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How Much Can It Be Bent Before Breaking?
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How Much Can It Be Bent Before Breaking? Changing the Foundations of Arbitration in Securities Disputes

M. Saleh Jaberi* & Bruno Zeller**

ABSTRACT

Following the emergence of arbitration in the stock market disputes, governments and brokers have tried to modify the arbitration procedure in order to adapt it to their needs. Consequently, the foundations of arbitration, such as freedom to enter into an arbitration agreement and selection of arbitrators, have changed in relation to rules and practice. Some of the securities arbitrations have judicialized and have lost the fundamental principles of arbitration, while others have changed only some of the traditional arbitration traits. It is important to protect the nature of arbitration; otherwise, the necessary support of courts for the arbitration procedure and enforcement of arbitration awards both in the domestic and international realms arguably will be undermined. By analysing securities arbitration in countries in terms of both the common and civil law systems, this paper attempts to identify securities arbitration's limitations and discover the extent to which such arbitration has changed, and whether the same basic structure still exists, or whether a new form of ADR has emerged.

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I. INTRODUCTION

The use of Alternative Dispute Resolution (ADR) has a long history.¹ Many advantages of ADR over litigation have been cited, including “cost and time savings, efficiency, reduced caseloads,” joint-gain solutions, and the preservation of the future relationship of parties.² Arbitration is “[a] method of dispute resolution [that] involv[es] one or more neutral third parties who are usually agreed to by the disputing parties,”³ and, importantly, results in final and binding decisions.⁴

From a practical point of view, arbitration is “the determination of a dispute by one or more independent third parties (the arbitrators) rather than by a court in accordance with the terms of arbitration agreements”⁵ Therefore, arbitration is consensual in nature, and parties may organize their proceedings as they wish.⁶ It can be concluded that the parties’ arbitration agreement, selection of arbitrators by parties, and binding results are the

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1. JEROME T. BARRETT & JOSEPH P. BARRETT, A HISTORY OF ALTERNATIVE DISPUTE RESOLUTION 259 (2004) (ADR “was used by the ancient Greeks to avert war over land disputes on numerous occasions. It turned back Attila before he marched on Rome. It was used creatively by Muhammad to bring peace among his people. It was used repeatedly in an attempt to stave off the Civil War.”).

2. Carrie Menkel-Meadow, *Roots and Inspirations, A Brief History of the Foundations of Dispute Resolution*, in THE HANDBOOK OF DISPUTE RESOLUTION 24 (Michael L. Moffitt & Robert C. Bordone eds. 2005).

3. BLACK’S LAW DICTIONARY 112 (8th ed. 2004).

4. MARGARET L. MOSES, THE PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 2 (2d ed. 2008).

5. OXFORD DICTIONARY OF LAW 31 (5th ed. 2002).

6. HENRY BROWN & ARTHUR MARRIOTT, ADR PRINCIPLE AND PRACTICE 52-53 (2d ed. 1999).

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foundations of arbitration. However, there is a rule in practicing ADR that allows disputants to change these foundations in order to meet their needs. Flexibility is an important attribute of arbitration⁷ that plays a critical role in motivating individuals and legal entities to bring their dispute before arbitration. Accordingly, arbitration has expanded beyond its traditional use, and the conventional traits of arbitration have changed as a result. Court-annexed arbitration,⁸ employment arbitration,⁹ and securities disputes arbitration are examples of this new approach.

Arbitration in the stock market was not allowed for a long time in many countries to settle securities disputes.¹⁰ Furthermore, not all dispute mechanisms within the securities sector are considered truly arbitral processes. Some securities arbitrations are judicialized and have obviated the fundamental nature of arbitration, while others have changed only some of the traditional arbitration traits. Determining the borders of such changes is necessary in securities arbitration because it can have fundamental effects on disputing parties' rights. Arguably, changing some of arbitration's critical characteristics may deprive disputants of the right to enforce a final or provisional arbitration award. Moreover, as such changes may alter the nature of arbitration, the assistance of courts cannot be guaranteed. This paper will argue that securities dispute resolution in some countries has

7. George Gluck, *Great Expectations: Meeting the Challenge of a New Arbitration Paradigm*, 23 AM. REV. INT'L ARB. 231, 242 (2012).

8. Leo Levin, *Court-Annexed Arbitration*, 16 U. MICH. J. L. REFORM 537, 537 (1982) ("Court-annexed arbitration is unlike traditional arbitration in several ways: it is mandatory rather than voluntary; the arbitrators are typically assigned by a third party rather than chosen by the parties; and the award is not binding.").

9. See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (holding that employers could require employees to agree, as a condition of employment, to arbitrate federal statutory age discrimination cases); see also Richard A. Bales, *Compulsory Employment Arbitration and the EEOC*, 27 PEPP. L. REV. 1 (1999).

10. M. Saleh Jaberi & Bruno Zeller, *Alternative Dispute Resolution Agreements in the Securities Exchange: Analysing the Approach of Three Systems*, 9 MACQUARIE J. BUS. L. 199, 199-200 (2012).

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changed the nature of traditional arbitration. Therefore, the question is whether securities arbitration is a new ADR method or one that is different from arbitration.

II. ARBITRATION AGREEMENT

If an arbitral tribunal wants to issue an enforceable award, the process has to meet certain quality standards. The existence of a valid arbitration agreement is a condition of the due process requirement on which the jurisdiction of a tribunal is based.¹¹ The arbitration process excludes resolving the dispute in an ordinary court, which restricts access to the rights to a public hearing in a court of law; legitimacy of such restriction deeply depends on the parties' agreement. Accordingly, it is important to establish a proper, valid agreement.¹²

On the other hand, the contemporary business world requires customers to sign many contracts with vast organizations that offer specific services. A firm with a broad client base cannot take time to negotiate a detailed contract for each individual agreement.¹³ Furthermore, the importance of a country's securities exchange imposes another restriction on the parties' freedom to entering into a contract containing an arbitration clause. Regulation is a central vehicle of governmental coercion and is justified as a constraint on individual liberty when it advances larger social goals.¹⁴ Legal intervention corrects a power imbalance between the parties by equalizing the bargaining power between them, while at the same time depriving them of certain

11. MATTI S. KURKELA & SANTTU TURUNEN, *DUE PROCESS IN INTERNATIONAL COMMERCIAL ARBITRATION* 43 (2d ed. 2010).

12. *Id.*

13. MARVIN A. CHIRELSTEIN, *CONCEPTS AND CASE ANALYSIS IN LAW OF CONTRACT* 76 (4th ed. 2001).

14. Warren J. Samuels, *Economy as a System of Power and Its Legal Bases: The Legal Economics of Robert Lee Hale*, 27 U. MIAMI L. REV. 261, 280-81 (1973).

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rights.¹⁵ Specifically, in relation to disputes between brokerage firms and their clients, governments follow different approaches.

The arbitration agreement in broker–client contracts does not follow the conventional model of arbitration agreements where both parties have a relative bargaining strength, and therefore, the arbitration clause is subject to at least some free negotiations. Although it is legally possible for brokerage firms in some countries to tailor an arbitration agreement to the needs of both parties, these firms rarely allow their customers such freedom. Accordingly, there are three common approaches for bringing securities disputes before arbitration. The first method is used in Indonesia where the legislator confers a minimal amount of freedom to the disputing parties.¹⁶ They can only choose to solve their dispute in a specific tribunal or resort to litigation in a court.¹⁷ Complying with this policy, brokerage firms in essence tend to design an arbitration clause as follows:

All disputes, controversies or claims, which may arise between the parties in relation to this letter, shall be decided amicably by the parties. If such dispute, controversy or claim cannot be settled amicably within thirty (30) days, we and the Company agree to finally settle the case to the Indonesian Capital Market Arbitration (BAPMI). The above

15. *Id.*

16. Decree of the Indonesian Capital Market Arbitration Board, Number: KEP-02/BAPMI/11.2009, Regarding the Regulations and Procedures of the Indonesian Capital Market Arbitration Board, (Nov. 15 2009), *available at* http://www.bapmi.org/pdf/BAPMI_Rules%20procedures_english.pdf (unofficial translation). Article 2(1) states: “The Regulations & Procedures set out the procedures for the settlement of a dispute or difference of opinion which has arisen between the Parties, which, based on agreement between such Parties, will be settled in BAPMI by way of a Binding Opinion, Mediation, or Arbitration.”

17. *Id.*

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provision shall not limit the right of the Company to submit a claim to any other court of competent jurisdiction.¹⁸

Although the last sentence of this paragraph mentions that the brokerage firm, not the clients, has the right to take legal proceedings, it can be construed that where bringing a case before the court is allowed, it is possible for both parties to do so.

In the second method, the brokerage firms impose limitations on the customers in such a way that they cannot file a petition with a court and can only apply to a specific arbitration tribunal to solve their dispute.¹⁹ Such an arbitration clause is common in the United States and is usually drafted as follows:

This agreement contains a pre-dispute arbitration clause. By signing an arbitration agreement the parties agree as follows:

a. All parties to this agreement are giving up the right to sue each other in court, including the right to a trial by jury except as provided by the rules of the arbitration forum in which a claim is filed

g. The rules of the arbitration forum in which the claim is filed, and any amendments thereto, shall be incorporated into this agreement. . . .

Any controversy arising out of your business, the introducing broker's business or the customer's accounts, shall be conducted pursuant to the code of arbitration procedure of the Financial Industry Regulator Authority (FINRA).²⁰

In the third and last method, there is no arbitration contract in the traditional sense between brokers and investors. In other words, disputing parties are required by law to bring their dispute before a specific arbitration tribunal. Article 36 of Iran's *Securities Market Act* states: "The disputes among brokers, marketmakers, broker/dealers, investment advisors, issuers

18. CIPTADANA SECURITIES, OPENING ACCOUNT FORM OF CIPTADANA SECURITIES FOR INDIVIDUALS 10, available at http://www.ciptadana.com/download/media/AOF_-_Complete_update_2013_-_Individu_1_2.pdf.

19. Jaberi & Zeller, *supra* note 10, at 202-203.

20. *New Account Application*, DITTO TRADE (2013), available at <https://help.dittotrade.com/attachments/token/zuhtlr7qornhlv/?name=New+Account+Application.pdf>.

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and other concerned parties arising from their professional activities shall be investigated by the Arbitration Board”²¹

The difference between the Iranian approach and that of the United States is that the arbitration tribunal in the United States derives its competency from an agreement. Although it is an adhesion contract and clients cannot change it without entering and signing a new contract, a dispute cannot be brought before arbitration. However, in systems like the one in Iran, the competency of the arbitration tribunal is derived from a statute, and the parties’ agreement is not effective.

While all of these approaches use the term “arbitration” for their settlement process, the question is: which of these approaches is in line with the crucial foundation of arbitration which is consensual in nature? A further consideration is whether the flexibility principle, namely an underlying contractual principle, justifies all of these changes.

It is well established that the intention of parties to create legal relations is a principle of contracts.²² In other words, what we have in a contract is something that exists in no other area of the law—a situation where the parties create the obligations and liabilities that form the substance of their relationship,²³ which incorporates a dispute settlement clause. Therefore, those arbitration tribunals which do not derive their competence from a contractual clause are lacking a fundamental element: consensus. Following this argument, it is of no consequence whether an adhesive contract is the

21. Securities Market Act of the Islamic Republic of Iran of 22 Nov. 2005, available at http://www.tse.ir/cms/Portals/0/int/_Securities_Market_Act4.pdf.

22. DES BUTLER, CONTRACT LAW 1 (4th ed. 2012).

23. STEPHEN GRAW, AN INTRODUCTION TO THE LAW OF CONTRACTS 27 (6th ed. 2008); see also P. S. ATIYAH, AN INTRODUCTION TO THE LAW OF CONTRACTS 9 (3d ed. 1981) (describing that the obligations could be created by the intention of the parties, and that it comes to be a fundamental principle of the law that contracts are binding and enforceable as soon as they are agreed upon); EDWIN PEEL, THE LAW OF CONTRACT 1-2 (12th ed. 2007) (describing that the factor which distinguishes contractual from other legal obligations is that they are based on the agreement of the contracting parties, but that the agreement is not the sole factor which determines the legal effects of a contract once it is shown to exist).

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source of the arbitration commitment as it follows the principle of “freedom of contract.”

Freedom of contract, often used in the 19th and early 20th century in judicial opinions,²⁴ embraced two connected but distinct ideas: first, it indicated that contracts were based on a mutual agreement; while second, it emphasized that the creation of the contract was the result of a free choice of the parties unhampered by external control such as government or legislative interference.²⁵

After 1830 or thereabouts, the *laissez-faire*²⁶ ideology did have a significant influence on the development of contract law.²⁷ It has been argued that freedom of contract is an aspect of individual liberty, akin to “freedom of speech, or freedom in the selection of marriage partners or in the adoption of religious beliefs or affiliations.”²⁸ In the 19th century, the principle of “freedom of contract” and “sanctity of contract” became the foundations on which the law of contract was built. As late as 1875, one of the greatest judges of that period, Sir George Jessel, declared:

If there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting and that their contracts, when entered into freely and voluntarily shall be held sacred and shall be enforced by Court of Justice.²⁹

However, several arguments were mounted to attack the freedom of contracts. First, freedom of contract was thought to be based on an obsolete

24. BRYAN A. GARNER, A DICTIONARY OF MODERN USAGE 375 (2d ed. 2001).

25. ATIYAH, *supra* note 23, at 5. For more study about freedom of contract, see P.S. ATIYAH, THE RISE & FALL OF FREEDOM OF CONTRACTS (1979).

26. “Laissez-faire: [French ‘let (people) do (as they choose)] 1. Governmental abstention from interfering in economic or commercial affairs. 2. The doctrine favouring such abstention.” BLACK’S LAW DICTIONARY, *supra* note 3, at 584.

27. ATIYAH, *supra* note 23, at 5.

28. Richard A. Epstein, *In Defense of the Contract at Will*, in CONTRACT: FREEDOM AND RESTRAINT 239 (Richard Epstein ed., 2000).

29. *Printing and Numerical Registering Co. v. Sampson* (1875) L.R. 19 Eq., 462, 465.

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laissez-faire ideology which increased monopolistic abuse.³⁰ Therefore, limiting the scope of parties' free will was a progress in the law of contracts. Secondly, consumers were improperly influenced by advertisements and social biases where free bargaining was adopted.³¹ Their true volition was ignored and they could not choose prudently for themselves. In some cases, consumers' best interests were victimized because they were unable to defend their position in bargainings. Third, transaction costs and strategic behavior were two obstacles in the way of reaching an agreement between the parties.³² As a result, many equitable doctrines enforceable in the Court of Chancery were designed to protect those who entered into foolish and improvident contracts.³³ Arguably, the restriction on parties' choices has also found expression in some legal systems, specifically embracing broker-client contracts.

It is debatable whether arbitration can accommodate these mutations by applying the principle of flexibility. Collins illustrated the spectrum of possible limitation on parties' agreement by stating:

The idea of freedom contains negative element, which rejects the interference of the state in the terms of market transactions. The adherence to this negative aspect of liberty could not be absolute without endangering the justice of the market order. Parties entering into contracts had to be protected against threats of violence and fraudulent misrepresentations, but this intervention could be justified as being designed to protect freedom by ensuring the genuineness of the choice to inter the contract.³⁴

Arguably, the intervention of governments or firms could adjust the parties' positions, but cannot be a substitute for their contract-making intention. Therefore, the securities dispute agreement in the United States is the dividing border of the notion of arbitration. The Indonesian and U.S.

30. F. H. BUCKLEY, *THE FALL AND RISE OF FREEDOM OF CONTRACT* 1 (1999).

31. *Id.*

32. *Id.*

33. ATIYAH, *supra* note 23, at 5.

34. HUGH COLLINS, *THE LAW OF CONTRACT* 25 (4th ed. 2003).

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securities transaction contracts allow the clients to decide whether or not to enter into the securities arbitration agreement. Furthermore, the arbitration tribunal cannot settle a dispute before parties agree upon it. On the other hand, in systems like that in Iran,³⁵ the parties' agreement is not the source of arbitration, and they are not free to choose whether to bring their dispute before a court or other arbitration tribunals. However, other foundations of arbitration must be considered to find whether the term "arbitration" is merely a title or whether it is still a principle.

III. SELECTION OF ARBITRATORS

"In the most common forms of private, voluntary arbitration, parties choose an impartial arbitrator and define the arbitral power by mutual consent."³⁶ However, the importance of stock market disputes for the economic system of any country and the necessity of supervising and educating arbitrators due to the complexity and expert-demanding nature of such disputes have brought about changes in the conventional approach of selecting arbitrators.³⁷ Accordingly, some argue:

One may still find a reasonably simple and flexible arbitration wherein the parties maintain their right to appoint an arbitrator of their choice. This type of arbitration, however, cannot be successfully used to settle, in the context of the same proceedings, certain sophisticated problems which one may encounter in contemporary practice. Thus, a new arbitral paradigm has emerged more closely resembling a court proceeding

35. Switzerland also uses a similar approach. See SWX Swiss Exchange Rules of Procedure, Point 6.3 para. 1, available at http://www.six-exchange-regulation.com/download/regulation/archive/issuers/until_2009_06_30/rules_of_procedure_en.pdf.

36. DOUGLAS H. YARN, *DICTIONARY OF CONFLICT RESOLUTION* 35 (1999).

37. Constantine N. Katsoris, *Securities Arbitrators Do Not Grow on Trees*, 14 *Fordham J. Corp. & Fin. L.* 51 (2008) ("Over the last few decades, the resolution of public securities disputes has also become more complex. Accordingly, the need for qualified, knowledgeable arbitrators—and the manner in which they are selected—has become increasingly important.").

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administered by the local judges. In such arbitration the sophisticated problems may find an adequate solution.³⁸

Bernini's claim is arguably correct. However, it is based on the fact that the issue is sophisticated, and hence, requires an elevated level of competence. It is argued that in securities arbitration between brokers and customers a sophisticated problem is not always an issue, and hence, the argument of sophistication would only be relevant in isolated cases.³⁹

Notwithstanding the above, the arbitration tribunals that settle securities exchange disputes have various rules for selecting arbitrators. In the Indonesian Capital Market Arbitration Board (BAPMI), the disputing parties can choose their arbitrators, provided that certain conditions are met.⁴⁰ However, other financial regulatory authorities using arbitration proscribe combined methods. The Six Swiss Board of Arbitration in Switzerland, for example, utilizes the following approach:

The Board of Arbitration is based in Zurich and comprises one chairman and two arbitrators, one appointed by each of the parties in the individual case in question. The

38. Giorgio Bernini, *Future of Arbitration: Flexibility or Rigidity?*, in ARBITRATION INSIGHTS, TWENTY YEARS OF THE ANNUAL LECTURE OF THE SCHOOL OF INT'L ARBITRATION 52 (Julian D. M. Lew & Loukas A. Mistelis eds., 2007).

39. Community Solutions, *Review of the Financial Industry Complaints Service 2002—What are the Issues?*, LA TROBE UNIVERSITY, UNIVERSITY OF WESTERN SYDNEY 48 (2002), <http://www.endispute.com.au/wpd/ficsreview.pdf> (“[T]here are many types of complaints that are common to all product areas . . . and that the ability to deal with these complaints does not depend on product knowledge . . .”).

40. *Selection*, BAPMI (INDONESIAN CAPITAL MARKET ARBITRATION BOARD), http://www.bapmi.org/en/arbitrators_selection.php (last visited Feb. 2, 2015) (“Sometimes the disputing party has an intention to appoint someone outside of the List of BAPMI's Arbitrators, or the BAPMI's Management considers a foreign expert as an Arbitrator. Therefore, BAPMI's Rules gives an opportunity to the Management to appoint an Ad Hoc Arbitrator with the following limitations: (1) the appointment of Ad Hoc Arbitrator is only to the respective case and automatically ends when the Arbitration process of such case finishes; (2) the Ad Hoc Arbitrator is not handling a position of Sole Arbitrator or the Chairman of Arbitral Tribunal.”).

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chairman and his deputy are appointed by the President of the Swiss Federal Supreme Board for a four-year term of office.⁴¹

Similarly, FINRA,⁴² which plays the main role in solving securities exchange disputes in the United States, uses a list selection system:

The Neutral List Selection System is a computer system that generates, on a random basis, lists of arbitrators from FINRA's rosters of arbitrators for the selected hearing location for each proceeding. The parties will select their panel through a process of striking and ranking the arbitrators on lists generated by the Neutral List Selection System.⁴³

The similarity between the Swiss and the U.S. systems is that they merge the parties' autonomy in choosing arbitrators with the need for monitoring arbitrators. They neither give total authority to the parties nor completely ignore parties' preferences.

In the third method as described above, parties have no authority to choose arbitrators. Article 10 of The Regulations as to the Arbitration of Disputes Arising from the Trading of Securities and Commodities in the UAE's stock exchange states:

An arbitration Panel or Panels shall be formed by resolution of the Chairman of the Board, to undertake the task of determining disputes arising between transacting parties in the Market. It shall be presided over by a member of the judiciary nominated by the Minister of Justice or the head of the justice departments, as the case may be, and have

41. *Judicial Bodies*, SIX EXCHANGE REGULATION, http://www.six-exchange-regulation.com/enforcement/judicial_bodies_en.html (last visited Feb. 2, 2015).

42. Jill I. Gross, *The End of Mandatory Securities Arbitration?*, 30 Pace L. Rev. 1174, 1177 (2010) ("Until mid-2007, the [NASD and the NYSE] ran separate arbitration forums that handled a combined 99% of all securities arbitrations in the country. On July 30, 2007, [they] consolidated and formed FINRA.").

43. FINRA Code of Arbitration Procedure for Customer Disputes, art. 12400(a) (2008), http://finra.complinet.com/en/display/display_viewall.html?rbid=2403&element_id=4096&record_id=5174&filtered_tag=.

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two members, one nominated by the director general of the Market in question, while the other shall be nominated by the Chairman of the Board.⁴⁴

The Arbitration Board of the Iranian stock market has a similar approach. Article 37 of Iran's Securities Market Act states: "The Arbitration Board shall be composed of three members whereby one member shall be chosen by the Judiciary Head from among the experienced judges and two members shall be appointed by the Council from among the financial and economic professionals as recommended by the Organization . . ."⁴⁵

The issue is that some of these approaches use the principle of arbitration correctly, whereas others have gone beyond the arbitration definition. It should be noted that one of the main dividing lines between judges and arbitrators is the source of their power. The primary principle is that judges derive their authority from their official status in the public legal system which grants them jurisdiction in legal disputes while arbitrators' jurisdiction rests in parties' intentions.

It can be argued that the perceived issue of sophistication, as noted by Bernini, might suggest that some cases pose a limitation on selecting arbitrators in securities exchange disputes, and through the flexibility leverage, arbitration can be adjusted to such restrictions.⁴⁶ However, flexibility in general should not be used to set aside parties' intention and blur the dividing line between judges and arbitrators if a high level of sophistication is not present.

On the other hand, it has been argued that some ADR institutes have the power to appoint arbitrators under their own rules of arbitration.⁴⁷ To protect the nature of arbitration and clarify the borders of a court and an arbitration tribunal, this approach can be justified only where such institutes

44. The Regulations as to the Arbitration of Disputes Arising from the Trading of Securities and Commodities, art. 10 (2001) (UAE), available at http://www.sca.gov.ae/English/legalaffairs/LegalLaws/AmendedRules/2001_1.pdf.

45. Securities Market Act of the Islamic Republic of Iran, *supra* note 21.

46. See Bernini, *supra* note 38.

47. AA de Fina, *Selecting Arbitrators*, 3 CORP. & BUS. L. J. 59, 59 (1990).

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are chosen by consensual agreement of disputants. In other words, such arbitration panels indirectly derive their power from parties' intentions.⁴⁸ However, bringing stock market disputes before the arbitration panel in Iran and UAE is compulsory, and the parties' agreements are ineffective. Therefore, parties' volition cannot be tracked through selection of arbitrators. It is thus argued that the arbitration notion can only be extended to the usage of the combined approach as in Switzerland and the United States.

IV. BINDING OUTCOME

Arguably, the only aspect of arbitration that remains unchanged in both traditional arbitration and arbitration in the securities exchanges industry is that the awards are binding on the parties.⁴⁹ However, limited non-binding arbitration decisions in the securities disputes are not totally unprecedented either. According to the rules of the Financial Industry Complaints Service Limited (FICS) in Australia—which was merged with other organizations in 2008—the outcome of its arbitration process was binding on its members but not the consumers.⁵⁰ Article 36 of its rules stated: “The Service expects the complainants to abide by the decisions of a Panel. However, it recognises that complainants may wish to pursue whatever rights they have in the

48. United Nations Conference on Int'l Commercial Arb. Convention on the Recognition & Enforcement of Foreign Arbitral Awards, art. 1(2) (1958) (“[T]he term ‘arbitration award’ shall include not only awards made by arbitrators appointed for each case but also those made by permanent arbitral bodies to which the parties have submitted.”).

49. See, e.g., Regulations and Procedures of the Indonesian Capital Market Arbitration Board, art. 48 (“An Arbitral Award shall be final, binding and has the force of law for and must be performed by the Parties.”); FINRA Code of Arbitration Procedure for Customer Disputes, *supra* note 43, art. 12904(b) (“Unless the applicable law directs otherwise, all awards rendered under the Code are final and are not subject to review or appeal.”); see also, Securities Market Act of the Islamic Republic of Iran, note 21, art. 37 n. 5 (“Awards issued by the Arbitration Board shall be final and enforceable . . .”).

50. FINANCIAL INDUSTRY COMPLAINTS SERVICE LIMITED, art. 36, 37 (1995).

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courts.”⁵¹ Therefore, a client of a brokerage firm, for example, could bring a dispute before a court if he was not satisfied with the arbitration award. This approach is not totally consistent with the principles of arbitration.

The solutions reached through consensual processes—such as mediation and negotiation—are non-binding, so the negotiated outcome of the parties is crucial to reach a final resolution of the dispute.⁵² On the other hand, arbitration is one of several adjudicative processes that typically produce a win-lose result similar to litigation.⁵³ It is understood that while a binding decision is a common trait of arbitration and adjudication, it is a line segregating arbitration from other non-adversarial ADR techniques, such as mediation and negotiation.⁵⁴ Moreover, it has been argued that without finality, the purpose and benefit of arbitration are lost.⁵⁵

Following this trend, in *Schaefer v. Allstate*,⁵⁶ the Ohio Supreme Court promoted arbitration as a method of settling disputes by distinguishing it from other forms of ADR and by developing a bright-line rule: “For a dispute resolution procedure to be classified as ‘arbitration,’ the decision rendered must be final, binding and without any qualification or condition as to the finality of an award whether or not agreed to by the parties.”⁵⁷ If on

51. *Id.*

52. DONALD G. GIFFORD, LEGAL NEGOTIATION: THEORY AND APPLICATION 205-206 (1989).

53. LEONARD L. RISKIN & JAMES E. WESTBROOK, DISPUTE RESOLUTION AND LAWYERS 2-6 (2d ed. 1997).

54. JAY FOLBERG ET AL., RESOLVING DISPUTES, THEORY, PRACTICE, AND LAW 4 (2005).

55. *See, e.g.*, Brief of Amicus Curiae Am. Arbitration Ass’n in Support of Affirmance at 7, *Hall St. Assocs. v. Mattel, Inc.*, 552 U.S. 576 (2008) (No. 06-989) (stating that “the unique characteristics of arbitration will be substantially undermined” by interfering with finality); Brief for U.S. Council for Int’l Bus. as Amicus Curiae in Support of Respondent at 2, *Hall St. Assocs. v. Mattel, Inc.*, 552 U.S. 576 (2008) (No. 06-989) (“Arbitration requires final and definitive resolution of disputes, free from the risk of protracted litigation. If arbitration is regularly followed by challenges to the arbitral award, the efficient resolution of disputes—a hallmark of arbitration—will disappear.”); MOSES, *supra* note 4, at 2, 4 (stating that one of the main reasons international arbitration is chosen is “that arbitration results in a final and binding award”).

56. 590 N.E.2d 1241 (Ohio 1992).

57. *Id.* at 1245-47.

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the other hand, a flexible approach is taken, the consequences of such arbitration—even if it can be called “arbitration”—have ceased to follow the lines of established arbitration principles.

V. SIGNIFICANCE OF ARBITRATION

Why is it important to protect the nature of arbitration? The answer emerges when specific aspects of arbitration are considered. First, there are certain circumstances in which the court may support arbitration. UNCITRAL’s Model Law is used as the basis for arbitration law in almost sixty countries.⁵⁸ It provides that where there is an arbitration agreement between the parties, if either party files a dispute with the court, the court shall refer the case to arbitration.⁵⁹ By these means, arbitration becomes only one route to settle the disputes. Courts may also order interim measures upon request by the parties if it is not incompatible with an arbitration agreement,⁶⁰ unless the arbitration rules give the arbitrators such powers.⁶¹

Where a process, which is used by brokers and their clients to solve a stock market dispute, cannot be defined as arbitration, courts arguably are unable to support and provide the above mentioned privileges for disputing parties. More importantly, the process must be accepted by the courts or enforcement is unlikely.⁶² The New York Convention,⁶³ which has made

58. U.N. COMMISSION ON INTERNATIONAL TRADE LAW, UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION, U.N. Sales No.E.08.V.4 (2008), available at http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf [hereinafter UNCITRAL MODEL LAW].

59. See *id.* art. 8 (“A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests . . . , refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.”).

60. *Id.* art. 9.

61. For other examples of court assistance, see *id.* art. 11, 16(3), and 27.

62. Kathryn L. Hale, *Nonbinding Arbitration: An Oxymoron?*, 24 U. TOL. L. REV. 1003, 1006 (1993).

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enforcement of international arbitration awards effective and consistent among many countries,⁶⁴ states:

To obtain the recognition and enforcement mentioned in the preceding article, the party applying for recognition and enforcement shall, at the time of the application, supply:

- (a) The duly authenticated original award or a duly certified copy thereof;
- (b) The original agreement referred to in article II or a duly certified copy thereof.⁶⁵

Similarly, Article 35 of the UNCITRAL Model Law states that an arbitration award shall be enforced upon an application and supply an original or copy of the award to the competent court.⁶⁶

Accordingly, when the award that is issued by a securities arbitration tribunal is not final and binding on the parties, or where there is no arbitration agreement between brokers and customers since it is regulated by law, the enforcement of such an arbitration outcome seems very unlikely. This is even more problematic where there are international brokerage firms and foreign clients who have properties in countries other than the country in which they trade. In such a situation, the prevailing party needs to utilize the New York Convention to enforce an arbitration award in other countries, although this is not possible where its conditions for recognition and enforcement of an award are not provided. Furthermore, the Foreign Judgment Acts cannot be accessed as they enforce only court judgments. Another benefit of arbitration is the doctrine of *res judicata*, which is applied

63. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards was adopted in New York on June 10, 1958, and entered into force on June 7, 1958. *New York Convention Countries*, NEW YORK ARBITRATION CONVENTION, <http://www.newyorkconvention.org/contracting-states/list-of-contracting-states> (last visited Feb. 3, 2015). Since the adoption, the membership has grown steadily to 147 countries in 2012. *Id.*

64. Mark D. Wasco, *When Less Is More: The International Split Over Expanded Judicial Review in Arbitration*, 62 RUTGERS L. REV. 599, 606 (2010).

65. U.N. Conference on International Commercial Arbitration, Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. 4 (June 10, 1958), http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf.

66. UNCITRAL MODEL LAW, *supra* note 58, Art 35 (2) (“The party relying on an award or applying for its enforcement shall supply the original award or a copy thereof.”).

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by the court to the dispute after the arbitral award is rendered.⁶⁷ The doctrine of res judicata precludes re-hearing of claims that were or could have been adjudicated in a prior proceeding.⁶⁸ This principle is further expressed in Article 34 of the Model Law, which in essence allows an award to be set aside only in very limited circumstances.⁶⁹ Most tellingly, Article 34(4) notes that a court might suspend the setting aside proceedings in order to give arbitral tribunals an opportunity to resume the hearings and take action to eliminate the grounds for setting aside the award.⁷⁰

Courts favor arbitration and the expansion of the applicability of claim and issue preclusion. In the United States, for example, the Eleventh Circuit of Court of Appeal stated in *Greenblatt v. Drexel Burnham Lambert, Inc.*: “When an arbitration proceeding affords basic elements of adjudicatory procedure, such as an opportunity for presentation of evidence, the determination of issues in an arbitration proceeding should generally be treated as conclusive in subsequent proceedings, just as determinations of a court would be treated.”⁷¹ The Court added: “An arbitration decision can have res judicata or collateral estoppel effect, even if the underlying claim involves the federal securities laws.”⁷²

Similar opinions can be found among other U.S. federal court decisions.⁷³ As the court illustrated in *Greenblatt*,⁷⁴ these doctrines apply

67. W. REECE BADER, SECURITIES ARBITRATION: PRACTICE AND FORMS § 10.04 (2d ed. 2009).

68. G. Richard Shell, *Res Judicata and Collateral Estoppel Effects of Commercial Arbitration*, 35 UCLA L. REV. 623, 624-25 (1988).

69. UNCITRAL MODEL LAW, *supra* note 58, art. 34(4).

70. *Id.*

71. 763 F.2d 1352, 1360 (11th Cir. 1985).

72. *Id.* at 1360.

73. See e.g., *Tamari v. Bache & Co. S.A.L.*, 637 F. Supp. 1333, 1336 (N.D. Ill. 1986) (“Generally, ‘there is good reason to treat the determination of issues in an arbitration proceeding as conclusive in a subsequent proceeding, just as determinations of a court would be so treated.’”) (quoting Restatement (Second) of Judgments § 84 comment c (1980)); see also *Cremin v. Merrill*

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where the basic elements are afforded in arbitration, which definitely include elements on which arbitration is based. Accordingly, it has been argued that “the most principled ground for permitting arbitral preclusion is the contractual intent of the parties to the arbitration.”⁷⁵ Therefore, courts can litigate a case where they believe that the dispute settlement procedure used between a broker and his client has not embraced fundamental elements that constitute arbitration; hence, the finality rests with the courts.

VI. CONCLUSION

While arbitration benefits from the advantages offered by other forms of ADR, it is an attempt to simulate the litigation process and achieve the same outcome without the details and complexity of that process. The unique character of arbitration is based on several foundations, the main ones of which include parties’ agreement, their right to choose arbitrators, and binding nature of arbitral decision. In developing the securities exchange markets within the 20th century, many disputes that have arisen among parties involved in such markets, especially between brokers and investors, have been referred to arbitration.⁷⁶ However, the importance of supervising the market and the costly and time-consuming aspect of free negotiation for both parties have resulted in changes to the foundations of arbitration. Arguably, therefore, securities arbitrations in some countries are a new or different ADR method than traditional arbitration.

Some governments try to regulate securities arbitration and most brokerage firms serve their customers with pre-designed contracts. Under the siege of restraints, the question is: to what extent can such arbitration retain its particular characteristics in order to access conventional arbitration

Lynch, Pierce, Fenner & Smith Inc., 328 F. Supp. 2d 865, 869 (N.D. Ill. 2004) (noting that res judicata and collateral estoppel doctrines apply to arbitration awards).

74. *Greenblatt*, 763 F.2d at 1360.

75. *Shell*, *supra* note 68, at 673.

76. *BADER*, *supra* note 67, at §1.01[2].

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privileges such as support of national courts, enforcement of its awards by courts and res judicata?

Regarding the arbitration agreement, it is vital that states and brokers recognize the intention of parties. If the parties' desires are replaced by a statute, the nature of arbitration will be undermined. The ability to choose arbitrators is another foundation of arbitration. It is important that at least a limited choice in the selection of arbitrators be recognized. Binding decision is another characteristic of arbitration that has a direct effect on the nature of arbitration. Non-binding processes should be avoided if parties want to utilize the benefits of arbitration. As a result, tailoring an arbitration procedure for stock market disputes is a very subtle issue that demands the consideration of delicate issues of arbitration.