion must exist in the classwide arbitration setting if courts are to protect the absent class members' due process rights.

2. *Resolution of the Conflicting Arbitration and Class Action Policies*

a. *Congressional Intent*

The judicial involvement inherent in classwide arbitration[142] directly contradicts the "unmistakably clear congressional purpose [in the FAA] that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts."[143] Admittedly, arbitration is intended to operate outside the jurisdiction of the courts, and class action procedures imposed upon the arbitration setting would undercut some of the benefits of arbitration.[144] However, the legislators who enacted the FAA apparently did not foresee the litigation burdens confronting today's judiciary, the complexity with which litigation has developed, or the implications of the *McMahon* decision. In light of these developments, Congress's inaction on the issue may not necessarily indicate an implied prohibition against classwide arbitration.

b. *The Hybrid Device Still Promotes Expediency*

Judicial involvement in classwide arbitration does not per se negate all the benefits of arbitration. Undoubtedly, some of the advantages of arbitration will be diluted by the imposition of a class structure in which courts actively participate. Courts should avoid unnecessary intrusions that would inhibit arbitration's function as a

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140 *See supra* note 120.

141 7B WRIGHT & MILLER, *supra* note 5, § 1786, at 194.

142 In classwide arbitration, judicial involvement would arise in the form of class certification and due process protection. Courts protect class members' due process rights by invoking notice requirements and scrutinizing the adequacy of representation by the class representatives. For a discussion of three proposed models for classwide arbitration, see *infra* Part IV.E.

143 Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 (1967).

144 *See supra* note 132 and accompanying text.

speedy, economical, and thorough proceeding, with no judicial involvement.[145] However, if the alternative is to compel hundreds or thousands of individual plaintiffs to arbitrate each of their disputes in separate fora, then the prospect of the hybrid classwide arbitration device will offer a "better, more efficient, and fairer solution."[146]

D. The Hybrid Device and the Existing FAA Model are Compatible

Opponents of court-ordered consolidation insist that the absence of express statutory or contractual authority extends consolidation beyond the control of the courts.[147] Ideally, an arbitration should proceed completely independent of the judiciary. Inevitably, however, cases arise in which court involvement is necessary "to effectuate the arbitration agreement or the arbitrators's actions under the agreement."[148] For example, courts are empowered to enforce arbitration clauses[149] and sometimes appoint arbitrators.[150] There also are provisions for limited judicial review of arbitral awards.[151] Such judicial discretion appears to be warranted in the face of complex multiparty disputes. Thus, while limitations on court participation in arbitration proceedings clearly are desirable, such restraints should not interfere with judicial efforts to advance the goals of arbitration—speed, economy, finality, and the liberal enforcement of arbitration agreements.[152]

E. A Classwide Arbitration Model

> *"Classwide arbitration, as Sir Winston Churchill said of democracy, must be evaluated, not in relation to some ideal but in relation to its alternatives."*[153]

Court approval of the classwide arbitration device requires constructing a model for how such proceedings should evolve. Arbitrating as a class will necessitate some degree of judicial intervention at the outset to allow courts to monitor the certification process. Once the class is certified, the class representative will ap-

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145 *Izzy*, 186 Cal.App.3d 1321, 231 Cal. Rptr. at 321.

146 Keating v. Superior Court, 31 Cal.3d 584, 613, 645 P.2d 1192, 1209, 183 Cal. Rptr. 360, 377 (1982), *rev'd on other grounds sub nom.* Southland Corp. v. Keating, 465 U.S. 1 (1984).

147 Stipanowich, *supra* note 107, at 509.

148 *Id.*

149 9 U.S.C. §§ 2-4 (1982).

150 9 U.S.C. § 5 (1982).

151 9 U.S.C. §§ 9-12 (1982).

152 Stipanowich, *supra* note 107, at 512.

153 *Keating*, 31 Cal.3d 584, 613, 645 P.2d 1192, 1209, 183 Cal. Rptr. 360, 377.

pear before the arbitration panel as the champion of her class. Classwide arbitration, however, may sacrifice due process protections if court involvement in the proceedings decreases or ceases upon certification.

Three options should be considered with respect to court involvement in classwide arbitration proceedings. First, the certifying court could decide interlocutory appeals on questions of the adequacy of class proceedings in arbitration. One of the judiciary's due process responsibilities is to "undertake a stringent and continuing examination of the adequacy of representation by the named class representatives at all stages of the litigation."[154] Such appeals would surely delay the arbitration process and detract from its efficiency and economy. However, the advantages to plaintiffs of bringing 10b-5 claims as class actions remain.[155]

The second option may prove more protective of arbitration's efficiency. Once the court certifies the class, the arbitration can proceed without any appeals as to the adequacy of the class. Thus no judicial involvement during the arbitration will occur. To the extent that absent class members are concerned about the failure to meet any of the Rule 23(a) requirements, they can appeal these issues to the certifying court at the conclusion of the arbitration.

If a court finds, for example, that the class representative did not adequately represent the class, it can nullify the arbitration ruling as against the class. The ruling will stand with respect to the class representative, but not with respect to other plaintiffs' claims. Because the class representative would likely have arbitrated her claim individually had she not championed the class, the arbitration proceeding will have been worthwhile even if it is adjudged ineffective as against the entire class. The class members who the court subsequently removes from the arbitration may then proceed individually or establish a new class. This model avoids court intervention during the actual arbitration, but sanctions such involvement before and after the proceedings.

The third option is arguably the most efficient method for the hybrid arbitration. This model would allow the arbitrators alone to oversee the certification process. Such a model might allay the skepticism of arbitration purists who insist that court involvement and arbitration are mutually exclusive. It is not viable, however, if courts adequately are to protect plaintiffs' interests; due process issues connected with class action aspects of classwide arbitration are

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154 National Ass'n of Regional Medical Programs, Inc. v. Mathews, 551 F.2d 340, 344 (D.C. Cir. 1976), *cert. denied, sub. nom.* National Ass'n of Regional Medical Programs, Inc. v. Califano 431 U.S. 954 (1977).

155 *See supra* notes 72-94 and accompanying text.

simply too important to be relegated to arbitrators. While the panelists in a 10b-5 arbitration may be experts in securities regulation, they are not experts in the constitutional concerns attached to class certification.[156] As a result, they cannot ensure the fairness of the proceedings to all absent class members.

Moreover, the FAA does not require arbitrators to give reasons or create records for their findings.[157] Therefore, the courts' traditional outsider status in arbitration notwithstanding, court involvement must exist in the classwide arbitration setting in order to attain the optimum balance between efficiency for the parties and courts, and procedural due process for the plaintiffs.

The second option—arbitration without court involvement during the actual proceedings, but with class certification hearings at the filing of the action and a freer appeals process at the close of the arbitration—presents the most effective means of protecting all interests involved. Conceivably, intermittent appeals during the course of a classwide arbitration (the first model described above) may be too inapposite to arbitration policy to gain judicial and/or congressional approval. On the other hand, the second option supports the current arbitration process, and argues only for class action rights on both ends of arbitration proceedings. This option retains the integrity of arbitration and class action proceedings. Thus, courts will be more likely to approve the hybrid device if this model is adopted.

CONCLUSION

The *McMahon* decision dramatically changed the face of dispute resolution in 10b-5 actions. In the past, all plaintiffs adjudicated their lawsuits if they so desired, and did so either individually or as a class. In the wake of *McMahon*, plaintiffs, upon signing customer

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156 One commentator noted that

> [t]here are no strict qualifications to serve as an arbitrator—it is not necessary to be an attorney, although legal training is evidently helpful. The most important quality is expertise in the subject of the dispute, both in the knowledge of how problems arise as well as how best to resolve them.

T. OEHMKE, COMMERCIAL ARBITRATION § 9:4, at 162-63 (1987). This passage suggests that arbitrators in securities disputes will be unqualified to resolve due process issues in classwide arbitration. In fact, allowing arbitrators to do so might, in itself, deprive plaintiffs of due process. Oehmke writes that

> *[t]he arbitrator is not bound by rules of law, evidence, or procedure* unless the parties specifically provide. The arbitrator is free to follow the broader principles of equity. In some cases, where the rule of law is clear, arbitrators may be mandated to follow it, but these situations are the exception. Fairness, as a basic premise, governs.

Id. § 2:7, at 27-28 (emphasis added).

157 *See* Bernhardt v. Polygraphic Co., 350 U.S. 198, 203-04 & n.4 (1956). *See also supra* note 18 and accompanying text.

agreements with arbitration clauses, now encounter compulsory arbitration of all claims arising under the Exchange Act. Thus courts must consider whether *McMahon*, by precluding adjudication in such instances, also precluded the opportunity for class action proceedings. Court approval of a hybrid classwide arbitration device in 10b-5 actions is most likely to protect plaintiffs' interests. While such a device is not completely devoid of judicial involvement, as arbitration customarily is, the classwide arbitration device is an untraditional mode of dispute resolution. The ultimate solution lies in the hands of Congress, which should signal support for the device by amending the FAA. Until such time, however, the judiciary must continue to search for the proper medium between efficiency and equity. In the 10b-5 context, the classwide arbitration device would serve both goals.

Daniel R. Waltcher