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Arbitration of Investors' Claims Against Issuers: An Idea Whose Time Has Come?

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I. Introduction

Arbitration of investors' claims against issuers has been "an idea whose time has come" for over twenty years, ever since the U.S. Supreme Court, in *Shearson/American Express, Inc. v. McMahon*[1] and *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[2] articulated a national policy in favor of arbitration and, overturning long-standing precedent, held that arbitration provisions contained in brokerage customers' agreements were enforceable with respect to federal securities claims. Following those decisions, arbitration of disputes between individual investors and brokerage firms before the SRO forums became the customary method of resolution; in contrast, because SRO forums did not accept class and derivative claims, investors remained free to bring those claims in court.[3] Some academics and practitioners sought to expand the use of mandatory

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[1] 482 U.S. 220 (1987).

[2] 490 U.S. 477 (1989).

[3] FINRA (and its predecessors NYSE and NASD) has never opened its forum to class or derivative actions against brokerage firms, and brokerage firms cannot require customers to waive class or derivative claims, FINRA Rule 12204, NASD Conduct Rule 3110(f)(4)(C), (5) (effective through Dec. 4, 2011), FINRA Rule 2268 (effective Dec. 5, 2011). For judicial interpretations of earlier versions of the NASD rule, see In re Piper Funds, 71 F.3d 298, 302 (8th Cir. 1995), Nielsen v. Piper Jaffray, 66 F.3d 145, 147 (7th Cir. 1995). For cases applying the comparable rule for industry arbitrations, see Good v. Ameriprise Finan., Inc., 2007 WL 628196 (D. Minn. Feb. 8, 2007), Clark v. First Union Sec., Inc., 153 Cal. App. 4th 1595 (2d Dist. 2007).

FINRA has stated two reasons for its position on class actions. One is based on pragmatic concerns: "the judicial has already developed the procedures to manage class action claims. Entertaining such claims through arbitration at [FINRA] would be difficult, duplicative and wasteful." Exch. Act Rel. 34-3171 (Oct. 28, 1992). FINRA's second reason is policy-oriented: "class actions are better handled by the courts and that investors should have access to the courts to resolve class actions efficiently." *Id*. It is not clear

arbitration to encompass investors' claims against publicly traded issuers. Accordingly, proposals were floated to include in an issuer's governance documents a provision that would require arbitration of investors' claims against the issuer, including federal securities claims and breach of fiduciary duty claims, both direct (individual and class) and derivative.[4] Additional proposals were put forward in the post-Private Securities Litigation Reform Act of 1995 (PSLRA) deregulatory climate.[5] All proponents emphasized the traditional benefits of arbitration, *i.e.*, a faster, less expensive, more flexible dispute resolution process by arbitrators possessing expertise in the subject matter. Many also advocated for arbitration as an antidote to perceived abuses of federal securities class actions.[6]

Publicly traded issuers and their counsel, however, did not seriously pursue any of these proposals, probably because of several legal obstacles. First, there was doubt about the legality and enforceability under state corporate law of an arbitration provision contained in an issuer's governance documents. Second, there was also doubt whether such a provision was an "agreement" that courts would enforce under Federal Arbitration Act (FAA) §2.[7] Third, SEC staff took the position that an arbitration provision in

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whether the FINRA intended to prevent broker-dealers from designating another arbitration forum for class actions, although a federal district court ruled that it did not prevent a brokerage firm that specified the AAA as an alternative forum in its arbitration clause from requiring class arbitration before the AAA after NASD declined to exercise jurisdiction. Levitt v. Lipper Convertibles. [cite] With respect to shareholders' derivative claims, FINRA and its predecessors have consistently taken the position that these claims "are not eligible for arbitration at NASD because, by definition, they involve corporate governance disputes that do not arise out of or in connection with the business of a member firm or an associated person." Rel. 34-51856 (June 15, 2005). See also In re Salomon Inc. Shareholders Deriv Litig. (SDNY Sept. 30, 1994); Diana v. MLPFS, S.D.N.Y. Oct. 5, 1977.

[4] Coffee, Shell, Schneider.

[5] Committee on Capital Markets Regulation, Moscow, Schumer-Bloomberg Report, Bartlett, U.S. Chamber of Commerce, Bondi, Ramirez.

[6] All those in note 4 except Ramirez, who advocated arbitration because of the obstacles created by PSLRA.

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governance documents would violate Securities Act §14[8] and Securities Exchange Act §29(a),[9] the anti-waiver provisions.[10] In addition, although business interests continued to rail against federal securities class actions in the post-PSLRA era, that statute imposed significant obstacles on plaintiffs who bring federal securities fraud litigation in order to achieve the statute's twin goals of "curb[ing] frivolous lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims."[11] As a result, it was hard to see how relocating federal securities fraud claims to a more flexible, less law-oriented arbitration forum would provide any advantages to corporate defendants. In addition, issuers could expect that adoption of an arbitration provision would expose them to criticism from investor advocates and negative publicity.[12] Taking into account all these factors, the costs of adopting an arbitration provision likely outweighed any benefits. Accordingly, few publicly traded corporate issuers took the bold step of adopting arbitration provisions in their governance documents.

In recent years, however, there have been significant legal developments that, for the first time, make inclusion of an arbitration provision in a publicly traded issuer's governance documents a proposal worthy of serious consideration. First, while there continues to be legal uncertainty about the legality and enforceability of arbitration provisions contained in corporate governance documents, a recent Delaware Chancery Court opinion suggests that certificates of incorporation of publicly traded Delaware

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[10] Another obstacle was that only after Green Tree Financial Corp. v. Bazzle, 539 U.S. 444 (2005), discussed *infra* notes and accompanying text, did the American Arbitration Association (AAA) and other commercial arbitration forums adopt procedural rules to handle class arbitrations. This was probably a less significant obstacle since corporations could reasonably foresee that if they wanted class arbitrations the forums would adopt rules to accommodate them.

[11] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 309 (1997).

[12] The press frequently expresses negative views on customer arbitration, see Gross & Black, Perceptions

corporations could include arbitration clauses that would bind shareholders at least with respect to state fiduciary duty claims.[13] Second, while there is little case law analyzing what is an "agreement" under the FAA, courts are likely to follow applicable state law, so that if Delaware finds the provision enforceable under state corporate law the federal court will likely find it an "agreement" under the FAA.[14] Third, the SEC may find it difficult to maintain its opposition to arbitration provisions in governance documents in light of the fact that a number of foreign private issuers whose securities are traded in the U.S. have such provisions in their governance documents.[15] Finally, the Supreme Court recently upheld, in *AT&T Mobility LLC v. Concepcion*,[16] an arbitration provision in a consumer contract that disallowed classwide procedures because the FAA preempted California precedent striking down class arbitration waivers as unconscionable.[17] In light of *Concepcion*, issuers could achieve an advantage through adoption of an arbitration provision in their governance documents that they were not able to achieve through the PSLRA. They could finally achieve the demise of classwide securities claims!

Part II discusses the erosion of the obstacles that discouraged publicly traded issuers from adopting arbitration provisions in governance documents. Part III discusses the "game-changer," the Supreme Court's opinion *AT&T Mobility LLC v. Concepcion*.[18] Part IV considers the implications of *Concepcion* and the impact on investors if class actions against publicly traded issuers are eliminated. Part V concludes.

II. Obstacles Are Eroding

[13] *See infra* notes and accompanying text.
[14] *See infra* notes and accompanying text.
[15] *See infra* notes and accompanying text.
[16] No. 09-893 (Apr. 27, 2011).
[17] *See infra* notes and accompanying text.
[18] No. 09-893 (Apr. 27, 2011).

A. Legality and Enforceability under State Corporate Law

In a 2009 article[19] I reviewed the uncertainty under state corporate law about the legality and enforceability of arbitration provisions contained in a publicly traded[20] issuer's governance documents. I will summarize my earlier conclusions and then discuss recent Delaware developments that offer some encouragement for an issuer that wishes to adopt an arbitration provision.

While modern corporation statutes allow great flexibility and private ordering, the discretion of corporate managers and shareholders to limit shareholders' powers is not unlimited and cannot "achieve a result forbidden by settled rules of public policy."[21] For that reason it is unlikely that, absent legislative authorization, corporations could amend their certificates of incorporation to eliminate directors' fiduciary obligations.[22] As another example, a 1926 Delaware Supreme Court opinion struck down a charter provision that gave a board of directors the power to deny a stockholder the right to inspect books and records.[23] Unfortunately, there is very little recent case law addressing when this amorphous "public policy" standard has been violated.

Further, even if an arbitration provision adopted by all shareholders may be legal under state law, there is a serious question of fairness about taking away rights from current shareholders that do not assent to the provision. While it is true that modern corporate law, with its emphasis on flexibility and adaptability to change, allows substantial alteration, even elimination, of shareholders' rights without their consent, the

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[19] Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802, 838-842.

[20] Arbitration of shareholders' disputes in closely held corporations has long been generally accepted, but in those instances the arbitration clause is typically found in a shareholders' agreement. Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802, 843.

[21] Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 118 (Del. 1952).

[22] There is a contrary position. [cite]

[23] State ex rel. Cochran v. Penn-Beaver Oil Co., 143 A. 257, 259 (Del. 1926).

power of shareholders holding a majority of the vote to alter corporate governance and stock ownership rules is not absolute. Thus, for example, majority shareholders cannot adopt an amendment to eliminate the board of directors, because that would deprive minority shareholders of the protections afforded by a board of directors with fiduciary responsibilities to the corporation.[24] Providing appraisal rights to shareholders if they dissent from the adoption of an arbitration provision may help to alleviate fairness concerns.

Finally, assuming that an arbitration provision does not violate public policy and current shareholders that dissent from the provision are treated fairly, is the provision enforceable as to subsequent stockowners? Courts routinely state that charter provisions are binding on all shareholders, including subsequent purchasers, in the context of customary corporate governance provisions[25] and changes in the terms of the shares.[26] But again this principle is not without limits. Some changes so fundamentally alter the corporate governance structure or the shareholders' property rights as to require special protections for subsequent shareholders.[27] Traditionally corporate law has required notice on the stock certificate itself, but this is infeasible today where few shareholders take possession of a stock certificate. Arbitration proponents assert that notice on the corporation's website and in its SEC filings is sufficient to bind future owners, and since

[24] In Delaware a statutorily defined "close corporation" may provide for management by the shareholders if all the incorporators or shareholders agree to it and notice of the provision is conspicuously noted on the stock certificate. DEL. CORP. ANN. Tit. 8, §351 (2009). *See also* MODEL BUS. CORP. ACT. §7.32 (1984) (a similar provision under which the agreement ceases to be effective when the corporation becomes public).
[25] *See, e.g.*, Goldbloss v. Reiman, 55 F. Supp. 811, 819 (S.D.N.Y. 1943), Mason v. Meillard, 240 N.W. 671, 674 (Iowa 1932).
[26] In re Appraisal of Ford Holdings, Inc. Preferred Stock, 698 A.2d 973 (Del. Ch. 1977) (enforcing a provision in the certificate of incorporation stipulating the fair value of preferred stock in an appraisal proceeding, even though there was no evidence that the current holders agreed to the provision or even knew of it).
[27] Eliminating the board of directors; restrictions on transferability of shares

plaintiffs in securities fraud actions will likely rely on the FOTM presumption to establish reliance, it may be inconsistent for them to argue that a public notice cannot bind them.

The foregoing summary is not intended to answer definitively the questions of whether arbitration provisions in governance documents of publicly traded issuers are legal and enforceable under state corporate law. Rather, it drives home the point that because of the considerable uncertainty as to these issues, publicly traded issuers and their counsel would be hesitant to put forward for shareholder vote an arbitration provision unless the likely benefits would be greater than the anticipated costs in terms of litigation and corporate reputation.

A recent Delaware Chancery Court opinion, *In re Revlon Inc. Shareholder Litigation*,[28] however, changes the equation and suggests that certificates of incorporation of publicly traded Delaware corporations could include an arbitration clause that would bind shareholders at least with respect to state fiduciary duty claims. This development stems from three trends in mergers and acquisitions (m&a) litigation. First, there has been a significant rise in securities class actions brought in state courts alleging breach of fiduciary obligations in m&a.[29] Second, Delaware Chancellors have become vocal in their criticism of the methods used by some plaintiffs' attorneys (referred to as "frequent filers") in filing and litigating (or more precisely, not litigating, but seeking quick settlement of) these cases and have instituted measures to curb what they perceive as

[28] 990 A.2d 940 (Del. Ch. 2010). See also Douzinas v. Am. Bur. of Shipping, Inc., 888 A.2d 1146 (Del. Ch. 2006) (dictum suggesting that a provision in a certificate of incorporation could require arbitration of derivative claims).

[29] Jennifer Johnson, UCLawReview (forthcoming), has statistics.

abuses.[30] Third, plaintiffs' attorneys have increasingly instituted litigation against Delaware corporations and their directors in state courts other than Delaware.[31]

Revlon is an instance of greater judicial scrutiny of frequent filers, in which the Chancellor granted a motion to replace the original lead counsel because of counsel's failure to advocate on behalf of the class and lack of candor to the tribunal. In the opinion the Chancellor acknowledged that greater oversight by the Delaware Chancery could lead to plaintiffs' counsel filing in other jurisdictions and stated:

> If they do, and if boards of directors and shareholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.

In support of this statement, the Chancellor principally relied on 8 Del. C. § 102(b)(1)[32] and *Elf Atochem North America, Inc. v. Jaffari*,[33] in which the Delaware Supreme Court upheld a provision in the operating agreement of a two-member limited liability company that required that all intra-entity disputes be resolved exclusively by arbitration or court proceedings in California. The Chancellor, however, indicated that there were limits on this power:

> I can envision that the Delaware courts would retain some measure of inherent residual authority so that entities created under the authority of Delaware law could not wholly exempt themselves from Delaware oversight. The issues

[30] Revlon is an example (replacing lead counsel); In re Cox Communications (attorneys fees cut)
[31] Jennifer may have statistics.
[32] authorizing any provision in the certificate of organization "for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders …, if such provisions are not contrary to the laws of this State."
[33] 727 a.2d 286, 287 (Del. 1999).

implicated by an exclusive forum selection provision must await resolution in an appropriate case.[34]

After *Revlon*, a few Delaware corporations have amended their governance documents to provide that Delaware is the exclusive forum for intra-corporate litigation,[35] and it is likely that other corporations are seriously considering such an amendment. This has been some judicial resistance outside of Delaware to this development. In *Galaviz v. Berg*,[36] a California federal district court held that a bylaw adopted by the Oracle board of directors specifying Delaware as the exclusive forum was not enforceable at least with respect to those who were shareholders prior to its adoption because there was no element of mutual consent. The court, however, acknowledged that "were a majority of shareholders to approve such a charter amendment, the arguments for treating the venue provision like those in commercial contracts would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment."[37]

The Supreme Court, in *Shearson/American Express*,[38] described predispute arbitration agreements as a form of forum selection clause.[39] The Chancellor's reference in *Revlon* to *Elf Atochem* also indicates, at least to some extent, an equation of the two clauses. Accordingly, *Revlon* may provide encouragement to a publicly traded corporation that wishes to adopt an arbitration provision in its governance documents. The Delaware judiciary's reaction to an arbitration provision that would largely remove

[34] 990 A.2s 940, 960 note 8.
[35] Joseph A. Grundfest, Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches (The 2010 Pileggi Lecture): Forum selection clauses in the governance documents of publicly traded corporations are "exceedingly rare," although there has been a sharp increase since the *Revlon* decision.
[36] No. C 10-3392 RS (N.D. Cal. Jan. 3, 2011)
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[39] *See also* 14 Penn Plaza LLC v. Pyett, 129 S. Ct. 1456, 1469-70 (2009) (requiring arbitration of ADEA claims is not a waiver of the statutory claims).

fiduciary obligation litigation from judicial oversight, however, may well be different from its reaction to a clause that would specify the Delaware courts as the sole forum for fiduciary obligation litigation. The former raises the policy question of the extent to which Delaware corporations can "exempt themselves from Delaware oversight"[40] that *Revlon* acknowledged as a concern. Such an arbitration provision may be a "bridge too far" for the Delaware judiciary. If that should prove to be the case, then the federal courts, and ultimately the Supreme Court, would have to address whether such a reaction from the Delaware judiciary is impermissible anti-arbitration animus.[41] This could present an unprecedented show-down between a U.S. Supreme Court generally recognized as "pro-business" and the Delaware judiciary acknowledged for its business acumen and frequently described as "pro-management."

B. An Agreement to Arbitrate under FAA § 2

FAA §2 provides that "[a] written provision in … a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction … shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[42] The FAA's primary purpose is "ensuring that private agreements to arbitrate are enforced according to their terms;"[43] to that end, the FAA preempts state law that exhibits anti-arbitration bias.[44] If an arbitration provision in governance documents is an agreement under FAA §2, then courts would have to enforce it notwithstanding any state policy to the contrary. The U.S. Supreme Court frequently invokes a federal pro-arbitration policy

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[41] Doctors Associates v. Cassorato
[42] 9 U.S.C. § 2.
[43] Volt Information Sciences v. , 489 U.S. 468, 479 (19).
[44] Doctors Associates v. Cassorato

in interpreting arbitration agreements,[45] but the prerequisite for invoking this policy is an agreement to arbitrate.[46] Surprisingly, although in recent years the Supreme Court has heard many cases involving a variety of issues under the FAA, including arbitrability, it has not addressed the issue of what constitutes an agreement for purposes of FAA § 2. The two closest cases involve instances where there were arbitration agreements, but the parties resisting arbitration asserted that, as non-signatories, they were not bound by the agreement. In *First Options v. Kaplan*,[47] the Court stated that

> When deciding whether the parties agreed to arbitrate a certain matter…, courts generally …should apply ordinary state-law principles that govern the formation of contracts….The relevant state law here, for example, would require the court to see whether the parties objectively revealed an intent to submit the … issue to arbitration.[48]

In contrast, in an earlier opinion, *John Wiley & Sons, Inc. v. Livingston*,[49] the Court found that federal labor law was controlling because "a collective bargaining contract is not an ordinary contract."[50] Notwithstanding *John Wiley*, there is a consensus that "the validity of an agreement to arbitrate will be determined under non-discriminatory state law."[51]

As stated earlier, arbitration of shareholders' disputes in closely held corporations has long been generally accepted,[52] but in those instances, while the arbitration provision may also be included in the governance documents, the arbitration clause is typically

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[45] Cite examples
[46] First Options v. Kaplan, 514 U.S. 938, 943 (1995).
[47] 514 U.S. 938, 944 (1995).
[48] *Id.*
[49] 376 U.S. 543 (1964).
[50] *Id.* at 551.
[51] Edward Brunet, Richard E. Speidel, Jean R. Sternlight, & Stephen J. Ware, ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 40.
[52]

found in an actual agreement entered into by all the shareholders.[53] A recent Third Circuit opinion, applying Pennsylvania law, refused to enforce an arbitration provision contained in the bylaws of a professional corporation (a law firm) against a lawyer-shareholder in the absence of evidence that she assented to it.[54] The plaintiff specifically averred that she was never provided a copy of the bylaws, was never informed of the existence of the arbitration provision in the bylaws, and never signed any document that refers to the arbitration provision. To counter this, the law firm argued that as a shareholder who had served as a director, she had constructive notice of the terms of the bylaws. The Third Circuit had petitioned the Pennsylvania Supreme Court to certify the question, because "it exposed tension between corporate law principles and arbitration contract principles,"[55] but the state court denied the petition. Receiving no guidance, the Third Circuit held that Pennsylvania contract law required that an agreement to arbitrate must be "clear and unmistakable" and cannot arise "by implication."[56] Because plaintiff did not receive a copy of the bylaws containing the arbitration provision, she could not have explicitly agreed to arbitrate.

As discussed previously, while it may present practical difficulties, it is possible for publicly traded issuers to provide notice to their shareholders and even to deliver to them a copy of the governance document containing an arbitration provision, by including it, for example, in the proxy statement for the annual meeting of shareholders. Note that the Third Circuit stated that there cannot be an explicit agreement without

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[53] Shell, at 528 n.80.

[54] Kirleis v. Dickie, McCamey & Chilcote, P.C., 560 F.3d 156 (3d Cir. 2009). Maybe she would have been better off in arbitration, because the court subsequently granted the firm 's motion for summary judgment. [cite]

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[56] Id. at . See also Galaviz v. Berg, discussed supra note (refusing to enforce forum selection bylaw adopted by directors because there was no element of mutual consent, at least with respect to shareholders who purchased shares prior to adoption of bylaw).

receipt of the arbitration agreement; it does not state that receipt of the arbitration provision, without more, constitutes the explicit agreement required under Pennsylvania law. If an affirmative act of acceptance is required, possibly a shareholders' vote on the management proxy card would suffice, although there remains the problem of non-assenting shareholders.

Given the paucity of case law under FAA § 2, it is likely that other courts would also look to state contract law principles. It is possible that "the tension between corporate law principles and arbitration contract principles"[57] could lead to different outcomes. This is explored later in Part IV.

[Discuss arb clauses in employment manuals?]

[Discuss relevant Del and Cal law on what it takes to form a contract]

C. The SEC Staff's Position on Arbitration Clauses in Governance Documents

Securities Act § 14[58] and Securities Exchange Act § 29(a)[59] (the anti-waiver statutes) invalidate "any condition, stipulation, or provision binding any person to waive compliance with" the federal securities statutes and their rules.[60] In 1990, when a corporation that was planning its IPO sought to include an arbitration provision in its charter and bylaws, the SEC staff objected to its inclusion and stated that it would deny any request to accelerate the effectiveness of the registration statement because of the inclusion of the arbitration provision. The attorney who represented the issuer and the attorney who was at the time Assistant General Counsel, Office of the General Counsel,

[57] Kirlies
[58] 15 U.S.C. § 78cc (2006).
[59] 15 U.S.C. § 77n (2006).
[60] For the legislative history and leading cases analyzing these provisions, see Black, Radar, at 824-828.

at the SEC each wrote accounts of this incident. [61] According to issuer's counsel, an arbitration provision in the certificate of incorporation was valid and binding under applicable state law, and there was "nothing objectionable from a public policy perspective in structuring an initial offering of stock with this attribute."[62] In contrast, the SEC attorney was of the view that "it would be contrary to the public interest to require investors who want to participate in the nation's equity markets to waive access to a judicial forum for vindication of federal or state law rights, where such a waiver is made through a corporate charter rather than through an individual investor's decision."[63] He based his argument, in part, on the anti-waiver provisions; the practitioner, in contrast, asserted that there was "no basis" to conclude that a court would invalidate the arbitration provision under the anti-waiver provisions.[64]

In my 2009 article, I extensively reviewed the anti-waiver arguments[65] and will not repeat that analysis here. I concluded that although there were significant differences between customer/broker and purchaser/issuer claims that would provide a basis for distinguishing *McMahon/Rodriguez*, it was not likely that those differences would persuade courts that the latter type of claims could not be brought in arbitration, assuming that the requisite consent was present.[66] The SEC staff's position, however, presented a significant practical obstacle. An issuer that wanted to include an arbitration provision in its governance documents would have to want it very badly to work around the practical

[61] Carl W. Schneider, *Arbitration in Corporate Governance Documents: An Idea the SEC Refuses to Accelerate*, 4 INSIGHTS , no. 5 , 21 (May 1990); Thomas L. Riesenberg, *Commentary Arbitration and Corporate Governance: A Reply to Carl W. Schneider,* 4 INSIGHTS, no. 8, 2 (Aug. 1990).
[62] Schneider at 22.
[63] Riesenberg at 2
[64] Schneider at 24.
[65] Radar at 828-832.
[66] I went on to argue that an arbitration provision with a class action waiver would violate the anti-waiver provisions. Radar at 832-835. I will address this infra at

difficulties caused by the agency's refusal to accelerate the effective date and, more significantly, incur the SEC staff's disapproval.

There are sign that times have changed. The SEC has never publicly modified its staff position that arbitration clauses in corporate documents are contrary to federal public policy, although there were published reports in 2007 that the SEC, under the leadership of Chairman Christopher Cox, considered changing its policy.[67]

Moreover, some foreign private issuers whose securities trade in U.S. markets require arbitration of investors' claims in their corporate governance documents[68] or ADS agreements.[69] The best known of these FPIs is Royal Dutch Shell (RDS), incorporated under the laws of England and Wales, with its official residence in the Netherlands, whose American Depositary Receipts are traded on the NYSE. Its Articles of Association generally require that all disputes between shareholders and the company and/or its directors be exclusively resolved in The Hague under the Rules of Arbitration of the International Chamber of Commerce ("ICC").[70] The arbitration provision includes all disputes arising under UK, Dutch or U.S. law (including securities laws).[71] In the event that a court determines that the arbitration provision is unenforceable with respect to any dispute, that dispute may be brought only in the courts of Wales and England.[72]

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[67] Kara Scannell, *SEC Explores Opening Door to Arbitration*, WALL ST. J. A1 (Apr. 16, 2007); *SEC and Congress gang up on arbitration*, FINANCIAL WEEK (July 23, 2007).
[68] Royal Dutch Shell. Christos Ravenides (give numbers of how many he found and where the provisions were located)
[69] Harvard v. Surgut
[70] Articles of Association, at http://www.shell.com/home/content/investor/corporate_governance/articles_association/
[71] Royal Dutch Shell plc Annual Report and Form 20-F
[72] Id. The governing law of the Articles is the substantive law of England. Circuit courts have upheld choice of law and choice of forum clauses in international contracts among sophisticated investors from challenges based on SEA §29(a) (the anti-waiver clause). See Radar 826-27.

Indeed, a handful of securities and breach of fiduciary duty class claims (to date I have found no derivative claims) involving publicly traded domestic and foreign private issuers have been filed in the American Arbitration Association (AAA) forum.[73] In a matter that received quite a bit of publicity, Harvard, the owner of American Depositary Receipts (ADRs) representing preferred shares of Surgut, a public oil and gas company organized under the laws of the Russian Federation, brought a class arbitration seeking money damages and declaratory relief for Surgut's alleged failure to pay the full amount of mandated dividends. Harvard asserted breaches of the deposit agreement and the company charter and misrepresentations of material facts under Rule 10b-5.[74] Harvard elected to bring the class arbitration since the agreement permitted federal securities claims to be brought in federal district court.[75] An AAA arbitration panel determined that arbitration clause permitted class arbitration, and a federal district court confirmed this award.[76] After an appeal to the Second Circuit was stayed, Harvard and Surgut stipulated to the voluntary dismissal of the arbitration.[77]

If the SEC permits trading in the U.S. markets of foreign private issuers that have arbitration provisions in their governance documents, it will be hard-pressed to justify its continued opposition to the use of such provisions by U.S. issuers.

III. Class Arbitration, the U.S. Supreme Court, and The Game Changer – *AT&T Mobility LLC v. Concepcion*

[73] Website address. Publicly available database. I have not found any derivative claims involving public corporations, but they would not be included in AAA database.
[74] Harvard's Demand for Arbitration, available at AAA website
[75] The arbitration clause is set forth in Harvard's Demand for Arbitration, available at AAA website. Any claims not subject to the arbitration clause would be litigated in federal and state courts in New York City.

[76] 2007 WL 3019234 (S.D.N.Y. Oct. 11, 2007).
[77] Stipulation of Voluntary Dismissal and Order of Approval (undated).

As the preceding discussion demonstrates, a publicly traded issuer would encounter significant legal obstacles if it sought to include an arbitration provision in its governance documents. These obstacles, however, are not necessarily insurmountable in the face of a determined campaign by a motivated issuer and its counsel. One reason why publicly traded issuers have not seriously pursued any of the proposals that have been circulated over the past twenty years may be that they were not persuaded that there would be significant benefits to outweigh the considerable costs.

Arbitration vs. Litigation. From the perspective of a publicly traded issuer contemplating amending its governance documents to require arbitration of investors' claims, the cost-benefit analysis of arbitration versus litigation is complex. Arbitration would certainly entail costs not incurred by litigation.[78] Because litigation is the default rule and arbitration in this context is not customary, transaction costs would be incurred in drafting the arbitration provision, amending the corporate governance documents, which will require solicitation of shareholders' vote, and in all likelihood litigating the legality of the provision. Adopting an arbitration clause may also cost a corporate defendant in terms of reputation and bad publicity, given a strong belief among many consumers and investors, and their advocates, that arbitration is unfair and biased toward the businesses that are "repeat players."[79] The corporation may also experience a negative reaction from the SEC staff that could affect subsequent dealings with the agency. Finally, litigation offers some direct cost savings over arbitration because the

[78] *See generally* Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433 (2010) (reviewing factors outside the context of securities fraud and derivative claims).

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government provides the forum and the judges for nominal filing fees,[80] although, in the context of federal securities and derivative claims, where other costs (principally, lawyers' and experts' fees) are high, these costs may not be a significant factor in the equation.[81] Accordingly, arbitration must offer businesses meaningful advantages to warrant the additional costs.

What are the potential advantages of arbitration? According to Professors Drahozal and Ware, parties will pay the additional costs associated with arbitration when they expect it will provide them with a better process or a better outcome.[82] Some of the pertinent factors they identify include: arbitration may be faster and cheaper, it may lessen the risk of an aberrational jury verdict, it may result in more accurate outcomes because of arbitrator expertise or application of trade rules, it may better protect confidential information.[83] Others stress the parties' control over the process.[84] Types of disputes where businesses often prefer arbitration include routine, small-stakes contracts,[85] transnational contracts,[86] and situations where parties wish to maintain an ongoing relationship.[87] Conversely, Professors Drahozal and Ware identify certain categories of cases where parties prefer litigation over arbitration. The most important[88]

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[80] Id.
[81] Model ADR Procedures, ADR in Securities Disputes, CPR Legal Program 19 (1991).
[82] *See* Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433, (2010)..
[83] Id.
[84] Report on Growing Use of ADR by U.S. Companies 16-17 [or perhaps separate para. on this report and business perspectives]
[85] Such as securities broker-customer disputes.
[86] Arbitration is the dispute resolution mechanism of choice in international commerce. Christopher R. Drahozal, *Contracting Out of National Law: An Empirical Look at the New Law Merchant*, 80 NOTRE DAME L. REV. 523 (2005). Arbitration is seen as neutral forum, and awards are enforceable in foreign jurisdictions. Id.
[87] Drahozal & Ware.
[88] Another is where the governing law and contract terms are well-developed and relatively certain in application. They give the example of litigation involving interpretation of provisions in bond debentures. There is no need for arbitrator expertise and they don't want a compromise approach. Id

for our purposes is high-stakes "bet the company" litigation, where the limited grounds for judicial review may make the risk of an aberrational arbitration award unacceptably high.[89]

Commercial arbitration providers concur with the academic perspective. Organizations that have as their mission the promotion of dispute resolution alternatives to litigation compile comparisons of arbitration and litigation.[90] While the description of at least some of these comparisons are slanted in favor of the advantages of arbitration,[91] some of the advantages attributable to the latter would be attractive to corporate defendants, including the limited discovery production, the confidentiality of proceedings,[92] and the parties' ability to select arbitrators, often with special expertise.[93] However, the description of the significant negative factor of arbitration in high-stakes litigation should curb any corporate defendants' enthusiasm for it: "award is final & binding; limited grounds to vacate or modify award."[94] Similarly, a list of ten "Questions Regarding Choice of Arbitration or Litigation" includes two that point to litigation as preferable from the corporate defendants' perspective:

"Is a vital corporate interest or "bet the company" case involved that requires the full panoply of procedural protections afforded by a court, including full appellate rights?"

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90 E.g., CPR ADR Suitability Guide (2003).

91 E.g., in arbitration "parties may select & tailor procedures" and "have more control over scheduling," in litigation, in contrast, "formal, inflexible procedures govern" and "can entail docket delay, scheduling in large part outside parties' control"), Id. at 30.

92 AAA has cut back on this advantage ;see infra

93 Id.

94 although it suggest that parties could agree to appellate review by another private panel of arbitrators. Id. In _____ the Supreme Court rejected parties' contractual attempt to require courts to provide expanded judicial review beyond that set forth in the FAA.

"Does either party (or both) seek to retain unabridged appellate rights?"[95]

Applying this analysis, businesses would likely prefer to litigate investors' claims, since these are high-stakes disputes where there is a risk of an aberrational arbital award imposing significant liability and hence meaningful judicial review is important.[96] Arbitration might provide an advantage for issuers organized under a jurisdiction whose judicial system and local law may not be known or may be viewed as unfavorable to investors, in which case a neutral forum and enforceability of an award may be important to attract investors.[97] Otherwise, while arbitration may offer some advantages, particularly confidentiality and limited discovery, the risks of the high stakes will likely outweigh these advantages.

But what if publicly traded issuers could eliminate at least some "high stakes" dispute resolution? That would certainly change the cost-benefit analysis. We turn now to the recent Supreme Court jurisprudence on class arbitration. Since 2005, the Court effected a complete reversal in its position on "high stakes" arbitration.

The Supreme Court and Class Arbitration. In *Green Tree Financial Corp. v. Bazzle*,[98] the Supreme Court considered whether an arbitration clause in consumer lending contracts that is silent on the issue could be interpreted to permit class arbitration. the issue of class arbitration. The South Carolina Supreme Court confirmed two class arbitration awards in favor of consumers, holding that (1) the arbitration clauses at issue in the case were silent as to whether arbitration might take the form of class arbitration, and (2) in that circumstance, South Carolina law interprets the contracts as permitting

[95] the CPR ADR Suitability Guide
[96] Chamber of Commerce makes this point in its amicus brief.
[97] Russian FPIs like Surgut
[98] 539 U.S. 444 (2005).

class arbitration. The U.S. Supreme Court considered whether these holdings were consistent with the FAA. All Justices treated the question as a matter of contract interpretation; no one expressed any doubt about whether the FAA permitted class arbitrations.[99] Justice Breyer wrote an opinion that was joined by Justices Scalia, Souter and Ginsburg, stating that whether a contract that does not explicitly refer to class arbitration implicitly forbids it was an issue of contract interpretation governed by state law. Under the FAA, however, the arbitrator, and not the court, decides issues of contract interpretation. Since the arbitrator had not decided the issue, the South Carolina Supreme Court's opinion was vacated and remanded. Justice Stevens, concurring in part and dissenting in part, would have affirmed the judgment below, seeing no need to remand because the state court's decision allowing class arbitration was correct as a matter of state law. Because that would have meant that there was no controlling judgment of the Court, he concurred in the judgment since Justice Breyer's opinion expressed a view close to his own. Chief Justice Rehnquist, joined by Justices O'Connor and Kennedy, would have reversed because they believed that the determination as to class arbitration was an exception to the general rule that questions of contract interpretation are for the arbitrator to decide. Further, they believed that the South Carolina Supreme Court's holding contravened the contract term that, under their interpretation, gave the commercial lender the right to select an arbitrator for each individual dispute and accordingly violated the FAA.[100]

[99] Justice Alioto raises this issue in Stolt-Nielsen

[100] Cite. Justice Thomas wrote a one-paragraph dissent reiterating his consistent position that the FAA did not apply to proceedings in state courts.

Courts[101] and commentators[102] intepreted *Bazzle* as authorizing arbitrators to permit class arbitrations so long as the arbitration agreement did not expressly prohibit it. In response to *Bazzle,* the AAA developed and implemented a set of rules to govern class arbitrations, which went into effect in October 2003.[103] As of September 2009 the AAA had administered 283 class actions under its Class Rules.[104] Although most are consumer- or employment-related, there is a small number that involves corporate or securities matters or other complex business disputes.[105]

Five years after *Bazzle,* the Supreme Court revisited the issue of the permissibility of class arbitration when the arbitration agreement is silent on the issue. In *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.,*[106] a majority of the Justices held that the arbitrators exceeded their power under the FAA because they construed an arbitration clause in a shipping charter to permit class arbitration as a matter of public policy.[107] The parties stipulated that the arbitration clause was silent with respect to class arbitration and that "[a]ll the parties agree that when a contract is silent on an issue there's been no agreement that has been reached on that issue."[108] The arbitration panel concluded that the arbitration clause allowed for class arbitration, relying in part on the fact that other

[101] Shroyer v. New Cingular Wireless Servs., 498 F.3d 976, 991 (9th Cir. 2007), Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 262 (Ill. 2006), Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., F.3d (2d Cir.)

[102] Need to find authority

[103] AAA, Amicus Brief in Stolt-Nielsen 3-4.

[104] Id. at 22.

[105] A review of the AAA class arbitration database conducted in fall 2010 identified six cases involving investment disputes and another for involving business disputes. Most originated as judicial actions in which defendants were successful in requiring arbitration in the AAA forum on the basis of an arbitration clause contained in an agreement. In four cases in which defendants challenged class arbitration, arbitration panels construed arbitration clauses that were silent on the question of class arbitration as permitting class arbitration. *Stolt-Nielsen* will likely have an impact on this issue.

[106] 130 S. Ct. 1758 (2010).

[107] The three dissenting Justices (Ginsburg, Stevens and Breyer) argued that the issue was not ripe for judicial review, since this was a "partial award" that ruled only that the arbitration clause permitted class arbitration.

[108]

arbitrators had, post-*Bazzle*, construed a variety of arbitration clauses to permit class arbitration and that "petitioners' argument would leave 'no basis for a class action absent express agreement among all parties and the putative class members.'"[109]

In finding that the arbitration panel had exceeded its powers, Justice Alito, writing for the majority, made clear what he viewed as the essential hubris of the arbitration panel:

> Rather than inquiring whether the FAA, maritime law, or New York law contains a "default rule" under which an arbitration clause is construed as allowing class arbitration in the absence of express consent, the panel proceeded as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied in such a situation. Perceiving a post-*Bazzle* consensus among arbitrators that class arbitration is beneficial in "a wide variety of settings," the panel considered only whether there was any good reason not to follow that consensus in this case. …. The conclusion is inescapable that the panel simply imposed its own conception of sound policy.[110]

The majority, moreover, did more than vacate the award; rather than remand to the arbitration panel, it went on to construe the arbitration clause as not permitting class arbitrations. Recognizing that this action appeared at variance with *Bazzle*, the majority took pains to narrow the import of that previous decision. Emphasizing repeatedly that the rationale of Justice Breyer's opinion did not constitute the views of a majority of Justices,[111] he described the plurality opinion as addressing only one narrow question: that the arbitrators, and not the court, should decide whether a contract is "silent" on the question of class arbitration.[112] Contrary to the belief of the parties and the arbitration

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[111] Essentially, then, Bazzle established no precedent! See Thomas J. Stipanowich, Stipanowich on Stllt: Outcome Over Clarity, at Http://cpradr.org/Resources/ALLCPRArticles/tabid265/ArticleType/Article/View/Ar... (last visited Dec. 9, 2010) ("It reminds me of the television show where a character woke up and discovered that the last couple of television seasons had all been a dream!")

[112] "Unfortunately, the opinions in Bazzle appear to have baffled the parties in this case at the time of the arbitration proceeding. For one thing, the parties appear to have believed that the judgment in Bazzle

panel in this case,[113] *Bazzle* did not address what standard the appropriate decision-maker should apply in determining whether an arbitration agreement allows class arbitration – "(For example, does the FAA entirely preclude class arbitration? Does the FAA permit class arbitration only under limited circumstances, such as when the contract expressly so provides? Or is this question left entirely to state law?)"[114] Emphasizing the contractual basis for arbitration, the majority held that "an implicit agreement to authorize class-action arbitration … is not a term that the arbitrator may infer solely from the fact of the parties' agreement to arbitrate."[115]

In *Stolt-Nielsen*, the majority of the Court signaled that *Bazzle* should no longer be read to encourage class arbitrations.[116] In addition, the Court's majority opinion, in arriving at its conclusion that parties must agree specifically to class arbitration, emphasized the fundamental differences between traditional arbitration and class arbitration. Thus, the majority reminded us, the typical arbitration is a relatively simple proceeding. Even when the subject matter of the dispute is complex, the task of the arbitrator is to resolve a single dispute that adjudicates the rights of a few identified parties who appear before the forum. In contrast, in a class arbitration, there is additional complexity because the arbitrator seeks to resolve many disputes that involves the adjudication of the rights of numerous parties, most of whom are absent from the

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requires an arbitrator, not a court, to decide whether a contract permits class arbitration…In fact, however, only the plurality decided that question. But we need not revisit that question here because the parties' supplemental agreement expressly assigned this issue to the arbitration panel, and no party argues that this assignment was impermissible." cite

[113] "Unfortunately, however, both the parties and the arbitration panel seem to have misunderstood Bazzle in another respect, namely, that it established the standard to be applied by a decision maker in determining whether a contract may permissibly be interpreted to allow class arbitration." cite

[114]

[115]

[116] See SI Strong, *Opening More Doors Than It Closes*, [2010] LLOYD'S MARITIME AND COMMERCIAL LAW QUARTERLY 565, 568 (describing the opinion as signaling that the court may be cutting back its pro-arbitration precedent and as "extremely troubling").

proceeding. The Court made this point most explicitly when it compared and contrasted class arbitration and class action litigation: "the commercial stakes of class-action arbitration are comparable to those of class-action litigation, … even though the scope of judicial review is much more limited…."[117] In short, there should be certainty that parties have agreed to a method of dispute resolution that appears ill-suited to their needs.[118] In addition, the Court highlighted two important issues that call into question the appropriateness of a private contractual justice system: protecting the interests of absent parties and providing meaningful review of an arbitration award that has significant consequences for the parties, including absent class members.

The Supreme Court returned to the differences between bilateral and class arbitration in *AT&T Mobility LLC v. Concepcion*,[119] in holding that the FAA preempted California law that disallowed class action waivers in consumer arbitration agreements. Under California's *Discover Bank* rule, a waiver found in a consumer contract of adhesion, "in a setting in which disputes between the contracting parties predictably involve small amounts of damages," acts to exempt the responsible party from liability and is therefore unconscionable under California law.[120] Although the Discover Bank rule applied to the waivers of all class claims (judicial and arbitration), a majority of the

[117] Id. at 1776.
[118] The Stolt-Nielsen majority emphasized that the agreement at issue involved arms-length bargaining among sophisticated parties, at least leaving open the possibility of distinguishing situations like AT&T Mobililty involving consumer class arbitrations.
[119] 131 S. Ct. 1740 (2011).
[120] Discover Bank, 113 P.3d at 1110.

Justices[121] found that it was "an obstacle to the accomplishment of the FAA's objectives:"[122]

> The overarching purpose of the FAA … is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings. Requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.[123]

As did Justice Alioto in *Stolt-Nielsen*, Justice Scalia enumerates the differences between bilateral and class arbitration to support his conclusion that "class arbitration, to the extent it is manufactured by *Discover Bank* rather than consensual, is inconsistent with the FAA."[124] In class arbitration, the traditional advantages of arbitration – informality, low cost, and speed – are lost because of the need of procedures to deal with class certification issues and protection of absent class members.[125] In particular, he emphasizes the increased risks to defendants presented by class arbitration, where "high stakes" combined with minimal judicial review may work to pressure defendants into settling claims of questionable merit.[126] For these reasons,

> We find it hard to believe that defendants would bet the company with no effective means of review, and even harder to believe that Congress would have intended to allow state courts to force such a decision.[127]

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[121] Justice Thomas reluctantly joined the majority and wrote a concurring opinion founded on statutory interpretation of FAA §§ 2, 4. Justice Breyer wrote a dissenting opinion, joined by Justices Ginsburg, Sotomayor and Kagan.
[122] Id. at
[123] Id.
[124] Id. at
[125] Id.
[126] Id.
[127] Id.

Although *Concepcion* considered class action waivers in the context of consumer arbitration contracts, the majority's opinion does not suggest any intent to limit its holding to consumer agreements. Accordingly, *Concepcion* should encourage a publicly traded issuer that wishes to eliminate securities class actions to consider seriously amending its governance documents to include an arbitration provision with a class action waiver.

IV. Reassessing Arbitration

The preceding sections considered the legality and enforceability of an arbitration provision in governance documents of publicly traded issuers under three bodies of law -- state corporate law, the FAA and the federal securities laws – and demonstrated that there are legal uncertainties under each. Accordingly, as to the ultimate resolution of the question, there are a variety of possible outcomes. Let us consider two possible scenarios that illustrate the complexity of the issue:

Scenario One.

(1) Under state corporate law (either judicial decision or statute), an arbitration provision with a class action waiver in the governance documents is not valid and enforceable. For example, the Delaware courts may hold that under this dispute resolution measure the Delaware courts did not retain sufficient "measure of inherent residual authority so that entities created under the authority of Delaware law could not wholly exempt themselves from Delaware oversight."[128]

(2) Under the FAA, the arbitration provision is held to be an "agreement to arbitrate," preempts the Delaware anti-arbitration policy and is therefore enforceable. Courts could, for example, recite the language in numerous opinions that the "certificate

[128] Revlon supra

of incorporation forms a contract between the corporation and its shareholders" to arrive at this conlclusion.

Scenario Two.

(1) Under state corporate law, an arbitration provision with a class action waiver in the governance documents is valid and enforceable. For example, the Delaware courts could rely on the Revlon dictum and hold that an arbitration clause is the equivalent of a forum selection clause.[129]

(2) In this scenario, a possible preemption issue arises if the court should find that the arbitration provision is not an agreement for purposes of FAA § 2. Does the FAA's preemptive effect extend to invalidating arbitration arrangements that do not constitute "agreements" under federal law? It does not seem likely that the FAA's preemption extends this far, since states have enacted their own arbitration statutes; does Justice Scalia's emphasis on "mutual consent" extend this far?

If the arbitration provision is determined to be legal and enforceable under state corporate law, the FAA or both, there remain two further challenges to an arbitration provision with a class action waiver included in the governance documents: (1) it is unenforceable because it is "unconscionable" under federal arbitration law; (2) it is invalid, with respect to federal securities claims, because it violates the anti-waiver provisions of the federal securities laws. To address these issues, we need to consider the impact of such a provision on investors.[130]

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[129] Revlon supra

[130] An important issue is what the effect of an arbitration provision in the issuer's governance documents would have on potential third-party defendants, such as accountants and underwriters. *See* Thompson-CSF v. AAA, 64 F.3d 773 (2d Cir. 1995) (setting forth various contract and agency theories for requiring non-signatories to arbitrate].

Institutional investors would likely not experience a diminishment of their remedies, since they would be able to bring individual securities actions in the arbitration forum so long as their losses were large enough to make it cost-effective. Institutional investors, in fact, have recently, in increasing numbers, been opting out of class actions to pursue their own remedies when they have a sufficient amount at stake.[131] Requiring them to bring their actions in the AAA arbitration forum is not likely to present difficulties for them; as we noted above, there have been federal securities claims arbitrated before the AAA.[132]

For other investors, particularly small retail investors, however, it is a different story. Their claims will not be sufficiently large to make it economically feasible to bring individual arbitration claims. The only chance for compensation for their losses will be if the SEC brings an enforcement action against the issuer and obtains a settlement fund that can, at the agency's discretion, be distributed to investors.[133] In the many instances where the SEC will not be able to pursue actions against issuers, some investors will not be compensated for their losses. Will the lack of an available remedy cause courts to strike down the class arbitration waiver under the FAA or federal securities laws?

The Second Circuit has been in the forefront of finding class action waivers unconscionable under the federal substantive law of unconscionability. In its first opinion in *In re American Express Merchants' Litigation,*[134] the Second Circuit held that, in the context of the particular dispute before the court, the class action waiver clause was

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[131] Coffee

[132] Harvard v. Surgut – in fact plaintiffs voluntarily brought this as an arb; they could have gone to federal district court.

[133] For description of Fair Fund, see Black, Bus Law

[134] 554 F.3d 300 (2d Cir), *petition for cert. filed*, 77 U.S.L.W. 3670 (May 29, 2009). I discuss this case in Radar

unenforceable because it would effectively preclude individual plaintiffs from vindicating their statutory rights under federal antitrust law.[135] Plaintiffs were able to prevail because of a financial consulting firm's affidavit that concluded that "it would not be worthwhile" for a plaintiff to pursue an individual claim in light of the high costs of maintaining the litigation and the small amount of individual damages.[136] Accordingly, the court agreed with plaintiffs that the class action waiver "flatly ensures that no small merchant may challenge American Express's tying arrangements under the federal antitrust laws,"[137] a troubling outcome because "private suits provide a significant supplement to the limited resources available to the Department of Justice for enforcing the antitrust laws and deterring violations."[138] Defendants sought certiorari before the Supreme Court, which granted the petition, vacated the decision, and remanded for reconsideration in light of *Stolt-Nielsen.*[139] On remand, which was decided prior to *Concepcion,* the Second Circuit affirmed its earlier decision,[140] essentially finding that *Stolt-Nielsen* was not relevant:

> While *Stolt-Nielsen* plainly rejects using public policy as a means for divining the parties' intent, nothing in *Stolt-Nielsen* bars a court from using public policy to find contractual language void. We agree with plaintiffs that "[t]o infer from *Stolt-Nielsen's* narrow ruling on contractual construction that the Supreme Court meant to imply that an arbitration is valid and enforceable where, as a demonstrated factual matter, it prevents the effective vindication of federal rights

[135] The court recognized the issue, but did not address whether class arbitrations are ever incompatible with the FAA. See *supra* note 142 and accompanying text.
[136] *Id.* at 317.
[137] *Id.* at 319.
[138] *Id.*
[139]
[140] 634 F.3d 187 (2d Cir. 2011).

would be to presume that the *Stolt-Nielsen* court meant to overrule or drastically limit its prior precedent."[141]

It seems unlikely, however, that this holding can stand post-*Concepcion.* Because the Supreme Court found that the FAA preempts a state law finding a class action waiver unconscionable because it acts as an exemption of liability, it is hard to see on what basis it could nonetheless find a class action waiver unconscionable under federal law for precisely the same reason.[142]

The argument that a securities class action waiver violates the anti-waiver provisions of the federal securities laws, because of the loss of the individual investors' private remedy, may be stronger. The costs of proving a federal securities fraud claim – including falsity, materiality, efficient market, scienter, causation and OOP damages[143] -- would be so large as to make pursuing an individual claim infeasible for small retail investors. Accordingly, unless the claims could be brought as class arbitrations, there is, as a practical matter, no remedy for investors with small holdings. A class action waiver in this context is the equivalent of a waiver of investor protections prohibited by § 29(a).

Opponents of the federal securities class actions, however, assert that they serve poorly the compensatory function[144] and therefore the individual investors are not really losing anything of significance. It should be noted that, in *Concepcion,* AT&T had, in fact, provided an attractive arbitration remedy for individual consumers so that they were not in fact left without a remedy. In Stoneridge, however, the Supreme Court cited with

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142 But see S.I. Strong, *Does Class Arbitration "Change the Nature" of Arbitration? Stolt-Nielsen, AT&T, and a Return to First Principles*, 17 HARV. NEGOT. L. REV. (2012) (arguing that *Concepcion* deals only with state law preemption issues and leaves courts free to strike class action waivers on other grounds).

143 *Dura*, 544 U.S. at 341, sets forth the elements.

144 I review the arguments in Radar

approval the argument of business interests that regulators could recover funds to compensate fraud victims so that expanding the potential defendants in Rule 10b-5 class actions was not warranted. Ironically, the best counter-argument for those advocating the importance of the federal securities class action is the PSLRA. It was enacted to cure the federal securities class action, not to kill it and reflects the Congressional judgment that a collective-action remedy is necessary for investor protection, especially retail investors. In the PSLRA Congress chose not to eliminate the securities fraud class action, but to cure it and thus confirmed its importance to the integrity of the U.S. capital markets.[145]

V. Conclusion

Post-*Concepcion*, publicly traded issuers have good reasons to consider seriously adoption of an arbitration provision, with a class-action waiver, in their governance documents. While there is considerable uncertainty about the legality and enforceability of such a provision, an issuer may well consider the potential benefits worth fighting for.

[The SEC should get involved – address the use of arbitration in the context of the broader issue of federal securities class actions. Possible solution – allow issuers to adopt arbitration provisions in governance documents if they want, but follow the FINRA model – derivative and class claims go to court.]

[possible Congressional action – Arbitration Fairness Act recently introduced again]

[145] Joint Explanatory Statement at 31, *supra* note 18.