

WHAT MAKES SECURITIES ARBITRATION DIFFERENT FROM OTHER CONSUMER AND EMPLOYMENT ARBITRATION?

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Securities arbitration is, in some respects, similar to consumer and employment arbitration. Just as many businesses in a variety of industries present their customers with take-it-or-leave-it arbitration agreements, many securities firms also insist that their customers agree to arbitrate as a condition of doing business. In addition, just as many employers in a variety of industries present their employees with take-it-or-leave-it arbitration agreements, many securities firms also insist that their employees agree to arbitrate as a condition of employment. In short, consumer and employment arbitration in the securities industry arise out of “adhesion” contracts, just as consumer and employment arbitration in many industries arise out of adhesion contracts. Therefore, much of the debate over adhesive arbitration applies to securities arbitration. I have participated extensively in the debate over adhesive arbitration,¹ and will not rehash my views here. Instead, this Article explores how securities arbitration differs from other adhesive arbitration. This short piece emphasizes what makes consumer and employment arbitration in the securities industry different from

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1. Stephen J. Ware, *Arbitration Law’s Separability Doctrine After Buckeye Check Cashing Inc. v. Cardegna*, 8 NEV. L.J. 107 (2008); Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251 (2006) [hereinafter Ware, *The Case for Enforcing*]; Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses, and Other Contractual Waivers of Constitutional Rights*, 67 LAW & CONTEMP. PROBS. 167 (2004) [hereinafter Ware, *Arbitration Clauses, Jury-Waiver Clauses*]; Stephen J. Ware, *Contractual Arbitration, Mandatory Arbitration and State Constitutional Jury-Trial Rights*, 38 U.S.F. L. REV. 39 (2003); Stephen J. Ware, *Consumer and Employment Arbitration Law in Comparative Perspective: The Importance of the Civil Jury*, 56 U. MIAMI L. REV. 865 (2002); Stephen J. Ware, *Arbitration Under Assault: Trial Lawyers Lead the Charge*, CATO INST. POL’Y ANALYSIS, Apr. 18, 2002, available at <http://www.cato.org/pubs/pas/pa-433es.html>; Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89; Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735 (2001); Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703 (1999); Stephen J. Ware, *Consumer Arbitration as Exceptional Consumer Law (with a Contractualist Reply to Carrington & Haagen)*, 29 MCGEORGE L. REV. 195 (1998); Stephen J. Ware, *Arbitration and Unconscionability after Doctor’s Associates, Inc. v. Casarotto*, 31 WAKE FOREST L. REV. 1001 (1996); Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83 (1996) [hereinafter Ware, *Employment Arbitration and Voluntary Consent*].

consumer and employment arbitration generally. I begin with arbitration between the securities industry and its customers and then turn to arbitration between the industry and its employees.

I. CONSUMER (INVESTOR) ARBITRATION

Arbitration of disputes between a member of the securities industry and its customers (investors) is, in one important respect, different from other consumer arbitration. Appreciating this difference requires a basic understanding of the securities industry's regulatory environment.² Most securities trades are conducted by securities "brokers"³ or "dealers."⁴ The Securities Exchange Act of 1934⁵ (Exchange Act) requires broker-dealers to register with the Securities and Exchange Commission (SEC) as a condition of doing business.⁶ The Exchange Act also requires broker-dealers to register with, and submit to the rules of, a Self Regulatory Organization (SRO) as a condition of doing business.⁷ The SEC has authority to regulate broker-dealers,⁸ but the

2. The following discussion borrows heavily from Ware, *Employment Arbitration and Voluntary Consent*, *supra* note 1, at 146–48, but the citations have been updated to the present.

3. "The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A) (Supp. IV 2004).

4. "The term 'dealer' means any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise, [but] does not include a person that buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business," or a bank engaged in "certain bank activities." *Id.* § 78c(5)(A)–(C).

5. 15 U.S.C. §§ 78a–78nn (2000 & Supp. IV 2004).

6. The Exchange Act provides that:

It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with subsection (b) of this section.

Id. § 78o(a)(1). "Since it was assumed that the exchange would establish careful high standards for entry and continuance in membership, [this provision] excluded from the registration requirements brokers who confine [] their activities solely to a registered securities exchange." SHELDON M. JAFFE, *BROKER-DEALERS AND SECURITIES MARKETS* § 2.04, at 19–20 (1977). And there are other exemptions from registration. See THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* §§ 14.4–14.6, at 631–35 (rev. 5th ed. 2006).

7. The Exchange Act provides that:

It shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than or [sic] commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to section 78o-3 of this

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bulk of the day-to-day regulation of broker-dealers is generally delegated to SROs by the SEC.⁹

The SRO that a broker-dealer must join may be either “a securities association registered pursuant to [the Exchange Act]”¹⁰ or “a national securities exchange,”¹¹ which means an exchange registered pursuant to the Exchange Act.¹² Only one securities association is registered under the Exchange Act: the Financial Industry Regulatory Authority (FINRA).¹³ There are ten national securities exchanges.¹⁴

While FINRA—the result of a July 2007 merger between the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE)—in some ways resembles a private trade association and the securities exchanges originated as private institutions, both FINRA and the exchanges have lost much of their private character.¹⁵

title or effects transactions in securities solely on a national securities exchange of which it is a member.

15 U.S.C. § 78o(b)(8). *But see* 17 C.F.R. 240.15b9-1 (2007) (creating exemptions from registration requirements of the Exchange Act).

8. 15 U.S.C. § 78o.

9. HAZEN, *supra* note 6, § 14.3[3], at 615.

10. 15 U.S.C. § 78o(b)(8).

11. *Id.*

12. The rules governing national securities exchanges can be found in 15 U.S.C. § 78f.

13. Definitions of Terms and Exemptions Relating to the “Broker” Exceptions for Banks, Exchange Act Release No. 56,501, 72 Fed. Reg. 56,514-01, 56,545 n.319 (Oct. 3, 2007). FINRA is the result of the National Association of Securities Dealers (NASD) consolidating with the New York Stock Exchange’s (NYSE) “member regulation, enforcement and arbitration functions.” FINRA, About the Financial Regulatory Authority, <http://www.finra.org/AboutFINRA/CorporateInformation/index.htm> (last visited Mar. 4, 2008). The SEC approved the merger of NASD and NYSE on July 26, 2007. Order Approving Consolidation of the Member Firm Regulatory Functions of NASD and NYSE Regulation, Inc., 72 Fed. Reg. 42,169 (Aug. 1, 2007), available at http://www.finra.org/web/groups/rules_regs/documents/rule_filing/p036359.pdf.

See also Press Release, NASD, Testimony of Mary L. Schapiro, NASD Chairman and CEO, Before the Senate Committee Hearing on Consolidation of NASD and the Regulatory Functions of the NYSE: Working Towards Improved Regulation (May 17, 2007), available at <http://www.finra.org/PressRoom/SpeechesTestimony/MaryL.Schapiro/p019169>; HAZEN, *supra* note 6, § 14.1[3][C][2], at 612.

14. SEC, National Securities Exchanges, <http://www.sec.gov/answers/exchanges.htm> (last visited Sept. 13, 2006). The ten exchanges include the American Stock Exchange, Boston Stock Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, International Securities Exchange, National Stock Exchange (formerly the Cincinnati Stock Exchange), Nasdaq Stock Market, L.L.C., New York Stock Exchange, NYSE Arca (formerly the Pacific Exchange), and the Philadelphia Stock Exchange. *Id.* The only other SRO, the Municipal Securities Rulemaking Board (MSRB), is for municipal securities dealers. *See* HAZEN, *supra* note 6, § 14.7, at 635–36. Additionally, as a result of the Commodity Futures Modernization Act of 2000, new exchanges likely will be recognized for the limited purpose of trading securities futures products. *See* HAZEN, *supra* note 6, § 14.3[3], at 616.

15. *See Silver v. New York Stock Exch.*, 373 U.S. 341, 350–52 (1963):

The limited-entry feature of exchanges led historically to their being treated by the courts as private clubs, and to their being given great latitude by the courts in disciplining errant

The SROs now have many of the characteristics of government agencies. An SRO may not come into existence without SEC approval,¹⁶ and the SEC has oversight responsibility over the SROs.¹⁷ The SROs must file their proposed rule changes with the SEC,¹⁸ and no SRO rule change can take effect unless the SEC finds that the proposed rule is consistent with the requirements of the Exchange Act.¹⁹ The SEC even has the power to “abrogate, add to, and delete from . . . the rules of a[n] [SRO]”.²⁰ In fact, many changes in the SRO rules governing arbitration have been made “largely in response to” SEC initiatives.²¹

In short, federal law restricts entry into the securities business to those who comply with SRO rules. To be a broker-dealer without complying with SRO rules is illegal. Therefore, SRO rules are governmental barriers to entry into the securities business. This is significant with respect to arbitration because all SRO rules require broker-dealers to arbitrate customer disputes upon customer request.²² In other words, to

members. As exchanges became a more and more important element in our Nation's economic and financial system, however, the private-club analogy became increasingly inapposite and the unregulated self-regulation became more and more obviously inadequate, with acceleratingly grave consequences. This impotency ultimately led to the enactment of the 1934 Act.

...

Thus arose the federally mandated duty of self-policing by exchanges. Instead of giving the Commission the power to curb specific instances of abuse, the Act placed in the exchanges a duty to register with the Commission, and decreed that registration could not be granted unless the exchange submitted copies of its rules, and unless such rules were “just and adequate to insure fair dealing and to protect investors.”

Id. (citations omitted).

16. See 15 U.S.C. § 78f (2000 & Supp. IV 2004) (governing registration as a national securities exchange); *id.* § 78o-3 (governing NASD, the predecessor to FINRA).

17. See *id.* § 78o-3 (with respect to the NASD); *id.* § 78s (with respect to exchanges/SROs).

18. See *id.* § 78s(b)(1).

19. See *id.* § 78s(b)(2).

20. *Id.* § 78s(c).

21. Order Approving Proposed Rules Changes by the NYSE, NASD AMEX Relating to the Arbitration Process and the Use of Pre-dispute Arbitration Clauses, Exchange Act Release No. 26,805, 43 SEC Docket 1250, 1251 (May 10, 1989).

22. See, e.g., NASD CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES, R. 12200 (Nat'l Ass'n Sec. Dealers, Inc. 2007):

Parties must arbitrate a dispute under the Code if:

Arbitration under the Code is either:

- (1) Required by a written agreement, or
- (2) Requested by the customer;

The dispute is between a customer and a member or associated person of a member; and
The dispute arises in connection with the business activities of the member or the associated person, except disputes involving the insurance business activities of a member that is also an insurance company.

Id.; NYSE RULES, R. 600(a) (New York Stock Exch. 2007) (“Any dispute, claim or controversy

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engage in the securities business, a firm must submit to arbitration. Securities firms are legally required to arbitrate.

This is a major difference between securities arbitration and other arbitration.²³ While the law imposes on securities broker-dealers a duty to arbitrate customer disputes, the law does not do this to businesses in other industries that use consumer arbitration. If a bank that has issued a credit card, for example, is arbitrating consumer disputes, that is because the bank contracted to do so.²⁴ If a computer business or a pest-control business is arbitrating consumer disputes, that is because that business

between a customer or non-member and a member, allied member, member organization and/or associated person arising in connection with the business of such member, allied member, member organization and/or associated person in connection with his activities as an associated person shall be arbitrated under the Rules of the Exchange as provided by any duly executed and enforceable written agreement or upon the demand of the customer or non-member.”)

“[M]ost arbitration clauses specify that any and all disputes shall be arbitrated pursuant to rules of NASD or the NYSE. Collectively, the NASD and NYSE handle about ninety-nine percent of securities arbitrations, with over ninety percent of the cases proceeding through the NASD forum.” Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123, 132 (2005). Professor Poser observed:

The NYSE Constitution of 1869 not only provided for arbitration of “all claims and matters of difference” between members but also gave non-members the right to arbitrate disputes with members if they agreed to abide by the rules of the Exchange. . . .

The NASD first offered arbitration facilities to the public in 1968, on a voluntary basis only. Disputes could be arbitrated only if all parties agreed to arbitrate after the dispute arose. In 1972, arbitration became mandatory for NASD members: Public customers could require brokers who were NASD members to arbitrate securities controversies by virtue of the NASD’s arbitration rules. Thus, the rules of the two principal SROs required their members to arbitrate disputes with customers, but customers had the option, at the time the dispute arose, of arbitrating or litigating in court.

Brokerage firms used written agreements in order to require their customers to arbitrate future disputes arising out of their relationship. In 1953, however, the Supreme Court held in *Wilko v. Swan* that agreements to arbitrate future disputes under the federal securities laws were unenforceable.

Norman S. Poser, *Making Securities Arbitration Work*, 50 SMU L. REV. 277, 281–82 (1996) (citations omitted). Thus, it was not until the late 1980s when *Wilko v. Swan*, 346 U.S. 427 (1953), was reversed by the Supreme Court in *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989), that investors—as well as broker-dealers—were generally obligated to arbitrate. See STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION § 2.27 & nn.292, 303 (2d ed. 2007).

23. One other difference between securities arbitration and other consumer arbitration is with respect to class actions. Outside the securities industry, arbitration clauses (if enforced) can require that claims be brought individually rather than as part of a class. See Ware, *The Case for Enforcing*, *supra* note 1, at 274–81. By contrast, SRO rules provide that class actions are not eligible for arbitration. See NYSE RULES, R. 600(d)(i); NASD CODE OF ARBITRATION PROCEDURE, R. 10301(d)(1) (Nat’l Ass’n Sec. Dealers, Inc. 2007). See, e.g., *Nielsen v. Piper, Jaffray & Hopwood, Inc.*, 66 F.3d 145, 148–49 (7th Cir. 1995) (finding arbitration of class action prohibited by NASD Rules); *Olde Disc. Corp. v. Hubbard*, 4 F. Supp. 2d 1268, 1271 (D. Kan. 1998), *aff’d*, 172 F.3d 879 (10th Cir. 1999) (same). See Matthew Eisler, Note, *Difficult, Duplicative and Wasteful?: The NASD’s Prohibition of Class Action Arbitration in the Post-Bazze Era*, 28 CARDOZO L. REV. 1891 (2007).

24. See, e.g., *Hutcherson v. Sears Roebuck & Co.*, 793 N.E.2d 886 (Ill. App. Ct. 2003).

contracted to do so.²⁵ By contrast, securities broker-dealers are obligated to arbitrate consumer disputes whether they contract to do so or not. While consumer arbitration in other industries is contractual, consumer arbitration in the securities industry is non-contractual for the business.²⁶ The broker-dealer's duty to arbitrate is imposed by law—SRO rule—rather than assumed by contract.

On the other hand, for the consumer, consumer arbitration in the securities industry is every bit as contractual as consumer arbitration in other industries. An investor is obligated to arbitrate securities disputes only if the investor has contracted to do so. The SRO rules do not require the investor to arbitrate.²⁷ They only require broker-dealers to arbitrate if the investor chooses arbitration over litigation.²⁸ In short, the SRO rules give the investor the choice of forum. The rules impose a one-sided duty to arbitrate.

It is against the backdrop of these SRO rules that most broker-dealers present their customers with adhesive arbitration agreements.²⁹ By making the investor's agreement to arbitrate a condition of contracting, a broker-dealer negates the investor's choice of forum because, after the contract is formed, both parties have a duty to arbitrate. Query whether fewer broker-dealers would present their customers with adhesive arbitration agreements if SRO rules stopped imposing on broker-dealers a duty to arbitrate? As it stands, securities industry customers may have a harder time than any other industry's customers in finding a way to do business without an arbitration clause.³⁰ This state of affairs may be an indirect effect of law—SRO rules—that requires broker-dealers to arbitrate customer disputes.

25. *See, e.g.*, *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995) (pest control); *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (computer); *Autonation USA Corp. v. Leroy*, 105 S.W.3d 190, 201 (Tex. Ct. App. 2003) (auto).

26. *See* WARE, *supra* note 22, § 2.55(a), at n.732 (distinguishing contractual from non-contractual arbitration).

27. *See supra* note 22.

28. *See id.*

29. For many years, broker-dealers have generally insisted on arbitration clauses in clauses in margin accounts, *see* U.S. GEN. ACCOUNTING OFFICE, GAO/GGD-92-74, *SECURITIES ARBITRATION: HOW INVESTORS FARE* 31 (1992) (all nine of the largest brokerage firms as well as the vast majority of small and medium size firms require their customers to sign pre-dispute arbitration clauses when opening margin or options accounts), and they have increasingly insisted on them for cash accounts as well. U.S. GEN. ACCOUNTING OFFICE, GAO/GGD-00-115, *SECURITIES ARBITRATION: ACTIONS NEEDED TO ADDRESS PROBLEM OF UNPAID AWARDS* 30 (2000) (six of the nine largest broker-dealers include pre-dispute arbitration agreements for cash accounts as well as margin accounts).

30. *See supra* note 29.

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II. EMPLOYMENT ARBITRATION

Part I of this Article discusses securities law imposing on broker-dealers a non-contractual duty to arbitrate customer disputes. In addition to imposing a duty to arbitrate on broker-dealers, securities law also imposes a duty to arbitrate on certain employees of broker-dealers. Pursuant to SEC mandate,³¹ the rules of each SRO require that certain employees of each of its members register with the SRO.³² I use the term “securities employees” to refer to such employees.³³ The SRO rules require securities employees to sign an arbitration agreement to register with the SRO.³⁴ In other words, to be a securities employee, an

31. 17 C.F.R. § 240.15b7-1 (2007) (adopted May 11, 1993).

32. *See, e.g.*, NASD MEMBERSHIP AND REGISTRATION RULES, R. 1021(a) (Nat'l Ass'n Sec. Dealers, Inc. 2007) (“All persons engaged or to be engaged in the investment banking or securities business of a member who are to function as principals shall be registered as such with NASD in the category of registration appropriate to the function to be performed as specified in Rule 1022.”); *id.* at R. 1031(a) (“All persons engaged or to be engaged in the investment banking or securities business of a member who are to function as representatives shall be registered as such with NASD in the category of registration appropriate to the function to be performed as specified in Rule 1032.”); *id.* at R. 1041(a) (“All persons associated with a member who are to function as Assistant Representatives—Order Processing shall be registered with the Association.”); *id.* at R. 1050(a) (“All persons associated with a member who are to function as research analysts shall be registered with NASD.”). *See also* NYSE RULES, R. 345 (New York Stock Exch. 2007). The NYSE Rules provide:

(a) No member or member organization shall permit any natural person to perform regularly the duties customarily performed by (i) a registered representative, (ii) a securities lending representative, (iii) a securities trader or (iv) a direct supervisor of (i), (ii) or (iii) above, unless such person shall have been registered with, qualified by and is acceptable to the Exchange.

(b) No member or member organization shall permit any natural person, other than a member or allied member, to assume the duties of an officer with the power to legally bind such member or member organization unless such member or member organization has filed an application with and received the approval of the Exchange.

Id.

33. Some commentators use the term “registered representative” to describe these employees. *See, e.g.*, Securities Arbitration Reform: Report of the Arbitration Policy Task Force to the Board of Governors National Association of Securities Dealers, Inc. 113 (Jan. 1996); U.S. GEN. ACCOUNTING OFFICE, GAO/HEHS-94-17, EMPLOYMENT DISCRIMINATION: HOW REGISTERED REPRESENTATIVES FARE IN DISCRIMINATION DISPUTES 7–8 (1994). Technically, however, registered representatives are a subset of the employees required to arbitrate by SRO rules. *See supra* note 32.

34. *See, e.g.*, NASD MEMBERSHIP AND REGISTRATION RULES, R. 1013(a)(2) (requiring securities employees to sign Form U-4 which provides for arbitration of employment disputes); NYSE RULES, R. 345.12 (same). Form U-4 currently provides that the employee “agree[s] to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the SRO indicated in Section 4 (SRO REGISTRATION) as may be amended from time to time and that any arbitration award rendered against me may be entered as a judgment in any court of competent jurisdiction.” NYSE, Revised Form U-4 § 15A(5) (2007), available at http://www.nyse.com/pdfs/CRD_FRM_BlankFormU4.pdf (emphasis omitted). “Until 1998, SROs required arbitration for all employment disputes between broker-dealers and registered representatives. A 1998 NASD rule change

individual must submit to arbitration even if neither the employee nor the employer wants to condition employment on the employee assuming a duty to arbitrate.

This is a major difference between arbitration in the securities industry and arbitration in other industries. In other industries, if neither the employee nor the employer wants to condition employment on the employee assuming a duty to arbitrate, then they get what they want: the employee is hired without a duty to arbitrate. In those industries, if an employee has a duty to arbitrate, then the employee must have assumed that duty by forming a contract containing an arbitration clause. In most industries, an employee's duty to arbitrate is plainly contractual. By contrast, the securities employee's duty to arbitrate is better classified as non-contractual, even though the securities employee assumes this duty by forming a contract containing an arbitration clause.

Many examples of "non-contractual" arbitration do involve a contract, such as an employment contract or a contract for the sale of an automobile. So in these contexts the duty to arbitrate is, in a sense, assumed by contract. The difference between "contractual" and "non-contractual" arbitration is whether it is possible to form a contract of the relevant sort without assuming the duty to arbitrate. For example, in transportation industries governed by the Railway Labor Act, it is not possible to form an employment contract without assuming the duty to arbitrate. In contrast, it is possible to form such an employment contract elsewhere in the private sector. Accordingly, transportation employment arbitration is "non-contractual," while other labor and employment arbitration is "contractual."³⁵

What has just been said about transportation employees governed by the Railway Labor Act is also true of securities employees. Forming a contract of the relevant sort (securities employment) without assuming the duty to arbitrate is impossible. This, I have argued,

is a baseline that should be changed. Employers and employees who each consent to an employment contract without an arbitration clause should have the right to form such a contract regardless of the industry they are in. The baseline in the [securities industry] compels employees and employers to choose between their right to litigate employment disputes and their wish to pursue their livelihoods in a particular industry. They should not be put to that choice.

exempted statutory discrimination claims from compulsory arbitration. Shortly after this rule change, the NYSE and numerous other exchanges adopted the NASD rule." Sarah Rudolph Cole, *Fairness in Securities Arbitration: A Constitutional Mandate?*, 26 PACE L. REV. 73, 77-78 (2005) (citing Order Granting Approval to Proposed Rule Change Relating to the Arbitration of Employment Discrimination Claims, Exchange Act Release No. 40,109, 67 SEC Docket 824 (June 22, 1998)).

35. See WARE, *supra* note 22, § 2.55(a), at n.647.

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The freedom “to engage in any of the common occupations of life” is part of the “liberty” protected by the Fourteenth Amendment. It cannot, therefore, be deprived without due process of law. It is now routinely deprived, however, with due process of law, by occupational licensing laws. A law of the sort [governing the securities industry] is an occupational licensing law. It conditions a license to engage in the pertinent occupation on the relinquishment of one’s right to litigate employment disputes. I contend that occupational licensing laws ought not to include, among the conditions for receiving a license, an agreement to arbitrate employment disputes.³⁶

Supporting this contention is the fact that an agreement to arbitrate waives a constitutional right, the right to jury trial.³⁷ Thus securities law requires parties to sacrifice a constitutional right as a condition of engaging in a particular occupation. That this has not been held unconstitutional may reflect the contemporary weakness of the right “to engage in any of the common occupations of life,” and the corresponding strength of occupational licensing as an exercise of the “police power” likely to survive constitutional challenge.³⁸

36. Ware, *Employment Arbitration and Voluntary Consent*, *supra* note 1, at 145 (citations omitted).

37. Ware, *Arbitration Clauses, Jury-Waiver Clauses*, *supra* note 1, at 169–70. While the Seventh Amendment is one of the few amendments in the Bill of Rights that constrains only federal, not state, government, *see* *Curtis v. Loether*, 415 U.S. 189, 192 n.6 (1974), nearly all state constitutions contain a provision that similarly protects the right to trial by jury. *See* Martin H. Redish, *Legislative Response to Medical Malpractice Insurance Crisis: Constitutional Implications*, 55 TEX. L. REV. 759, 797 (1977).

The Seventh Amendment, preserving the right to jury trial, and most state constitutional provisions recognizing this right, were enacted prior to the merger of law and equity. Courts generally interpret these constitutional provisions to confer a jury trial right only in cases arising at law, as opposed to cases in equity. *See, e.g.*, *Feltner v. Columbia Pictures Television, Inc.*, 523 U.S. 340, 347–48 (1998); *Marseilles Hydro Power, LLC v. Marseilles Land & Water Co.*, 299 F.3d 643 (7th Cir. 2002); *State ex rel. Diehl v. O’Malley*, 95 S.W.3d 82 (Mo. 2003); *Motor Vehicle Mfrs. Ass’n v. State*, 550 N.E.2d 919 (N.Y. 1990). That means, basically, that there is a right to a jury trial of claims for money damages, but not claims for equitable remedies like injunctions and specific performance.

38. On the history of this right, *see generally* RICHARD A. EPSTEIN, *BARGAINING WITH THE STATE* 196–202 (1993); James W. Ely, Jr., “*To Pursue Any Lawful Trade or Avocation*”: *The Evolution of Unenumerated Economic Rights in the Nineteenth Century*, 8 U. PA. J. CONST. L. 917 (2006); Wayne McCormack, *Economic Substantive Due Process and the Right of Livelihood*, 82 KY. L.J. 397 (1993–1994); Michael J. Phillips, *Entry Restrictions in the Lochner Court*, 4 GEO. MASON L. REV. 405 (1996); Timothy Sandefur, *The Right to Earn a Living*, 6 CHAP. L. REV. 207, 211–17 (2003).

In a constitutional challenge to the securities occupational licensing requirement of arbitration, perhaps the most favorable Supreme Court precedent is *Schwabe v. Board of Bar Examiners*, 353 U.S. 232 (1957), in which the state denied a license to practice to law on the ground of the applicant’s past arrests, use of aliases, and affiliations with the Communist Party. *Id.* at 234–38. I would like to read *Schwabe* as holding that government cannot require an individual to waive First Amendment rights to obtain an occupational license, and then argue that the same analysis should apply to a Seventh Amendment right. But *Schwabe* was not decided as a First Amendment case. Instead, the denial of the license was found to be in violation of due process, as the Court held that “any qualification

Of course, the Constitution generally restricts only state action, not private action. If all the employers in the securities industry—acting independently, rather than through SROs—chose to condition employment on an agreement to arbitrate, then those employers would be forcing employees to choose between their constitutional jury-trial right and their right “to engage in any of the common occupations of life.”³⁹ But this would be constitutional because of the absence of state action.⁴⁰ By contrast, I have argued (and continue to believe) that the SROs are state actors insofar as they require securities employees’ contracts of employment to contain arbitration clauses.⁴¹ In my view, the SROs are establishing the requirements to engage lawfully in a particular occupation. Thus they are exercising a governmental power, occupational licensing. I continue to believe occupational licensing requirements imposing arbitration should be repealed.⁴²

must have a rational connection with the applicant’s fitness or capacity to practice law” to satisfy the Due Process Clause of the Fourteenth Amendment. *Id.* at 239. Does an agreement to arbitrate have a rational connection with an applicant’s fitness to serve as a securities employee? *See also* *Standard Airlines, Inc. v. Civil Aeronautics Bd.*, 177 F.2d 18, 20 (D.C. Cir. 1949) (“The Government cannot make a business dependent upon a permit and make an otherwise unconstitutional requirement a condition to the permit.”); *White v. Franklin*, 637 F. Supp. 601, 612 (N.D. Miss. 1986) (“Issuance of a license or certification which is a prerequisite to engaging in certain employment could not be conditioned upon waiver of constitutional rights and any such condition would be void”) (dicta citing *Standard Airlines*, 177 F.2d at 20–21).

39. This would not trouble me as a matter of policy. *See* Ware, *Employment Arbitration and Voluntary Consent*, *supra* note 1, at 139–45.

40. Sarah Rudolph Cole, *Arbitration and State Action*, 2005 B.Y.U. L. REV. 1, 5. *But see* Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court’s Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1, 40–47 (1997); Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577, 631–41 (1997).

41. I reached this conclusion in 1996, *see* Ware, *Employment Arbitration and Voluntary Consent*, *supra* note 1, at 145–46, 149–55. Since then, at least one court and one scholar have done likewise. *See* *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182, 1201 (9th Cir. 1998), *overruled on other grounds by* *EEOC v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742 (9th Cir. 2003) (“as a government-mandated ‘condition to any participation in a . . . securities career,’ the current [post-1993] requirement that new employees register with a national securities exchange ‘constitutes government action of the purest sort.’”) (quoting *Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995)); Cole, *supra* note 40, at 3, 28–39 (“This article will demonstrate that, at least in the securities industry, since the SEC imposes a requirement that brokers and dealers register with a private self-regulatory organization (SRO), state action is present when SROs mandate that brokers and dealers participate in arbitration.”); Sarah Rudolph Cole, *Fairness in Securities Arbitration: A Constitutional Mandate?*, 26 PACE L. REV. 73, 82 (2005) (“For registered representatives beginning employment since 1993, the SEC is effectively mandating participation in arbitration for disputes that arise during the course of employment. While the agreement to arbitrate is contained in a private contract with an SRO, the mandatory registration requirement, when considered together with the lack of dispute resolution alternatives available to registered representatives, transforms the SRO mandatory arbitration process into state action.”). *See also* Karl E. Neudorfer, *Defining Due Process Down: Punitive Awards and Mandatory Arbitration of Securities Disputes*, 15 OHIO ST. J. ON DISP. RESOL. 207, 231–40 (1999).

42. In addition to repeal of SROs’ arbitration requirements, I would like to see repeal of state bar

III. CONCLUSION

Securities law imposes non-contractual duties to arbitrate on both broker-dealers and securities employees. Is the policy of imposing non-contractual arbitration on employers (broker-dealers) any better than the policy of imposing it on employees? Perhaps it is for those inclined to see “little guys,” rather than business, as victims.⁴³ But I believe governmental imposition of non-contractual duties to arbitrate is bad policy, regardless of the victim’s status as a worker or a capitalist.⁴⁴ These laws are bad policy because they restrict contractual freedom. I have long argued that the law should enforce contractual arbitration clauses,⁴⁵ not so much because of the virtues I see in arbitration, but because of the virtues I see in each party’s freedom to choose whether or not to obligate itself to use arbitration. Law *requiring* arbitration clauses in the customer agreements of all the businesses in an industry restricts contractual freedom as much as law *prohibiting* arbitration clauses in customer agreements. Similarly, law requiring arbitration clauses in the employment agreements of all the businesses in an industry restricts contractual freedom as much as law prohibiting arbitration clauses in employment agreements. The law should neither require nor prohibit arbitration clauses. It should leave them to the parties. In sum, securities law requiring arbitration clauses should be repealed. Securities arbitration should be contractual, like other arbitration.

requirements that lawyers arbitrate their clients’ claims of legal malpractice. See WARE, *supra* note 22, § 2.55(b)(7) (citing cases upholding such requirements).

43. See Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court’s Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 637 (1996) (contrasting “[l]arge companies such as banks, hospitals, brokerage houses[,] and even pest exterminators” with “customers, employees, franchisees [,] and other little guys”); Jean R. Sternlight, *In Defense of Mandatory Binding Arbitration (if Imposed on the Company)*, 8 NEV. L.J. 82 (2007).

44. While the policy of imposing non-contractual arbitration is wrong in both contexts, the constitutional case for reversing it must overcome more difficult state-action precedents in the context of securities-customer arbitration. See *Perpetual Sec., Inc. v. Tang*, 290 F.3d 132, 138 (2d Cir. 2002) (“It is clear that NASD is not a state actor and its requirement of mandatory arbitration is not state action.”); *Desiderio v. Nat’l Ass’n of Secs. Dealers, Inc.*, 191 F.3d 198, 207 (2d Cir. 1999) (same). By contrast, the Ninth Circuit’s discussion of state action in the context of securities-employment arbitration is more promising. See *Duffield*, 144 F.3d at 1200–02 (“as a government-mandated ‘condition to any participation in a . . . securities career,’ the current [post-1993] requirement that new employees register with a national securities exchange ‘constitutes government action of the purest sort.’”) (quoting *Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995)). For an excellent analysis of the relevant caselaw, see Cole, *Arbitration and State Action*, *supra* note 40, at 28–39.

45. See *supra* note 1.